GAMING

THE GAMING INDUSTRY AND BANKRUPTCY: GAMING AN EXIT FROM CHAPTER 11

*By Robert Jay Moore**

It is perhaps one of the most fundamental and understood tenets of bankruptcy law that upon the commencement of a Chapter 11 bankruptcy case under Title 11, United States Code (the Bankruptcy Code), an automatic stay springs into place, protecting a debtor from the "uncontrollable scramble" for its assets by creditors and providing the debtor with sufficient breathing space and an opportunity to formulate a plan of reorganization.[1] Chapter 11 permits a debtor to modify the terms of its obligations to creditors[2] so that the debtor can exit from bankruptcy with a healthier balance sheet and stable cash flow. When the value of a Chapter 11 debtor is insufficient to pay creditors in full on their claims, a plan of reorganization can be used to cause those claims to be satisfied by creditors' receipt of some or even all of the equity in a reorganized debtor. Chapter 11 also permits a debtor, in appropriate circumstances,

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1. 11 U.S.C. §362(a). *See In re A.H. Robins Co. V. Piccinin (In re A.H. Robins Co.)*, 788 F.2d 994, 998 Gaming Authorities (4th Cir.), *cert. denied*, 479 U.S. 876 (1986) (citations omitted).

2. For instance, a plan of reorganization may impair claims against a debtor and modify rights of its creditors. *See* 11 U.S.C. §§ 1123(b)(1) and (b)(5). The Bankruptcy Code specifically states that it is fair and equitable for a secured creditor to be paid in deferred cash payments if the creditor is able to retain its liens in the collateral and receive present value. 11 U.S.C. § 1129(b).

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to sell its assets and distribute the value realized from the sale to its creditors through a Chapter 11 plan.

When a licensed gaming enterprise contemplates entering into a bankruptcy reorganization process, the state statutory and the state and local regulatory overlays can complicate the planning and implementation process immensely, as contrasted with most other industries. As a consequence, although, as with virtually every debtor, taking that first step into Chapter 11 bankruptcy by the filing of a voluntary or involuntary petition is remarkably simple, negotiating and implementing an exit from Chapter 11 may be remarkably difficult. For instance, a gaming enterprise debtor may not be able to reorganize by simply converting its debt into the equity of a reorganized company – indeed, in that circumstance the debtor's creditors may be required, but may not even be eligible, to become licensed as equity owners of a gaming enterprise. The enterprise may not be able sell its assets to the economically highest bidder. Licensing complications affecting prospective buyers may even force a gaming debtor to engage in a sale process only to find that, independent of the bankruptcy approval process, the anointed buyer fails to qualify for a gaming license and the sale process must be repeated.

This paper will not delve in great depth into certain other unique regulatory issues that may arise in a gaming debtor's Chapter 11 case, such as regulatory hurdles and limitations on the ability to appoint and select a trustee during the case or when trying to confirm a plan that is opposed by a gaming debtor's licensed management, or methods of lending to or financing a gaming enterprise, whether before or after a Chapter 11 filing, and the methods of perfecting an interest in, and foreclosing upon, collateral owned by a gaming debtor. Although such issues are of obvious importance both to gaming borrowers and lenders, the focus of this paper is to provide the reader with insight into issues affecting a gaming debtor's exit from Chapter 11 once the bankruptcy forum has been invoked.

THE REGULATORY OVERLAY

The ownership and operation of gaming facilities are subject to extensive state and local regulation. Gaming laws typically are implemented and enforced by state created commissions or boards (Gaming Authorities), which are the gate-keepers for those who wish to enter into and remain active within the world of gaming ownership and operation.[3] As a

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3. Generally, Gaming Authorities are divided into two distinct arms. The first, and most visible to the public, is the state board or commission of individuals appointed to render Gaming Authority decisions. The second is the administrative and investigatory arm of the Gaming Authorities, which handles the day-to-day functions of the Gaming Authorities. This second arm reviews the applications of prospective licensees and others, conducts investigations into the backgrounds of applicants, monitors financial and other reporting requirements of licensees, monitors and investigates possible violations in gaming regulations, and makes formal recommendations to the gaming board members or

condition to obtaining and maintaining a gaming license, a casino must pay fees and taxes, observe stringent regulations on operations, submit and update comprehensive applications, and submit detailed financial, operating and other reports to Gaming Authorities. Gaming Authorities have broad powers to suspend, renew or revoke gaming licenses. In addition, substantially all of a casino operation's material transactions (*e.g.*, sales of substantial assets, encumbrance of assets, issuance of securities, and transfer of an existing or issuance of a new gaming license) require prior notice to Gaming Authorities for their review, and in many instances, approval.

Any individual with a material relationship to, or material involvement with, a licensed gaming enterprise may be investigated by Gaming Authorities to ensure that he or she is found "suitable" to have such a relationship. Consequently, officers, directors and other key persons (which include not only individuals - such as a general manager - but also related companies that may be designated for review by Gaming Authorities) must submit applications that contain detailed personal and financial information. Such persons are subject to thorough suitability (or licensing) investigation by Gaming Authorities. Gaming Authorities may deny a suitability or licensing application for any cause deemed reasonable, and such Gaming Authorities have broad discretion.

Any person or entity that holds the equity securities of a licensed gaming enterprise similarly may be required, at its own expense, to file a suitability application and subject itself to a suitability investigation by Gaming Authorities. Although the law in most jurisdictions offers up certain exceptions to the requirement that a shareholder be subjected to a suitability investigation and determination, those exceptions fall away if the prospective shareholder's position in the company's equity is large enough or if the shareholder is able to exercise any control over what may be deemed to be management and operating decisions. For instance, under Nevada law, an institutional investor that holds less then fifteen percent of the gaming enterprise's equity may obtain a waiver from suitability,[4] whereas Louisiana's version of the institutional investor exemption is unavailable to any institutional investor that holds five percent or more of the gaming enterprise's equity.[5]

Holders of a gaming enterprise's debt securities in certain circumstances also may be subjected to suitability investigations and approvals.

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commissioners. Because the administrative arm of Gaming Authorities is the arm that conducts the diligence and makes the recommendations to the board or commission, it is at this level at the earliest point in time that potential licensees, and any other parties seeking approvals from Gaming Authorities, must focus their attention by arranging appropriate meetings and keeping open lines of communications.

4. Nev. Admin. Code § 15.430.

5. La. Admin. Code tit. 42, § 2143.

THE ESTATE'S INTEREST IN ITS GAMING LICENSE

Under the gaming laws of virtually every state, a gaming license is not considered to be property of the holder, but rather a revocable, non-assignable (absent Gaming Authority consent) privilege to conduct permitted gaming activities. However, upon the filing of a bankruptcy petition, an estate is created.[6] The term "estate" is broadly defined in Section 541(a) of title 11 of the United States Code to include all of a debtor's legal or equitable interests in property, whether it is tangible or intangible, at the commencement of the case. Property interests are interpreted in an expansive manner and it is federal, not state, law that determines the scope of estate property.[7]

Obviously, a gaming license is central to the ability of a gaming enterprise to operate its business. Absent the license, there would be no gaming enterprise. Instead, there would merely be a collection of assets, such as restaurants, entertainment and lodging facilities, that might not otherwise be part of a viable single business enterprise or capable, whether individually or in the aggregate, of generating the same level of revenues or profitability.[8] Consequently, notwithstanding the fact that states generally deem a gaming license to be nothing more than a privilege held by a gaming enterprise at the state's discretion, it is difficult to say that the gaming debtor would not have some proprietary interest in the license that rises to the level of a property interest under Section 541.

This view finds support in several cases in which bankruptcy courts, pursuant to Section 362(a) of the Bankruptcy Code, have prohibited Gaming Authorities from revoking gaming licenses during the pendency of a bankruptcy case on account of the debtor's failure to pay certain prepetition fees and taxes.[9] Notwithstanding this body of law, the issue of

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6. 11 U.S.C. §541.

7. *See United States v. Whiting Pools, Inc.,* 462 U.S. 198, 205 (1983); *Butner v. United States*, 440 U.S. 48, 55 (1979).

8. There is still some residual value to hotel, restaurant and other related business operations and assets associated with a gaming enterprise. However, the collection of such business operations and assets is worth substantially less without the ability of the gaming enterprise to operate as a casino, which may be both the principal marketing draw for the related operations and the principal source of profitability. Moreover, the impact that a gaming license has on such related assets depends to some degree upon whether the state in which the license is issued is one in which only a limited number of gaming licenses are issued (*e.g.*, Louisiana and Missouri) or one in which the issuance of new licenses is not limited (*e.g.,* Nevada and New Jersey). In "open" states (not a technical term), the threshold for obtaining a gaming license generally is lower. One must still pass investigation, but, theoretically, there can be unlimited number of casinos in an "open" state.

9. *See National Cattle Congress, Inc.,* 179 B.R. 588 (Bankr. N.D.Iowa 1995), *remanded with directions*, 91 F.3d 1113 (8th Cir. 1996) (the debtor has, at a minimum, a proprietary interest in its license to be administered by the Bankruptcy Court, and the Iowa Gaming Commission's revocation of the license in order to compel the post-petition payment of a pre-petition claim was deemed void *ab initio*); *In re Elsinore Shores Associates,* 66 B.R. 723 (Bankr.D.N.J. 1986) (Section 362(b)(4) which, ordinarily, would except from the

how the estate may value and dispose of its property interest in a gaming license is subject to significant constraint and requires further analysis.

PREEMPTION ISSUES

Although a gaming debtor may hold a property interest in a gaming license, that does not necessarily mean that the gaming debtor will be able to transfer the gaming license, sell its gaming operations or reorganize without first complying with state gaming laws and regulations. Indeed, unless applicable provisions of the Bankruptcy Code preempt state gaming laws under the Supremacy Clause of the U.S. Constitution, a Chapter 11 gaming debtor otherwise must comply with all applicable gaming laws to exit from bankruptcy through a confirmed Chapter 11 plan.[10]

"It is a familiar and well-established principle that the Supremacy Clause. . .invalidates state laws that 'interfere with, or are contrary to,' federal law."[11] Where Congress is acting within its constitutional limits, it may preempt state laws simply by expressing its intent to do so within a statute.[12] Where Congress's intent to preempt is not expressed, federal courts may infer that intent under certain circumstances. Congress's intent to preempt all state law in a particular area may be inferred where federal regulation is sufficiently comprehensive to allow the reasonable inference that Congress left no room for state regulation.[13] Preemption of all laws in a whole field will be inferred where the field is one in which the federal interest is so dominant that the federal system will be assumed to preclude state laws on the same subject.[14] Even where federal law has not completely displaced state regulation in a specific area, state law may be nullified to the extent that it actually conflicts with federal law.[15]

However, generally, the preemption of state law is disfavored and one must show a "clear and manifest" intent on the part of Congress to

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operation of the automatic stay actions of governmental units to enforce their police and regulatory powers, did not apply because the attempt to revoke the debtor's gaming license was not intended to protect the health, safety or welfare of the public, but rather to protect the state of New Jersey's pecuniary interests); *In re NLV Corp.*, 1981 WL 157765 (Bankr. D. Nev. 1981) (Section 105(a) of the Bankruptcy Code invoked to prohibit Nevada Gaming Authorities from shuttering the debtor's casino); *see also Board of Trade of Chicago v. Johnson*, 264 U.S. 1 (1924) (U.S. Supreme Court refused to limit the concept of property to the definition of property under nonbankruptcy law, holding that a seat on the Chicago Board of Trade, which was not considered property of the seat holder under Illinois law, constituted property of the debtor seat holders' bankruptcy estate).

10. *See* 11 U.S.C. §1129(a)(3), which provides as a predicate to confirmation that "[t]he plan has been proposed in good faith and not by any means forbidden by law."

11. *Hillsborough County. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 712 (1985) (citations omitted).

12. *Id.* at 713.

13. *Id.*

14. *Id.*

15. *Id.*

preempt.[16] This restrained approach to federal preemption generally is no less true in the bankruptcy context.

Although, as stated above, federal law determines the scope of estate property, the scope of a debtor's interest in property is determined by state law.[17]

> Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law. . ..Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a windfall merely by reason of the happenstance of bankruptcy[18].

Absent a countervailing federal interest, "the basic federal rule is that state law governs."[19]

Following the Supreme Court's direction, the Third Circuit and other courts subsequently have concluded that "unless federal bankruptcy law specifically has preempted a state law restriction imposed on property of the estate, the trustee's rights in the property are limited to only those rights that the debtor possessed pre-petition."[20]

1. *Section 363 of the Bankruptcy Code Does Not Preempt Gaming Regulations Governing Sales or Other Dispositions*

Section 363(b)(1) of the Bankruptcy Code permits a trustee or debtor to use, sell or lease property of the estate following notice and a hearing. Because Section 363(b)(1) does not expressly authorize the trustee or debtor to sell property contrary to restrictions imposed by state and contract law, courts uniformly have been of the view that Section 363(b)(1) is not in conflict with state law, and does not preempt applicable state law restrictions on the sale or transfer of property.[21] Section 363(b)(1) is an enabling statute that gives the trustee or debtor in posses-

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16. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544, *reh'g. denied*, 114 S.Ct. 2771 (1994); *Bldg. & Trades Council v. Assoc. Builders*, 507 U.S. 218, 224 (1993); *Dept. of Revenue of Oregon v. ACF Industries*, 510 U.S. 332, 345 (1994); *English v. Gen. Elec. Co.*, 496 U.S. 72, 87 (1990); *Silkwood v. Kerr-McGee Corp.,* 464 U.S. 238, 255 (1984).

17. *Butner v. United States*, 440 U.S. 48, 55 (1979).

18. *Id.* at 55 (citations and internal quotations omitted).

19. *Id.* at 57; *see also Integrated Solutions Inc. v. Serv. Support Specialties Inc.,* 124 F.3d 487, 492 (3d. Cir. 1997) (trustee precluded from assigning debtor's prejudgment tort claims in violation of New Jersey law); *Nobelman v. Am. Sav. Bank,* 508 U.S. 324, 329 (1993) ("In the absence of a controlling federal rule, we generally assume that Congress has left the determination of property rights in the assets of a bankrupt's estate to state law.").

20. *Integrated Solutions*, 124 F.3d at 492.

21. *Id.* at 493-94.

sion the authority to sell or dispose of property to the extent that the debtor would be entitled to do so under state law.[22]

Consequently, a gaming debtor that seeks to sell or dispose of its gaming license or other assets pursuant to Section 363(b)(1) must do so in total compliance with any applicable state gaming laws and regulations.

2. *The Extent to Which a Plan of Reorganization May Preempt Gaming Regulations Remains Subject to Debate.*

Section 1123(a) specifies what must be included in a plan of reorganization under Chapter 11. Section 1123(a)(5) provides, in part, that "[n]otwithstanding any otherwise applicable nonbankruptcy law a plan shall. . .provide adequate means for the plan's implementation."

Prior to the Ninth Circuit's decision in *In re Pacific Gas and Electric Company* (*PG&E*), 350 F.3d 932 (9th Cir. 2003), decisions from several courts, including the Ninth Circuit, appeared to suggest that Section 1123(a)(5) supported preemption of contrary state laws because, by the statute's plain language, a plan can be implemented "notwithstanding otherwise applicable nonbankruptcy law."[23]

In *PG&E*, the debtor proposed a plan that contemplated the disaggregation of its power generation assets, electric transmission assets, gas transmission assets and electric and gas retail distribution business among four new corporations, each of which would be owned by the debtor's parent. The plan proposed that only one of the four new entities would remain subject to regulation by the California Public Utilities Commission (CPUC), while the remaining three thereafter would be subject to the exclusive regulatory jurisdiction of the Federal Energy Regulatory Commission (FERC). If the debtor were not disaggregated, it would remain subject in its entirety to regulation by the CPUC.

The debtor's disclosure statement made clear that the plan would have broad preemptive effect over many local and state laws pursuant to Bankruptcy Code Section 1123(a)(5) and identified a nonexclusive list of many of the statutes, rules, orders and decisions that would be preempted. The bankruptcy court rejected at the disclosure statement stage the "across-the-board, take-no-prisoners preemption strategy" employed by the plan proponents, holding that there is no express preemption of non-bankruptcy law that permits wholesale unconditional preemption of

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22. *Id.*; *see also In re Schauer*, 835 F.2d 1222, 1225 (8th Cir. 1987); *Universal Cooperatives, Inc. v. FCX, Inc. (In re FCX, Inc.)*, 853 F.2d 1149, 1155 (4th Cir. 1988); *In re Crossman*, 259 B.R. 301, 307-08 (Bankr. N.D. Ill. 2001); *In re Bishop College*, 151 B.R. 394, 398-99 (Bankr.N.D.Tex. 1993); *In re Buildnet, Inc.*, 2004 WL 1534296 (Bankr.M.D.N.C.).

23. *See, e.g., Wade v. Bradford*, 39 F.3d 1126, 1130 (10th Cir. 1994); *Great W. Bank & Trust v. Entz-White Lumber & Supply, Inc.* (*In re Entz-White Lumber & Supply, Inc.*), 850 F.2d 1338, 1340 (9th Cir. 1988); *Universal Cooperatives*, 853 F.2d at 1155; *In re Kizzac Mgmt. Corp.*, 44 B.R. 496, 504 (Bankr. S.D.N.Y. 1984); *Public Service Co. of New Hampshire v. New Hampshire (In re Public Service Co. of New Hampshire*), 108 B.R. 854, 891-92 (Bankr. D.N.H. 1989).

numerous state laws. . ."[24] Instead, it concluded that some nonbankruptcy laws may impliedly be preempted by the debtor's plan under Section 1123(a)(5), but it reserved ruling on the preemption issues until a plan was proposed that did not so broadly preempt. On appeal, the district court eschewed the application of the federal courts' long standing presumption against preemption, and elected to adopt a plain reading of Section 1123(a)(5) and its preemptory language, reversing the bankruptcy court.

The Ninth Circuit, reaffirming the long established presumption against preemption (discussed above), reversed the district court on grounds that another section of the Bankruptcy Code, Section 1142(a), limited the preemptive effect of Section 1123(a)(5). Section 1142(a) directly authorizes a debtor to implement its confirmed Chapter 11 plan and provides as follows:

> Notwithstanding any otherwise applicable nonbankruptcy law, rule, or regulation *relating to financial condition*, the debtor and any entity organized for the purpose of carrying out the plan shall carry out the plan and shall comply with any orders of the court.[25]

In summary, Section 1123(a)(5) provides that a plan must provide adequate means for its implementation. Section 1142(a) is the statute that actually empowers a debtor to implement its confirmed plan. The Ninth Circuit essentially concluded that because the preemptive effect of Section 1142(a) is limited to nonbankruptcy laws, rules and regulations *relating to financial condition*, Section 1123(a)(5)'s preemptive effect could not be greater.

The law on the preemptive effect of Section 1123(a)(5) today remains unsettled. In the Ninth Circuit and in any other courts outside of the Ninth Circuit that subscribe to its opinion in *PG&E*, a plan that proposes to preempt gaming laws will be found to be proper only if the gaming laws in question relate to the debtor's financial condition. A plan that proposes to preempt gaming laws relating to matters fundamental to a bankruptcy restructuring, such as a sale to a third party, the conversion of debt to controlling equity of a reorganized gaming operation, the replacement of old ownership with new ownership, or the replacement of old management with new management, will be met with vigorous regulatory opposition and likely lead to lengthy, costly and ultimately unsuccessful court battles with Gaming Authorities and, perhaps, others opposed to the plan.[26]

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24. *PG&E*, 273 B.R. 795, 820 (Bankr. N.D.Cal. 2002).

25. 11 U.S.C. § 1142(a) (emphasis added).

26. Gaming Authorities generally have little or no desire to participate in the bankruptcy arena. Outside of bankruptcy, Gaming Authorities have virtually unfettered power and control in regulating the business and financial affairs of a gaming enterprise. Once a gaming enterprise files for bankruptcy, there is risk that the bankruptcy court will intrude upon Gaming Authorities' domain. The tension caused by this risk of intrusion

SOVEREIGN IMMUNITY

Further complicating matters for the gaming debtor is the question whether a debtor is constitutionally permitted to bring suit against Gaming Authorities in order to enforce its rights under the Bankruptcy Code. The Eleventh Amendment to the U.S. Constitution makes states immune from suit in federal court by private parties, absent an express waiver by the state or a valid abrogation by Congress. *Alden v. Maine*, 119 S. Ct. 2240 (1999).

In 1994, pursuant to its power under Article I of the U.S. Constitution to establish "uniform laws on the subject of bankruptcies throughout the United States,"[27] Congress enacted Section 106 of the Bankruptcy Code. Section 106(a) purports to abrogate sovereign immunity as to a governmental unit with respect to actions arising under numerous provisions of the Bankruptcy Code, including, among others, Sections 105, 362, 365, 502, 503, 547, 548, 551, 553, 1107, 1141 and 1146.

However, as a consequence of the United State's Supreme Court's 1996 decision in *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 54 (1996), the constitutionality of Congress's attempt to abrogate states' sovereign immunity pursuant to Section 106(a) has been cast into doubt. Although the facts in *Seminole* had nothing to do with bankruptcy (rather, they related to the constitutionality of certain provisions of the Indian Gaming Regulatory Act (IGRA), which, among other things, permits a Native American tribe to sue a state if necessary to compel it to comply with its good faith duty under the IGRA to negotiate the scope of gaming activities that the Indian tribe may conduct), the Supreme Court concluded that Congress could not use Article I legislation to circumvent the Eleventh Amendment's grant of sovereign immunity. In footnote 16 of the *Seminole* opinion, the majority went on to proclaim as "exaggerated" both in substance and significance the assertion raised in the dissenting opinion of Justice Stevens that the majority opinion would prohibit "federal jurisdiction over suits to enforce the bankruptcy, copyright and antitrust laws against the states."[28] The majority noted that "although the copyright and bankruptcy laws have existed practically since our nation's inception, and the antitrust laws have been in force for over a century, there is no established tradition in the lower federal courts of allowing enforcement of those federal statutes against the states."[29]

In the decade following *Seminole*, the majority of circuit courts that considered Bankruptcy Section 106(a) concluded that it was unconstitu-

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means that Gaming Authorities tend to tread very carefully in the bankruptcy realm. It is not uncommon for Gaming Authorities to refrain from making a single appearance in a gaming bankruptcy case. However, a direct challenge to the jurisdiction of the Gaming Authorities almost certainly would precipitate a fierce fight by them to preserve what they perceive to be their exclusive right to exercise the powers granted to them under state law.

27. United States Constitution, Article I, § 8, clause 4.

28. *Id.* at 73 n. 16.

29. *Id.*

tional and, thus, did not abrogate state sovereign immunity. However, in a very recent 5-4 decision the Supreme Court ruled that the Eleventh Amendment does not prohibit a bankruptcy estate from commencing lawsuits against states or state agencies to avoid preferential transfers pursuant to Sections 547 and 550 of the Bankruptcy Code. In *Central Virginia Community College v. Katz*, 126 S. Ct. 990, 994- 995 (2006), the Supreme Court acknowledged that the aforementioned statements made by the majority and dissenting opinions in *Seminole* "reflected an assumption that the holding in that case would apply to the Bankruptcy Clause."[30] Nevertheless, the Supreme Court continued that "we are not bound to follow our dicta in a prior case in which the point now at issue was not fully debated."[31]

The Supreme Court noted that "bankruptcy jurisdiction, at its core, is *in rem* and, consequently, "does not implicate state sovereign immunity to nearly the same degree as other kinds of jurisdiction."[32] The Supreme Court then examined the historical context in which the Bankruptcy Clause was adopted by the Framers of the Constitution.[33] The Supreme Court observed that the Bankruptcy Clause was designed to, among other things, remove the inconsistencies and attendant unfairness of the then existing nonuniform state laws authorizing imprisonment as a remedy for the nonpayment of an insolvent's debts.[34] The Supreme Court concluded that the adoption of the Bankruptcy Clause in the Constitution "reflects the States' acquiescence in a grant of congressional power to subordinate to the pressing goal of harmonizing bankruptcy law sovereign immunity defenses that might have been asserted in bankruptcy proceedings."[35] Thus, the states, in effect, consented to the limited subordination of their sovereign immunity in connection with the bankruptcy laws passed by Congress pursuant to the Constitution and are not protected by sovereign immunity under the Eleventh Amendment from suits to avoid preferential transfers.[36] The Supreme Court concluded as follows:

> Congress may, at its option, either treat States in the same way as other creditors insofar as concerns "Laws on the subject of Bankruptcies" or exempt them from operation of such laws. Its power to do so arises from the Bankruptcy Clause itself; the relevant "abrogation" is the one effected in the plan of the Convention, not by statute.[37]

Following *Katz*, the question that remains is the extent to which courts will conclude that States have waived sovereign immunity. In the short time since the Supreme Court issued *Katz*, at least one district court

30. *Id.* at 996.
31. *Id.*
32. *Id.* at 995.
33. *Id.* at 995-1005.
34. *Id.* at 996.
35. *Id.* at 996.
36. *Id.*
37. *Id.* at 1005.

has had the opportunity to address the issue of the extent of sovereign immunity in the context of a gaming bankruptcy case. *In re Emerald Casino, Inc. v. The Ill. Gaming Board (In re Emerald Casino, Inc.)*, 2006 WL 644487 (N.D. Ill. 2006), the United States District Court for the Northern District of Illinois affirmed the decision of the bankruptcy court to deny the request of the debtor casino operator that it issue a post-plan confirmation injunction against the Illinois Gaming Board (IGB) and its members to stop them from revoking the debtor's gaming license and to compel the IGB to comply with the terms of the debtor's confirmed plan of reorganization. In *Emerald Casino*, the debtor confirmed a plan of reorganization that provided for the sale of its gaming license, subject to the IGB's approval. The plan was premised on a settlement reached among the debtor, the state attorney general's office, and the IGB pursuant to which the IGB agreed to stay and dismiss pre-existing disciplinary proceedings against the debtor. The settlement was premised upon the occurrence of certain conditions.

The plan acknowledged the debtor's agreement with the state. However, it contained express language that nothing in the plan would be deemed a waiver by the Board, the State or their agents of their sovereign immunity (the settlement contained similar language). An auction subsequently was conducted and a winning bid was designated. Although the plan thereafter was confirmed, one of the conditions to the settlement failed and, in a split with the IGB, the attorney general's office recommenced disciplinary proceedings.

In obtaining confirmation of its plan, the debtor cited to the continued support of its plan by a majority of the members of the IGB, although it also represented that nothing contained in the plan would prevent the resumption of the disciplinary proceedings by the IGB. The IGB in fact reviewed and voted to officially approve the plan. Shortly after the plan was confirmed, and following the failure of the condition precedent to the prior settlement, the IGB and debtor entered into a second settlement agreement pursuant to which the IGB agreed to stay its disciplinary proceedings and conduct a suitability review of the purchaser of the license. As with the first settlement agreement and the plan, the second agreement contained a provision asserting that the IGB did not waive sovereign immunity or consent to bankruptcy court jurisdiction. The debtor never sought to modify its plan so as to reference the second settlement.

After the existing members of the IGB resigned and new members were appointed, and notwithstanding the subsequent settlement, the IGB resumed disciplinary proceedings and thereafter revoked the debtor's gaming license.

In its suit for an injunction, the debtor argued that it reasonably relied upon representations made to it by the IGB before and after plan confirmation and cited Bankruptcy Code Sections 1141 and 1142 as the predicates for the bankruptcy court's authority to issue an injunction bar-

ring the IGB's revocation of its license. It argued that because the IGB was to receive property under the plan, the plan's terms were binding against the IGB under Section 1141(a). It further argued that the IGB's post-plan confirmation settlement agreement bound the IGB to the provisions of the plan.

Each of the bankruptcy court and district court disagreed. Because the conditions precedent for the effectiveness of the pre-plan confirmation settlement failed, the debtor could not rely on that settlement as the predicate for enforcing any rights against the IGB. The debtor also could not rely upon its subsequent settlement with IGB, the provisions of which were never set forth in the plan. The debtor had never sought to amend or modify the plan to reflect the further agreement.

The bankruptcy court and the district court also agreed that the IGB was entitled to sovereign immunity under the Eleventh Amendment. The debtor asserted that the injunctive relief it sought was not barred by the state agencies' sovereign immunity because such relief would amount to an *in rem* exercise by the bankruptcy court of its jurisdiction to protect the debtor's interest in its gaming license. However, in each of the bankruptcy and district courts, the debtor's attempt to force the IGB to suspend disciplinary proceedings and to conduct a suitability review went well beyond the bankruptcy court's *in rem* jurisdiction. "That type of relief is precisely the type of coercive judicial process for which sovereign immunity protects the state."[38]

The bankruptcy and district courts also concluded that the IGB never waived its sovereign immunity. Such waiver can only occur where the state has been unequivocal in its waiver. Here, it was not. Contrarily, each of the settlements between the debtor and the IGB, and the plan itself, contained provisions indicating that the IGB never intended to waive its sovereign immunity. The IGB's negotiations with the debtor outside of the bankruptcy proceedings also did not constitute a waiver of sovereign immunity.

Whether a bankruptcy court will determine that sovereign immunity bars a debtor's action against, or attempt to bind, Gaming Authorities in cases following *Katz* and *Emerald Casino* will depend upon the facts of each case. Not surprisingly, the *Emerald Casino* decision, in particular, is likely to lead Gaming Authorities around the country to take every step they can to avoid submitting themselves to bankruptcy court jurisdiction and waiving sovereign immunity in a gaming bankruptcy case.

RESTRUCTURING ALTERNATIVES

The complications created by the regulatory overlay of state gaming laws and the reality that a strategy for emergence from Chapter 11 that is dependent upon preemption of that regulatory overlay likely is neither

38. *Emerald Casino, Inc. v. The Ill. Gaming Bd. (In re Emerald Casino, Inc.)*, 2006 WL 644487 (N.D.Ill. 2006)

legally viable nor practical materially affects how the gaming debtor and the creditors of the gaming debtor must approach the Chapter 11 case. For purposes of the remaining analysis in this article, the assumption will be made that the parties either have agreed, or at least have determined not to dispute that the parties must comply with applicable gaming laws and regulations.

In general, restructuring alternatives for gaming debtors really are no different from those that exist for debtors in other industries. An estate may engage in a restructuring that, among other possibilities, seeks to: (i) refinance its outstanding debt (Refinancing Alternative); (ii) engage in a sale pursuant to Section 363 or pursuant to a plan of reorganization (Sale Alternative); (iii) de-leverages the company through a new consensually negotiated or non-consensually "crammed down" capital structure that typically involves equitizing some or all of its non-trade debt (Equity Swap Alternative); (iv) brings in new investors or new sources of capital and financing that permit the reorganized debtor to pay creditors and/or finance necessary capital expenditures and ongoing operating expenses (New Ownership Alternative); or (v) combines the foregoing alternatives in some fashion (Hybrid Alternatives). The state gaming law regulatory overlay impacts decision-making as to which alternative is best to pursue, the costs and time delays associated with compliance, and certain unique aspects of the plan confirmation and implementation documentation.

1. *Refinancing Alternative.*

As with any Chapter 11 bankruptcy, some portion of a gaming debtor's debt is likely to be subject to some sort of refinancing in bankruptcy. If the debtor is "healthy" enough (for instance, notwithstanding its present illiquidity, the debtor's assets are still worth substantially more than its debt, or it is in the process of completing an operational turnaround that already has put it on course to generate substantial earnings before interest, taxes, depreciation, and amortization), its management and owners will cause the debtor to refinance all of its outstanding debt and pay creditors in full so that existing equity is left in place.

Depending on the amount of the refinancing and the covenants built into the refinancing documents, take-out lenders need to be aware that they could be subject to suitability investigations and approvals by Gaming Authorities. If a lender is determined to be subject to suitability review, plan effectiveness could very well be dependant upon the lender's being approved by the Gaming Authorities.

2. *Sale Alternative.*

Absent the extraordinary circumstance of a solvent debtor that is able to pay its creditors in cash in full or, with impaired class consent, less than in full, from a refinancing, operations or a combination thereof, perhaps the next easiest or practical alternative available for the gaming

debtor and its creditors is a Sale Alternative for cash, either pursuant to Section 363 of the Bankruptcy Code or through a plan.[39] The principal advantage of a cash Sale Alternative is that, if certain significant creditors (in number or amount) are unwilling or unable to undergo the licensing or suitability scrutiny that would be required of them under applicable gaming laws in the context of a plan based on an Equity Swap Alternative, a cash Sale Alternative process permits such creditors to avoid scrutiny altogether. In a Sale Alternative process, only the buyer and its insiders, ownership and affiliates will undergo such scrutiny.[40] In many gaming cases, the cash Sale Alternative thus may be the only alternative that creditors are willing to support.

On the other hand, pursuit of a Sale Alternative may not net creditors their best recovery. The market for the sale of gaming enterprises may be poor or the bids received may not meet expectations. Bidding by non-insiders might be chilled if insiders are permitted to bid on the debtor's business or it is perceived that the insider or existing licensee will fight a sale. Additionally, there are no assurances that the buyer selected will pass muster with Gaming Authorities. Moreover, during the period between approval of the sale and the closing, the debtor and creditors will need to make certain that old (*i.e.,* licensed) management remains in place to bridge the gap between the date that the sale has been approved or a plan that contemplates the sale is confirmed, and the date that the sale closes (the timing and gating precondition of which likely will hinge on approval of the sale and buyer by Gaming Authorities). As set forth above, officers, directors and certain other senior management of a gaming enterprise must be either licensed or found suitable by Gaming Authorities to operate and control a gaming enterprise. Typically some or all of the officers, directors and senior management will continue with the debtor, at least until the sale closes. However, if certain key individuals depart, for whatever reason, the debtor may have an immediate need to replace them and must do so with individuals who are already licensed or who can quickly become licensed.

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39. Not infrequently, certain key intellectual property rights associated with a casino operation may be held by non-debtor insiders, affiliates or sponsors such that their disposition is not solely within the control of the debtor and otherwise subject to its power in the chapter case to sell under Bankruptcy Code Section 363 or through a plan. This fact must be borne in mind during the post-sale or post-confirmation, but pre-sale consummation review and approval period for a prospective new licensee or sponsor in circumstances where the license is to be transferred away from an existing equity holder/sponsor/manager who holds such rights or in whose name the casino is operating.

40. A Sale Alternative in which existing creditors remain significant creditors of the buyer or exchange debt for some portion of the equity of a new licensee may or may not result in Gaming Authority scrutiny of existing creditors. If any creditor, because of the size of its claim against the debtor, would be entitled to receive under a plan a distribution of equity of the buyer that would represent a material portion (determined by reference to each state's applicable law) of the outstanding equity of the buyer, absent some otherwise applicable exemption, that creditor typically would be subject to Gaming Authority scrutiny.

3. *Equity Swap Alternative.*

Receiving and holding equity securities of a reorganized gaming debtor may net, over time, the highest and best return to creditors. In order to implement the Equity Swap Alternative, however, a significant percentage of the debtor's creditors (at least two-thirds in amount and a majority in number of those voting in the class whose claims will be subject to conversion into equity of the reorganized) must be willing to vote to accept a plan based on an Equity Swap Alternative. Many creditors, particularly large institutional creditors that hold sizeable positions of a gaming debtor's bond or note debt, may not be willing to expose their institutions (and certain of their management) to the expansive regulatory scrutiny and investigation that could be required under state gaming laws. Moreover, there is risk that certain creditors could be found by Gaming Authorities to be unsuitable as owners of a gaming enterprise. Until a creditor is found to be suitable, it cannot receive as a distribution under the plan an equity interest in the reorganized debtor. Once a creditor is found unsuitable, it is not permitted to hold the equity interest it otherwise would be entitled to receive under the plan. Consequently, the Equity Swap Alternative plan must contain some mechanism for the liquidation of such an equity interest, which liquidation could result in the "unsuitable" creditor's receipt of some level of consideration compensating it for the equity that it otherwise would have be entitled to receive that will differ in form and may differ materially in value and timing of receipt from that which other creditors who are found suitable will receive.

The Equity Swap Alternative plan also must address licensing issues for the future officers, directors and senior management of the reorganized debtor. Unless the plan proposes to retain the old board, officers and management team, creditors that will hold a controlling interest in the reorganized enterprise will have to find replacements that already have been licensed or found suitable by Gaming Authorities in the applicable jurisdiction, or who are easily and quickly capable of obtaining a license or being found suitable. This may prove to be a difficult task, particularly in states in which there are a limited number of licensed gaming enterprises. However, generally, individuals that already have been found suitable or that already hold gaming licenses in another state are more likely to be found suitable, more quickly, than individuals who have never before been found suitable or licensed in the subject jurisdiction.[41]

Finally, assuming that an Equity Swap Alternative plan can be confirmed, attention must be given to who will manage the gaming debtor during the period between the plan's confirmation date and the date that Gaming Authorities license or find suitable new ownership and management, the date upon which such a plan likely would become effective.

41. Being licensed in one jurisdiction does not provide assurance of licensure in another jurisdiction.

Two options prevail: key members of old management may be given economic incentives to remain with the debtor until the plan becomes effective, or the gaming debtor may employ an interim management team composed of individuals and/or entities already found suitable or licensed by Gaming Authorities in the jurisdiction.

The cumulative complexity of the foregoing factors may result in an Equity Swap Alternative plan being disfavored by creditors that otherwise may be amenable to, or even desirous of, such an approach to a restructuring.

4. *New Ownership Alternative.*

The New Ownership Alternative just as easily could be called the Equity Sale Alternative, because the debtor's parent essentially is selling its equity stake in the gaming debtor for cash or securities that will be used for the benefit of the estate and its creditors. The sale of the gaming debtor's equity may be particularly attractive to a buyer and/or the gaming debtor where there are tax attributes (i) of which the stock buyer believes it can take advantage through an equity purchase or the debtor believes it can most effectively utilize and maximize by retaining ownership, and (ii) for which a premium may be realized over the amount that would be generated through a sale of the gaming debtor's assets. The New Ownership Alternative shares many of the same advantages, but also suffers many of the same licensing constraints, that exist in the Cash Sale Alternative. Because the equity of the gaming debtor is property of the gaming debtor's shareholder(s) and not property of the gaming debtor's estate, other hurdles may need to be addressed to ensure that value is conveyed to creditors. For instance, how is this approach best effectuated? Can or should the sale be conducted pursuant to Section 363 or through a plan? Either alternative would require a mechanism for the parent or shareholders that hold the shares to transfer them to the buyer, which may require the parent or shareholder(s) to commence companion Chapter 11 cases. How does one ascertain and allocate the value received between the parent/shareholder(s) and gaming debtor (and its creditors)? This allocation may be best effectuated through a consensual plan in which the gaming debtor's parent or shareholder have reached agreement and consented to the downstreaming of value to the gaming debtor's estate.

5. *Hybrid Alternatives.*

Structures of Hybrid Alternatives are driven by many factors, including, for example, the composition of the creditor body and the extent of its willingness to undergo a suitability investigation, the health or robustness of the gaming industry, the state of competition (driven in part by whether the debtor is in an "open" license state or a "limited" license state), the creditor body's relationship with management and ownership, the physical condition of the casino and hotel, and the existence of se-

cured debt and the nature and extent of the collateral. The Hybrid Alternative structures are limited only by the creativity of the debtor, its creditors and their professionals.

Recently, Hollywood Casino Shreveport (HCS), a riverboat casino and hotel complex in Shreveport, Louisiana, and its secured bondholders were able to confirm a plan of reorganization that proposed one such Hybrid Alternative structure. In summary, under the HCS plan, HCS's old owner and operator, Penn National Gaming, Inc. (Penn), which indirectly owned 100% of HCS's outstanding equity, was replaced by a new majority owner and operator, Eldorado Resorts LLC (Eldorado). Eldorado was the successful bidder in a pre-bankruptcy bidding process run by HCS with the substantial input of an ad hoc committee consisting of two tranches of bondholders, one issue secured by an admiralty lien on the vessel and a deed of trust on the hotel and the other by the debtor's personal property and equipment. Eldorado, a licensed owner and operator of casinos in Nevada, purchased a 75% controlling stake in reorganized HCS and became its new management. The bondholders, which held $189 million in principal amount of HCS bonds and were undersecured, agreed to swap their existing debt for, among other things, (i) 100% ownership in a newly created corporation (Newco) that holds a 25% noncontrolling stake in reorganized HCS, (ii) $140 million principal amount of new secured notes issued by reorganized HCS, and (iii) $20 million of preferred distributions to be paid over eight years through Newco. Under the plan, each trade creditor was permitted to elect to received a fixed percentage cash distribution on its allowed claims or pro rata distribution with the bondholders of new notes, preferred distributions and equity in Newco. In addition, HCS's senior executive officer and board member, who already was licensed by the Louisiana Gaming Authorities, agreed to become Newco's sole officer and director, on a transitional interim basis.

Because the bondholders collectively received far less than a controlling stake in the equity of reorganized HCS, under applicable Louisiana regulatory provisions only those bondholders who would be deemed post-closing to hold at least a 5% ownership interest in reorganized HCS were subject to undergoing a suitability investigation by the Louisiana Gaming Authorities. Even as to the three bondholders whose claims would have translated into equity interests in Newco that would have exceeded this 5% limit, Louisiana law provided an exemption from the suitability investigation process if the bondholders qualified as "Institutional Investors" and otherwise exercised no control over the licensee.[42]

42. Certain plan document provisions that would have permitted the shareholders of Newco to require the transfer of Eldorado's management and ownership of the casino to a new sponsor in the event that the reorganized issuer defaulted on the new secured note obligations, were deleted prior to confirmation to address concerns expressed by the Louisiana Gaming Authorities that such provisions created a sufficient potential level of control as to subject all converting bondholders to a suitability determination. It should be

6. *Factors Affecting Selection of Restructuring Alternatives.*

a. *Cost and Time Delay Necessitated by Compliance.* If the debtor, and its creditors, elect to engage in a sale of the debtor's assets, either pursuant to Section 363 of the Bankruptcy Code or pursuant to a plan of reorganization, they must be mindful that, following the typical bidding and bankruptcy court approval process, the successful buyer will be required to submit itself to a suitability or licensing investigation by Gaming Authorities. Any such investigation likely will commence only after the bankruptcy court has approved the sale to the buyer.[43] A final decision by Gaming Authorities regarding the suitability or licensability of the buyer could take several months.[44] Moreover, if Gaming Authorities conclude that the buyer is not suitable, then the debtor and the estate must either start a new sale process from scratch or explore other restructuring alternatives.[45] The costs and delays associated with the failure to close with the gaming debtor's selected buyer could be very damaging to the bankruptcy estate and to creditors' ability to recover on their claims.

Similarly, until Gaming Authorities find suitable a creditor that, pursuant to a plan, has agreed to accept equity in the reorganized debtor in satisfaction of all or some of its debt, that creditor cannot receive a distri-

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noted that even if the institutional investor exemption is otherwise applicable to a converting bondholder, the Louisiana Gaming Authorities retain the discretion to conduct, or require the bondholder to undergo, a suitability examination.

43. In the HCS Hybrid Alternative example summarized above, Eldorado, the buyer of a 75% equity stake in the reorganized HCS, was able to undergo licensing investigation prior to plan confirmation only because it had entered into its agreement to acquire its stake pursuant to a marketing process conducted by HCS prior to the petition date. Eldorado worked closely with Louisiana Gaming Authorities to address their questions and concerns during the course of the HCS Chapter 11 case.

44. The assets of President Riverboat Casino – Missouri and its equity owned by parent President Casinos, Inc, both Chapter 11 Debtors (collectively, "President"), are undergoing a third marketing and sale process (the second and third through bankruptcy court-sanctioned auctions) for essentially the same gaming assets. This process has spanned two years during which the City of St. Louis awarded a redevelopment project on adjacent property to a competing casino operation and the Missouri Gaming Commission conducted extensive and lengthy suitability investigations. At the time of this writing, the Commission has yet to make a licensing determination with respect to the transfer of the President license.

45. The risk associated with Gaming Authority disapproval of a successful bidder can be somewhat ameliorated if the debtor has found, and the court has approved as part of the initial bankruptcy sale process, a willing, qualified back-up bidder. The presence of a back-up bidder would permit the debtor to avoid a renewed sale process. However, obtaining a back-up bidder in the context of a gaming enterprise sale process may not be particularly easy, principally because bidders have little or no desire to put up a meaningful good faith deposit and then await completion of a Gaming Authority review process for the successful bidder that could last for many months following a sale process, during which the seller's performance and the buyer's objectives may have changed materially. Gaming Authorities are loathe to conduct simultaneously multiple or speculative investigative processes – the likelihood in most jurisdictions is that Gaming Authorities will commence an investigation process for a back-up bidder only in the event that the successful bidder is determined not to be suitable.

bution of the new equity. If Gaming Authorities conclude that the creditor is not suitable to own the equity interest, then the creditor is forbidden from ever receiving a distribution of such equity. And, if Gaming Authorities cannot find suitable a significant creditor or creditors that, but for regulatory scrutiny, would hold a controlling interest in the reorganized debtor, the debtor's plan itself may not be able to become effective.

b. *Impact of Regulatory Compliance on Plan Documents.* At least two provisions should be included in any plan documents in a gaming case. First, any sale agreement and the plan (or order approving a Bankruptcy Code Section 363 sale) should provide that all operative documents may be subject to Gaming Authority approval. By way of example, a confirmation order might contain the following language:

> *Governmental Approvals.* This Confirmation Order shall constitute all approvals and consents required, if any, by the laws, rules, or regulations of any state or any other governmental authority with respect to the implementation or consummation of the plan and any documents, instruments, or agreements, and any amendments or modifications thereto, and any other acts referred to in or contemplated by the plan, disclosure statement, and any documents, instruments, or agreements, and any amendments or modifications thereto, *other than such approval of the Gaming Authorities as may be required under applicable state law.* (Emphasis added.)

Second, because, as discussed above, Gaming Authorities have the ability to prevent a person or entity from becoming an owner of a gaming enterprise if that person or entity is not found suitable, a plan that contemplates an Equity Swap Alternative must contain an acceptable mechanism that prevents a holder of an allowed claim who is in a plan class that is to receive equity in the reorganized debtor from receiving such equity. Such mechanism cannot violate Section 1123(a)(4) of the Bankruptcy Code, which provides as follows:

> Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall. . .provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.[46]

Section 1123(a)(4) is designed to ensure that all members of a class of claims under a plan are provided the same treatment.[47] The same treatment does not necessarily mean the same consideration. Rather, it simply means that so long as all members of a class of claims are equally subjected to the same procedures, then, irrespective of the fact that some class members may wind up receiving more than others, Section 1123(a)(4) is not violated.[48] In *Central Medical Center,* the plan of reorgan-

46. 11 U.S.C. § 1123(a)(4).
47. *In re Cent. Med. Ctr. Inc.,* 122 B.R. 568 (Bankr. E.D.Mo. 1990).
48. *Id.*

ization established a mandatory redemption schedule under which a given number of bonds (in the bondholder claims class) would be selected randomly by the indenture trustee to be redeemed each year between 1997 and 2011. This provision of the plan was challenged as unfairly discriminatory to the bondholder class members in violation of Section 1123(a)(4). In support of their challenge, the objecting parties argued that: (i) under the proposed lottery system, those bondholders chosen first would receive an interest rate different from those bondholders chosen later, and (ii) those bondholders that would be paid first would enjoy a greater present value on their claims than would those bondholders paid later. The court rejected these arguments, concluding that because the plan equally subjected all of the bondholders to the same set of procedures, the plan complied with Section 1123(a)(4).[49]

VALUATION ISSUES

Valuation issues may play a critical role in Chapter 11 gaming cases. Valuation issues may arise in various contexts throughout the case, including the determination of the existence of equity value, allowance of secured claims and the determination of the value of undersecured deficiency claims, determination of the need for and means of providing adequate protection to a secured creditor, and "cram down" in connection with plan confirmation.

The methodology and assumptions underlying the valuation determination may vary. While taking no definitive position on the issue, the Bankruptcy Code recognizes that the needs and circumstances of the case will dictate the philosophy of valuation. Section 506(a) specifically provides that the value of the creditor's interest in the estate's interest in property shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property. The two valuation standards applied most often in Chapter 11 cases are: going concern value and liquidation value.[50]

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49. *Id.* at 574-75; *see also In re Dow Corning Corp.*, 255 B.R. 445, 501(E.D. Mich. 2000) (there is no requirement that settlement offers be proportional within a class; Section 1123(a)(4) is satisfied when class members are "subject to the same process for claim satisfaction"); one mechanism adopted to provide an acceptable treatment for those within a plan class that might not be found suitable to own the equity of a gaming enterprise that was determined to be in compliance with Section 1123(a)(4) was utilized in the HCS bankruptcy case for those bondholder claimants that either refused to submit to suitability or that were not found suitable. The HCS plan and confirmation order provided that no equity in the reorganized debtor would be issued to a creditor until the Louisiana Gaming Commission found such creditor to be suitable or subject to an applicable exception to such determination, and for the sale or liquidation by Newco of the withheld equity that otherwise would have been issued to such creditor, with the net proceeds of such sale or liquidation paid to the creditor. Of course, depending upon the size of the withheld equity and the nature of the buyer, such further sale or liquidation also may be subject to a suitability determination.

50. *In re Chateaugay Corp.,* 154 B.R. 29, 34 (Bankr. S.D. N.Y. 1993) (going concern); *In re T.H.B. Corp.,* 85 B.R. 192, 195-96 (Bankr. D. Mass. 1988) (liquidation).

The Supreme Court weighed in on Section 506 valuations in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), a case involving the valuation of collateral for purposes of the "cram down" provisions of chapter 13. Ending a conflict among the Circuits, the Court held that the proper interpretation of Section 506(a) requires the proposed use or disposition of the collateral to be determinative.[51] When a debtor intends to continue to hold and use the collateral, a liquidation value is inappropriate; rather, the proper valuation standard is the price a willing buyer in the debtor's trade, business or situation would pay to obtain like property from a willing seller.[52] The Court left to the bankruptcy court, as the trier of fact, the task of identifying the best method of determining value. *Rash* may be applicable generally in other settings.[53] If the debtor proposes to retain and use the property, the considerations that led the Court to its conclusion in a chapter 13 "cram down" setting would appear to be equally germane to Chapter 11.[54]

Neither the Bankruptcy Code nor the Bankruptcy Rules define or establish the time for determining valuation of collateral. The purpose of the valuation dictates its timing.[55] Depending on the circumstances, the relevant date of the valuation could be the petition date, the date of the valuation hearing, the date of the confirmation hearing, the effective date of the plan or at any other relevant point during the case.[56]

Enterprise value drives the casino reorganization process in that it determines the total amount of value available for distribution to the various classes of debt and equity. Enterprise value may be determined by the results of an arms-length marketing process for a sale to a third party or estimated by investment bankers, typically utilizing three methodologies: discounted cash flow; precedent transactions; and comparable public companies. The discounted cash flow method often is the most controversial as casino properties frequently have substantial operating leverage and disagreement may exist among prospective buyer, debtor, secured and unsecured creditors, and equity as to the appropriate assumptions for a turnaround business plan. Appraisals also may be required to ferret out the distinct values of collateral pools as a subset of enterprise value. Valuation issues also are complicated by management services agreements that may provide a disguised form of dividend to the equity holder/sponsor, but also that may include the provision of necessary services, such as insurance coverage, and access to trademarks and license

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51. *Associates Commercial Corp. v. Rash,* 520 U.S. 953, 962 (1997).

52. *Id.* at 960.

53. *Id.* at 965, n.6.

54. *See e.g., Matter of T-H New Orleans Ltd. Partnership,*116 F.3d 790 (5th Cir. La. 1997); *In re Inter-City Beverage Co., Inc*, 209 B.R. 931, 933 (Bankr. W.D.Mo.1997); *In re River Valley Fitness One, L.P.*, 2003 WL 252111 (Bankr. D.N.H. 2003); *In re LTV Steel Co., Inc.,* 285 B.R. 259, 268 (Bankr. N.D.Ohio 2002); *In re Bishop*, 339 B.R. 595 (Bankr. D.S.C. 2005).

55. *Stanley, supra*, 185 B.R. at 423.

56. *See, e.g., T-H New Orleans Ltd. Partnership, supra*, 116 F.3d at 797-800; *Stanley, supra,* 185 B.R. at 423-25; *In re Leedy*, 230 B.R. 678 (Bankr. E.D. Va. 1999).

agreements. Careful analysis of the agreement and services provided is required to determine if the contract is at a market rate or inflated to provide a disguised dividend to equity holders. Valuation analysis also must be applied to the various securities to be issued under a plan, to determine the risks of obtaining and pricing exit financing, and to assess the financial feasibility of the company under various plan scenarios.

Disputes often arise in allocating the enterprise value to value of secured assets and unsecured assets, particularly in cases where the state has limited gaming licensing and there can be significant value attributable to the gaming license itself. The gaming license typically cannot be hypothecated, in which case it cannot be part of a collateral package. Determination of the "value" of the license thus is a critical element of analyzing the potential recovery by unsecured creditors. Complications arise in valuing the secured assets depending on whether the secured assets are to be valued as if a gaming licensee operates them when the license itself is not part of the collateral package. For example, the value of slot machines, a floating vessel such as a riverboat casino, and even the hotel and restaurants associated with the casino, each of which may collateralize a secured note or bond, may vary dramatically if analyzed and valued independent of the uncollateralized gaming license in a "closed" state where gaming licenses are limited. Similarly, the split in value between various pools of secured debt can be controversial. These issues are complicated by the fact that the ownership and transferability of the license in bankruptcy are subject to regulatory constraint.

NATIVE AMERICAN GAMING

This article has focused on bankruptcy exit alternatives and approaches for the domestic corporate gaming debtor in the United States. However, in 2006, no discussion of bankruptcy and gaming law can be complete without reference to Native American gaming enterprises. Federally-recognized Native American tribes are considered sovereign political entities under U.S. law and enjoy a certain degree of sovereign immunity as a result thereof.

In 1988, Congress passed the IGRA, which sets the terms by which Native American tribal entities are permitted to operate gaming enterprises. Since Congress's passage of the IGRA, the tribal gaming industry has seen enormous growth. The most recent statistics offered by the National Indian Gaming Commission (NIGC), the federal regulatory agency charged with oversight of Native American gambling enterprises under the IGRA, reveals that in 2004, some 367 tribal gaming establishments operated by approximately 220 federally recognized tribes accounted for annual revenues approaching $20 billion.

Although, generally, the Native American gaming industry has enjoyed remarkable financial success and growth, at some point, it is likely that, as with businesses in virtually any commercial industry, one or more

tribal gaming operators will face financial distress that could lead it to require the protection of insolvency laws.

However, it is not entirely clear how Native American tribes and business enterprises would be treated under the Bankruptcy Code. The Bankruptcy Code does not define a tribe and does not address whether a tribe is eligible to become a debtor under Title 11.[57] However, even assuming that a tribal gaming enterprise is so eligible, its bankruptcy would raise myriad novel issues of first impression that include, among others: (i) the harmonization of the Bankruptcy Code and the IGRA; (ii) the role of NIGC; (iii) the role of the Native American tribes as regulators of their own gaming enterprises; (iv) whether or the extent to which the sovereign immunity of the Native American tribe whose gaming enterprise has filed for bankruptcy is waived upon a bankruptcy filing;[58] (v) lien perfection laws and priority issues (and in particular, the interplay between state laws and federal laws governing the mortgage of tribal land which is held in trust by the United States);[59] (vi) debtor in possession financing (see below); and (vii) the administration of the debtor gaming enterprise by the Office of United States Trustee.[60]

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57. The author was able to find only a single published opinion that suggests that a Native American tribal enterprise is eligible to file for bankruptcy. *See In the Matter of Cabazon Indian Casino,* 57 B.R. 398 (9th Cir. BAP 1986) (the debtor in the Chapter 11 case was a casino operated by a Native American tribe. The Bankruptcy Appellate Panel for the Ninth Circuit, held that the debtor, a federally recognized Native American tribe, was not entitled to receive exemptions from excise taxes under the Federal Insurance Contribution Act and the Federal Unemployment Tax Act, as the tribe was neither a state, the instrumentality of a state, or a political subdivision of a state.)

58. Can a Native American tribal enterprise be the subject of an involuntary bankruptcy petition?

59. For instance, 25 U.S.C. § 483a(a) subjects the holder of Indian trust lands to foreclosure "in accordance with the laws of the tribe which has jurisdiction over such land or, in the case where no tribal foreclosure law exists, in accordance with the laws of the State. . .in which the land is located." Section 483a(a) requires the approval of the Bureau of Indian Affairs (BIA) as a predicate to the mortgaging of Indian trust lands. Section 483a(a) says nothing about priorities of mortgage interests. Very recently, the Ninth Circuit addressed this issue squarely. *In re Emerald Outdoor Advertising, LLC,* 444 F.3d 1077 (9th Cir. 2006), the Ninth Circuit ruled that a deed of trust that was (i) recorded first in time in the county in which the trust lands are located, in accordance with Washington state law, and (ii) approved by a prior BIA Certificate of Approval, was senior in priority to a commercial lease that had been properly recorded with the BIA prior to the recordation of the deed of trust, but that had not been recorded in the county records in accordance with Washington state law. Because section 482a(a) incorporates state law and state law is what the lender followed, the lender perfected its lien vis-à-vis subsequent interest holders upon recordation with the county, irrespective of ministerial defects in the recordation of the Certificate of Approval by the BIA. *Id.* at. 1081. It is important to note that the result here was dictated by the fact that the Native American tribe involved had no laws governing the foreclosure of mortgaged land. *Id.* at 1080. Consequently, in accordance with Section 483a(a), Washington state law governed the determination of lien perfection and prioritization.

60. For a more detailed, relatively recent discussion of the complexities associated with a distressed Native American enterprise's eligibility to file for bankruptcy, see R. Spencer Clift, III, The Historical Development of American Indian Tribes; Their Recent

Because federally recognized Native American tribes enjoy immunity from suits instigated by private parties, including suits to enforce contractual obligations, and because of the federal regulatory overlays relating to Native American tribes, negotiating financings in the context of a bankruptcy or in contemplation of a bankruptcy will also involve some unique considerations. For instance, unlike traditional financing transactions, lenders would need to negotiate with the distressed tribal entity for express waivers of its sovereign immunity and consents to the jurisdiction of certain state or federal courts so as to enable lenders to enforce their rights and the tribal entity's obligations under the financing documents. A debtor in possession loan to a tribal gaming enterprise that has filed for chapter 11 may not only require bankruptcy court approval under the applicable standards of the Bankruptcy Code, but also (i) review and approval by the BIA to the extent the loan involves a pledge or encumbrance of Native American trust lands or other trust assets, *and* (ii) NIGC approval if the enterprise is to be managed by non-Native American parties (for instance, a bankruptcy trustee).

If the successful exit from a traditional gaming debtor chapter 11 case is complicated by virtue of issues created by regulatory overlays and state sovereign immunity, it is fair to assume that the complexity involved in a tribal gaming cases will be exponentially greater and require careful thought and planning.

CONCLUSION

As this article demonstrates, because of the unique state regulatory, federal preemption and sovereign immunity issues that affect the gaming industry, debtors, creditors and bankruptcy practitioners alike must take extreme care in considering bankruptcy exit strategies for a gaming enterprise that is (or is to become) a chapter 11 debtor. Careful planning, and the retention of gaming counsel that is well-versed in the gaming laws and familiar with the Gaming Authorities of the jurisdiction(s) in which the gaming enterprise operates, are essential to ensuring an exit from bankruptcy that maximizes value to the estate and its economic stakeholders. In addition, it is all but inevitable that someday, perhaps soon, a Native American gaming enterprise will need to avail itself of the federal bankruptcy laws. The interplay between federal laws in respect of Native American tribes and Native American gambling enterprises, individual tribal laws, state laws and the Bankruptcy Code, will pose significant and unique challenges for those practitioners that must shepherd their clients (whether they be debtors, creditors or regulators) through the chapter 11 process.

Dramatic Commercial Advancement; and Discussion of the Eligibility of Indian Tribes Under the Bankruptcy Code and Related Matters, 27 Am. Indian L. Rev. 177, 195 (2003).