THE NEGATIVE EFFECTS OF CONFUSION OVER COLLATERAL AGREEMENTS UNDER THE INDIAN GAMING REGULATORY ACT: WHICH AGREEMENTS NEED REVIEW?

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INTRODUCTION

A bank hired a top-100 law firm[1] to document loans for a $28 million Indian gaming casino financing project.[2] Whether done as the result of genuine confusion or neglect, the law firm did not encourage the bank to seek approval from the National Indian Gaming Commission ("NIGC") regarding a Notice and Acknowledgement of Pledge agreement.[3] After the transaction had closed and the loans were funded, it appeared that everything was proceeding as planned — until the borrower defaulted.[4] The bank engaged the law firm to recover what was owed under the agreement; however, the casino owner claimed that the agreement was unenforceable for lack of NIGC approval.[5] Although eventually reversed on other grounds, the casino received a multi-million-dollar legal malpractice verdict against the law firm.[6]

Despite the eventual reversal of the malpractice verdict against it, the law firm undoubtedly suffered significant expenses and harm over the protracted, decade-long litigation,[7] all of which resulted from confusion over a single

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[1] *Rankings & Reviews for Dorsey & Whitney LLP*, VAULT.COM, http://www.vault.com/company-profiles/law/dorsey-whitney-llp/company-overview.aspx (last visited Oct. 13, 2017).

[2] Heidi M. Staudenmaier & Ruth K. Khalsa, *Theseus, the Labyrinth, and the Ball of String: Navigating the Regulatory Maze to Ensure Enforceability of Tribal Gaming Contracts*, 40 J. MARSHALL L. REV. 1123, 1127 (2007) [hereinafter Staudenmaier & Khalsa, *Theseus*] (citing SRC Holding Corp., 352 B.R. 103 (Bankr. D. Minn. 2007)).

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] Leonard v. Dorsey & Whitney LLP, 553 F.3d 609, 631 (8th Cir. 2009); Staudenmaier & Khalsa, *Theseus*, *supra* note 2, at 1127-28.

[7] Martha Neil, *8th Circuit Sides with Dorsey & Whitney in $900K Malpractice Case*, ABA J., (Jan. 16, 2009, 11:43 PM), http://www.abajournal.com/news/ article/ 8th_circuit_sides_with_dorsey_whitney_in_900k_malpractice_case.

question: Which agreements require NIGC approval to be enforceable under the Indian Gaming Regulatory Act ("IGRA")? Tribes and the law firms representing them are put in a difficult position due to confusion in the courts over this seemingly simple question. Adding to the confusion is the NIGC's suggestion that tribes submit all collateral contracts to determine whether they are collateral contracts (which may not require NIGC approval) or management contracts (which require NIGC approval).[8] In effect, tribes interested in entering gaming-related contracts, even those tangentially related to gaming, are forced to seek NIGC review or risk the potentially harsh consequences of an unenforceable agreement. This requirement places an additional and unnecessary burden on tribes, beyond that required under IGRA, thus inhibiting IGRA's stated goal of promoting tribal economic development and self-sufficiency.

I. MANAGEMENT CONTRACTS AND COLLATERAL AGREEMENTS UNDER IGRA

Consistent with its stated purpose to protect Indian tribes from organized crime and overreaching by management companies,[9] IGRA includes many safeguards to prevent non-Indians from taking advantage of tribes involved in gaming.[10] One primary safeguard is the NIGC's review of contracts between Indian tribes engaged in gaming and outside parties—specifically, outside management companies.[11] These IGRA provisions provide the NIGC with the authority to review and approve contracts between Indian tribes engaged in gaming and management companies seeking to engage in management of tribal casinos. This safeguard also has the consequence of rendering certain unapproved contracts void.[12]

A. Management Contracts

25 U.S.C. § 2710(d)(9) provides that an Indian tribe may enter into a management contract for the operation of a Class III gaming activity, if the agreement is approved by the Chairman of the NIGC.[13] As noted in the IGRA, however, while Secretarial review of management contracts concerning Indian gaming is required, IGRA does not provide standards for approval of such

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[8] *See infra* Part I.A-B.

[9] Indian Gaming Regulation Act, 25 U.S.C. § 2702 (2012) provides, in relevant part: "The purpose of this chapter is . . . to provide a statutory basis for the regulation of gaming by an Indian tribe adequate to shield it from organized crime and other corrupting influences, to ensure that the Indian tribe is the primary beneficiary of the gaming operation, and to assure that gaming is conducted fairly and honestly by both the operator and players . . ."

[10] FELIX S. COHEN, COHEN'S HANDBOOK OF FED. INDIAN LAW § 12.08 (2012) (2015 supplement) [hereinafter COHEN].

[11] *See* 25 U.S.C. § 2711 (2012); *see also* 25 C.F.R. §§ 531, 533, 537 (2017).

[12] *See* 25 U.S.C. § 2771(f) (2012).

[13] 25 U.S.C. § 2701(d)(9) (2012).

contracts.[14] Although IGRA does not define management, 25 C.F.R. § 502.19 provides that a *primary management official* is any person "who has authority . . . [t]o set up working policy for the gaming operation."[15]

The result of failure to gain NIGC approval of a management contract is a voided contract.[16] Further, a management contract that has not been approved by the NIGC is not legally binding.[17] Because of the harsh potential consequences of failure to gain NIGC approval of a management contract, it is essential to determine which agreements qualify as management contracts.

25 C.F.R. § 502.15 defines management contracts as, "any contract, subcontract, or collateral agreement between an Indian tribe and a contractor or between a contractor and a subcontractor if such contract or agreement provides for the management of all or part of a gaming operation."[18] In determining whether an agreement is a management contract, it is important to remember that "[i]f any term of the contract relates to some type of management activity . . . the agreement should be submitted to the NIGC for approval or declination."[19]

Any contract that gives a contractor authority to control or direct any aspect of gaming activity qualifies as a management contract.[20] For example, in *First American Kickapoo Operations, L.L.C. v. Multimedia Games, Incorporated*,[21] an operating lease that granted a contractor the opportunity "to set up working policy" for the tribe's gaming operation was a management contract which required NIGC review under IGRA.[22] The court held that the contract was a management contract because it authorized the contractor "to exert considerable and continuing influence over the day-to-day running" of the gaming operation.[23]

Similarly, in *United States ex rel. Bernard v. Casino Magic*, despite an express provision to the contrary, an agreement's requirement that a tribe comply with a contractor's recommendations, when viewed together with other agreements, constituted a management contract under IGRA.[24] Finally, in *New Gaming Systems Incorporated v. National Indian Gaming Commission*, an equipment lease and a promissory note that granted a contractor control over the type of gaming equipment available at the casino and required the tribe to use a specific cash accounting system in exchange for a percentage fee, was a

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[14] *Id.* § 2701(2).
[15] 25 C.F.R. § 502.19 (b)(2) (2017).
[16] *Id.* § 533.7.
[17] *See, e.g.*, First Am. Kickapoo Operations v. Multimedia Games, 412 F.3d 1166, 1176 (10th Cir. 2005).
[18] 25 C.F.R. § 502.15 (2017).
[19] Staudenmaier & Khalsa, *Theseus*, *supra* note 2, at 1156.
[20] COHEN, *supra* note 9, at § 12.08[3].
[21] *Kickapoo*, 412 F.3d at 1166.
[22] *Id.* at 1172.
[23] *Id.* at 1178.
[24] 293 F.3d 419, 424-26 (8th Cir. 2002).

management contract requiring NIGC approval.[25]

In an extreme example, one court found that a tribe's agreement to transfer the right to manage gaming operations over a facility on tribal lands pursuant to an agreement to be negotiated is itself a management contract because it effectively alienates the tribe's right to negotiate with any other potential manager and, thus, gives the contractor the exclusive ability to conduct gaming for the tribe.[26]

Agreements that do not provide the right or contingent right for a contractor to manage, however, are not management contracts under IGRA and do not require NIGC approval to be enforceable. For example, a contract for construction of a casino that does not provide for gaming responsibilities does not qualify as a management contract, thus, it does not require NIGC approval.[27]

B. Collateral Agreements

A management contract "is often only one component of a complex relationship between an Indian tribe and an outside entity."[28] Tribes and contractors may, in addition to management contracts, reach agreements for other services, such as construction and development, financing, and purchase of land.[29] A collateral agreement is:

> [A]ny 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).[30]

The NIGC has never asserted that every document qualifying as a collateral agreement is subject to approval by the NIGC.[31] Courts, however, have shown confusion over which collateral agreements require approval by the NIGC.[32] As a result, some courts have incorrectly presumed that all documents meeting the definition of collateral agreement require approval.[33] For example, in *United*

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[25] 896 F. Supp. 2d 1093, 1102-05 (W.D. Okla. 2012).

[26] COHEN, *supra* note 9, at § 12.08[3] (citing Machal, Inc. v. Jena Band of Choctaw Indians, 387 F. Supp. 2d 659, 669 (W.D. La. 2005)).

[27] *See generally* United States ex rel. St. Regis Mohawk Tribe v. President R.C.-St. Regis Mgmt. Co., 451 F.3d 44 (2d Cir. 2006) [hereinafter "Mohawk"].

[28] Kevin K. Washburn, *The Mechanics of Indian Gaming Management Contract Approval*, 8 GAMING L. REV. 333, 344 (2004) [hereinafter Washburn, *Mechanics*].

[29] *Id*.

[30] 25 C.F.R. § 502.5 (2017).

[31] *See Mohawk*, 451 F.3d at 51 (recognizing broad power of NIGC to determine which contracts require approval).

[32] *See* Washburn, *Mechanics*, *supra* note 27, at 345.

[33] *See Mohawk*, 451 F.3d at 47(dictum); *see also* COHEN, *supra* note 9, at § 12.08.

States ex rel. St. Regis Mohawk Tribe v. President R.C.-St. Regis Management Company, the court explicitly stated that the approval provisions that apply to management contracts apply to collateral agreements.[34]

This assertion is, however, patently incorrect. This is because "[t]he NIGC has authority to approve a collateral agreement *only if it also meets the definition of 'management contract'*; that is, provides for the 'management of all or part of a gaming operation.'"[35] Therefore, collateral agreements not meeting the definition of management contracts or contracts collateral to a management contract are not subject to NIGC approval.[36] Thus, such contracts are enforceable under traditional contract principles. Further, the NIGC does not even have standards for approving collateral agreements that do not qualify as management contracts.[37] One of the primary reasons for this confusion is that the NIGC has never been a party to the federal court decisions concerning IGRA approval requirements of collateral agreements.[38]

Admittedly, some courts have found that even agreements that are collateral to a management contract require NIGC approval. For example, in *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Kean-Argovitz Resorts, L.L.C.*, the court held that a development agreement drafted to allow development during the NIGC approval process was unenforceable, despite two express disclaimer provisions in the contract that it was not a management contract.[39]

The court found the development contract was unenforceable for three reasons. First, the agreement provided that the non-tribal contractor would arrange all funding for the casino and pre-opening costs.[40] The loans for this provision were to be repaid solely from gaming revenue and the contractor's loan commitment was consideration for exclusive development rights.[41] Second, an exclusivity provision in the agreement provided that the tribe agreed to use only the contractor for all gaming-related development on tribal land.[42] Third, the enforceability of the collateral agreement was conditioned upon NIGC approval of the management contract, thus, the collateral agreement was essentially a part of the management contract, albeit by a different name.[43]

Similarly, in *Jena Band of Choctaw Indians v. Tri-Millennium Corporation*, a single provision that provided two contractors the exclusive right to operate the

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[34] *Mohawk*, 451 F.3d at 50 n.5.
[35] COHEN, *supra* note 9 § 12.08[4] (emphasis added).
[36] *Id.* § 12.08[4].
[37] *Id.*
[38] *Id.* (citing United States ex rel. St. Regis Mohawk Tribe v. President R.C.-St. Regis Mgmt. Co., 451 F.3d 44 (2d Cir. 2006)).
[39] 249 F. Supp. 2d 901, 907 (W.D. Mich. 2003) (hereinafter "Match"), *vacated*, 383 F.3d 512 (6th Cir. 2004).
[40] *Match*, *supra* note 38, at 906.
[41] *Id.*
[42] *Id.*
[43] *Id* at 907.

tribe's first gaming facility as well as the exclusive right to enter into a management contract with the tribe, "rendered the otherwise benign . . . Settlement Agreement void as an unapproved collateral agreement providing for the management of a gaming operation."[44]

Conversely, several courts have found agreements between an Indian tribe and contractors were not collateral to a management agreement, thus, did not require NIGC approval. In *Bounceback Technologies.com, Incorporated v. Harrah's Entertainment, Incorporated*, a consulting agreement was not a management contract nor collateral thereto, thus, it did not require NIGC approval.[45] This was, in part, because the only terms concerning the transfer of management authority were included in a separate management agreement. Thus, viewing the various agreements together, the collateral agreement in question did not alter the allocation of management authority in the contract.[46]

Similarly, in *United States of America ex rel. Saint Regis Mohawk Tribe v. President R.C.-St. Regis Management Company*, a construction contract did not constitute a management contract or collateral to a management contract, thus, it did not require NIGC approval.[47] There were four primary reasons for the court's determination. First, the collateral agreement contained no terms relating to the "operation of games, receipt of revenue, issuance of prizes, or payment of expenses."[48] Second, the only relationship to gaming was the mention of a "casino facility" in the contract, which was used to describe the building to be constructed.[49] Third, the contract was a standard-form contract used by the contractor's professional organization which dealt only with construction-related requirements and included rights and obligations of a finite nature and definite term.[50] Finally, the payment was not based on a share of revenue.[51]

II. NIGC BULLETIN

Although the NIGC does not have authority to approve collateral agreements, the NIGC still exercises authority to review collateral agreements to determine if they are management contracts requiring approval:

> In order to provide timely and uniform advice to tribes and their contractors, the NIGC and the BIA have determined that certain gaming-related agreements, such as consulting

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[44] Staudenmaier & Khalsa, *Theseus*, *supra* note 2 at 1146 (citing Jena Band of Choctaw Indians v. Tri-Millennium Corp., *Inc.*, 387 F. Supp. 2d 671, 680 (W.D. La. 2005)).

[45] *Id.* at 1150 (citation omitted).

[46] *Id.*

[47] No. 7:02-CV-845, 2005 U.S. Dist. LEXIS 12456, at *1, *10 (N.D.N.Y. June 13, 2005).

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.*

> agreements or leases or sales of gaming equipment, should be submitted to the NIGC for review. In addition, if a tribe or contractor is uncertain whether a gaming-related agreement requires the approval of either the NIGC or the BIA, they should submit those agreements to the NIGC. The NIGC will review each such submission and determine whether the agreement requires the approval of the NIGC. If it does, the NIGC will notify the tribe to formally submit the agreement. If the NIGC determines that the agreement does not require the approval of the NIGC, the submitter will be notified of that fact and the NIGC will forward the agreement to the BIA for its review.[52]

There are several policy justifications favoring the NIGC's review of collateral agreements, even those agreements that are ultimately determined to not require NIGC approval. First, the NIGC must make its own determination as to whether an agreement requires its approval.[53] Second, it is necessary for the NIGC to review collateral agreements as part of the review of management contract in order to determine if any relationship between a tribe and contractor exceeds IGRA's compensation limits.[54] Third, the review process serves as a check to prevent contractors from taking advantage of the tribes.[55]

III. THE *MACHAL V. JENA BAND OF CHOCTAW INDIANS*[56] RATIONALE

As stated in Cohen's Handbook of Federal Indian Law § 12.08, *Machal* provided a "better-reasoned approach" regarding the distinction between which collateral agreements require NIGC approval.[57] In *Machal*, the court explained, "only those collateral agreements that should also be considered management contracts because they provide for the management of a gaming operation are void without NIGC approval."[58]

The court further explained that if any contract that relates to the eventual development of an anticipated gaming operation is construed as a management contract — collateral or otherwise — it would be more difficult for tribes to acquire the economic assistance often needed for procuring land and paying the expenses necessary to the creation of a gaming operation and obtaining the

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[52] NAT'L INDIAN GAMING COMM'N, BULLETIN NO. 1993-3, SUBMISSION OF GAMING-RELATED CONTRACTS AND AGREEMENTS FOR REVIEW (July 1, 1993), https://www.nigc.gov/compliance/detail/submission-of-gaming-related-contracts-and-agreements-for-review.

[53] *See* Washburn, *Mechanics, supra* note 27, at 345-46.

[54] *Id.* at 345.

[55] *Id.* at 333, 346.

[56] 387 F. Supp. 2d 659, 666 (W.D. La. 2005) [hereinafter "*Machal*"].

[57] COHEN, *supra* note 9 at §12.08[4] n.28.

[58] *Id.*

requisite governmental approvals. Potential investors would be unable to contract with tribes, and therefore, they would not be able to ensure that they could recoup any of the money they invested in the tribe.

It is in the best interest of tribes that they be able to enter into enforceable contracts that are precursors to the creation and licensing of a gaming operation. Without such contracts, many tribes would not be able to procure the financial backing that is often necessary for the creation of gaming operations. Such a state of affairs would thwart the policies underlying the IGRA. By making it easier for tribes to obtain financial backing, we make it easier for tribes to acquire the economic development and self-sufficiency that accompanies the income from tribal gaming operations.[59]

As discussed below, the *Machal* approach is consistent with the underlying approach of the IGRA and should be adopted by the courts.

IV. EFFECTS OF THE CONFUSION OVER COLLATERAL AGREEMENTS

The purpose of IGRA is, in part: "to provide a statutory basis for the operation of gaming by Indian tribes as a means of promoting tribal economic development, self-sufficiency, and strong tribal governments . . ."[60] However, tribes are disadvantaged by confusion over which collateral agreements require NIGC approval, which, in turn, compromises the IGRA's overarching goal. This problem is magnified by two additional factors. First, there is clear disagreement between the NIGC and the courts—as well as disagreement among the courts themselves—over which agreements require NIGC approval. And second, the NIGC has never been a party to a suit, thus, there is no judicial clarity.

As a result, even if a lawyer drafting a collateral agreement mimics the agreement model from a case where the court determined an agreement was not collateral to a management contract, "an agreement may be deemed unenforceable for lack of NIGC approval on the basis of a single management-related term that transfers only a minor aspect of managerial responsibility."[61] Thus, lawyers, tribes, and contractors seeking to enter into agreements with a tribe must walk a thin line of uncertainty to avoid entering into an unenforceable agreement.

The first and most obvious way confusion over the approval of management agreements disadvantages the tribes is that it effectively requires tribes to seek approval of all collateral agreements which could plausibly qualify as management agreements. This is because of the uncertainty surrounding which agreements a court will find qualify as management contracts or agreements collateral to management contracts. Further, the NIGC encourages the review of agreements to determine whether they require approval. As a result, tribes are all

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[59] *Id.*

[60] 25 U.S.C. § 2702(1) (2012).

[61] Staudenmaier & Khalsa, *Theseus*, *supra* note 2, at 1157 (citation omitted).

but required to subject themselves to the long delays — sometimes exceeding 18 months — potentially to find out that a collateral agreement was not a management contract or collateral thereto, thus, did not even require NIGC approval.[62] This is significant because, as in most industries, time is money, but for casinos this could mean millions, if not billions.[63] Further, the possibility exists that, despite the NIGC's determination a certain contract is a collateral agreement that does not require official approval, a court will still find that the contract did require NIGC approval.

In addition to the losses discussed above, there are two additional ways that a tribe seeking to enter into a collateral agreement are affected by this delay. First, in the short-term, the tribes miss out economically: every day that development is delayed is one less day customers can be gambling in the tribe's casino. Second, when casino construction and development is delayed by NIGC approval of collateral agreements, tribes lose bargaining power to engage contractors and subcontractors in favorable deals. This could affect which contractors and developers are willing to enter agreements, and may compromise the tribe's bargaining power with those contractors that *are* willing to enter into agreement. Thus, this delay — despite its intent to protect the tribes — contradicts IGRA's underlying goal of tribal self-sufficiency through economic development by depriving the tribes of potential revenue and savings.

Because of the potential issues caused by NIGC review, tribes are incentivized to attempt to sidestep the delay by either attempting to hide management contract provisions in collateral agreements or to "gamble" on whether a court will declare a given contract void. If a tribe attempts to hide management contract provisions in a collateral agreement, it is possible that a court, after reviewing the agreement, may retroactively void the contract based on a determination that the agreement is a management contract or collateral to a management contract. Similarly, a tribe that decides to enter into a contract, in the hope the contract will later be found enforceable, may expose itself to the potential financial losses associated with an unenforceable agreement.

This risk, however, poses yet two more problems for the tribes seeking to engage legal representation for drafting collateral agreements. First, a firm familiar with the prolonged litigation in *SRC Holding Corporation*, discussed above, may be less willing to assist a tribe in any matters concerning gaming. Even those firms that are willing may be far more likely to recommend NIGC approval of almost any agreement, given the high degree of uncertainty and subsequent risk of malpractice. Second, to compensate for the potential risk of malpractice, yet again, tribes may be at a bargaining disadvantage and have to pay law firms higher compensation in exchange for the risk the firm will take on

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[62] Washburn, *Mechanics*, *supra* note 27, at 334.

[63] 2016 INDIAN GAMING REVENUES INCREASED 4.4% (July 12, 2017), https://www.nigc.gov/news/detail/2016-indian-gaming-revenues-increased-4.4. *See also* Staudenmaier & Khalsa, *Theseus*, *supra* note 2, at 1123.

for a potential malpractice suit if a given contract is later declared void.

Another issue, as discussed above in *Machal*, is that investors may be weary to invest in tribal gaming for a variety of reasons. Among these reasons is the uncertainty of the enforcement of contracts. Unlike a typical business-investment transaction where the parties to a contract need only worry about contract law principles and pitfalls, potential tribal gaming investors must be cognizant of the possible adverse financial effects of a contract that is determined void for lack of NIGC approval. Again, given the uncertainty, investors may require higher compensation to make up for the inherent risks of their investment.

These problems are exacerbated by the fact the parties on either side of the contract may later use lack of NIGC approval as either a sword or a shield. For example, a tribe that entered into a contract for development may seek to avoid their obligations under the contract by asserting that the contract is void for want of NIGC approval. This may be advantageous to a tribe under circumstances where economic development is slower than anticipated. Conversely, a company seeking to avoid its obligations may, after entering into the contract, similarly assert lack of NIGC review of a contract as an affirmative defense to its failure to meet its obligations.

Considering the policy rationale in *Machal* and IGRA's underlying goal of promoting tribal self-sufficiency and economic development, it would be beneficial to develop a bright-line rule for determining which agreements require NIGC approval. The risk of a void contract that leaves one party to bear the risk would be minimized if the courts agreed to establish a presumption for the enforceability of contracts based on written assertion that the contracts are not "management contracts." This would give the tribes more bargaining power, thus allowing them to benefit under traditional free-market principles.

Alternatively, courts should allow for severability of contracts that are determined to be collateral to management contracts. Contracts should not be declared void merely because they contain terms that render the contract unenforceable absent NIGC approval. Instead, those collateral agreement terms should be severed. Allowing for the severability of those contracts collateral to management contracts would prevent the tribe or a management company from taking advantage of each other. This would, in turn, reduce the risk of entering into such contracts with tribes interested in gaming and the risk of malpractice, thus, furthering the goals of promoting tribal self-sufficiency and economic development.

CONCLUSION

Given the disagreement between the federal courts and the NIGC as to which agreements require NIGC review, there is a great deal of uncertainty. In an attempt to provide clarity, the NIGC will provide determinations into whether a certain agreement is a management contract or collateral to a management contract such that it requires NIGC approval or, alternatively, whether an

agreement is collateral and enforceable as a contract without approval. However, this determination process adds considerable time and expense, thus burdening tribes.

A tribe seeking to avoid the long review process could retain legal counsel to write an agreement avoiding the pitfalls of those agreements determined to be management contracts or collateral thereto by referencing cases where courts have determined agreements did not require such approval. But, this approach is risky given the uncertainty and confusion within the courts and the disagreement between some courts and the NIGC. Thus, the confusion over which agreements require NIGC approval continues to put the tribes at a disadvantage, subsequently interfering with the underlying goal of allowing the tribes to achieve economic self-sufficiency through gaming.