Casino and Gaming Issues in Chapter 11 Cases

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When Gaming Goes Heads Up with the Bankruptcy Code: Unique Restructuring Issues for Gaming Businesses in Difficult Economic Times[1]

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The intersection of gaming and bankruptcy law has long presented legal conflicts that have never been easily reconciled. This problem has been exacerbated in recent years by the current global and national economic turbulence that has greatly impacted the casino gaming industry and has led to a sizeable increase in the number of businesses using bankruptcy to restructure and/or liquidate assets.[2]

Many institutional investors on Wall Street, as well as private equity firms and large national and international banks, either own equity in, or have lent money to, public and private gaming companies. With creditors anticipating that casino revenues would remain at historically high levels or would continue

[1] This article is an expansion of a previously published article. *See* Dawn M. Cica, Laury Macauley & Sean M. McGuinness, *In and Out of Bankruptcy: Weathering the Financial Storm in Gaming*, Nev. Gaming Law., Sept. 2011, at 17, *available at* http://www.lrlaw.com/files/Uploads/Documents/Nevada_Gaming_Lawyer.pdf.

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[2] The five-year period between 2006 and 2010 saw business filings nationwide rise almost threefold—in 2006, there were 19,695 filings as compared to 56,282 during fiscal year 2010. Statistical Tables for the Federal Judiciary, Administrative Office of the United States Courts, *available at* http://www.uscourts.gov/Statistics/StatisticalTablesForTheFederalJudiciary.aspx.

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to climb, many of these loans were made at the top of the market with high debt leverage ratios. However, because gaming is essentially an entertainment industry, the economic tumult precipitously reduced consumer discretionary spending, leading to deflated casino revenue.[3]

Moreover, businesses in the gaming industry have faced an onslaught of additional competition nationwide. States like California have allowed a substantial expansion of Indian gaming.[4] Moreover, a myriad of states across the nation have expanded authority for gaming enterprises to include, among other things, the addition of traditional casino gaming at racetrack facilities.[5]

As a result of these economic forces and the resulting decrease in discretionary income, casino profitability has suffered and major capital projects have been delayed or shelved. Additionally, many gaming companies have been unable to meet their income or other covenants in their debt obligations. In fact, Nevada's 256 largest casinos netted a loss of nearly $4 billion in the 2011 fiscal year.[6] Faced with such challenges, and the particular conflicts inherent in the gaming and bankruptcy legal constructs, both lenders and debtors in the gaming industry have been forced to develop creative solutions unique to casino businesses, whether in or out of the bankruptcy context.

I. Restructuring Alternatives

In the wake of financial defaults, gaming debtors and lenders often turn first to restructuring options in order to avoid the filing of a bankruptcy. Nevertheless, the novel aspects of the casino business still present numerous difficulties for lenders.

Casinos are typically financed with a combination of secured and unsecured debt much in the same way as any other business. They own property, certain of which they can pledge to secure their debt. Unlike general commercial loans, however, the lender's tripartite relationship to its collateral and the borrower is regulated by state gaming laws. For example, in Nevada, the pledge of privately owned stock in gaming companies requires the prior approval of gaming authorities before they can become effective. A gaming license itself is not subject to encumbrance, since it is considered a revocable privilege to conduct gaming activities.[7] Nevertheless, lenders routinely take the

[3] American Gaming Ass'n, State of the States: The AGA Survey of Casino Entertainment 5 (2011) (According to the American Gaming Association, total U.S. consumer spending on commercial casino gaming declined in 2008 and 2009, only to rebound slightly with an increase of 0.9% in 2010. In Nevada, the increase was a modest 0.1%.).

[4] *Id.* at 23.

[5] *Id.* at 4 (As of December 31, 2010, there were 456 Tribal casinos nationwide, covering twenty-eight different states; there were forty-five racetrack casinos, covering twelve states.).

[6] Nevada State Gaming Control Board, Nevada Gaming Abstract 2011 (Jan. 6, 2012) (reporting that Nevada's 256 largest casinos generated a net loss of $3,996,656,422.00 in the 2011 fiscal year).

[7] Nev. Rev. Stat. § 463.220(2) (2009) states in part, "No state gaming license may be assigned either in whole or in part;" *see also*, Nev. Gaming Reg. 8A.010(4) (regulations of the Nevada Gaming Commission, which defines "personal property gaming collateral" and "operating license" separately).

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position that the "enterprise value" of the casino constitutes intangible personal property, allowing them to assert a security interest in that goodwill.[8]

In addition to those regulatory issues, the necessary set-up of a casino business itself presents unique challenges to the lender. One of the most important characteristics of the gaming business is the typically large amount of cash on hand in the casino. This cash is located in the casino cage, throughout the casino in gaming machines, at the gaming tables, and is represented by chips. Pursuant to the Uniform Commercial Code (UCC), Section 9-313(a), a lender's security interest in that cash can only be perfected by possession.[9] However, because cash is the lynchpin of the gaming enterprise (and casinos need to maintain a minimum bankroll on hand per gaming regulations),[10] a lender's actual possession of such cash (and perfection of its security interest thereby) would prohibit the continual and profitable operation of the casino.

Even if the lender was granted a security interest in gaming tables and slot machines, the lender does not automatically have a security interest in the cash generated by the use of that gaming equipment.[11] Although there are no cases that directly address whether the revenue generated by such gaming equipment constitutes "proceeds" under the UCC, it is questionable whether such a position would prevail, because cash neither diminishes the value of the lender's collateral when generated, nor is generated from the sale or transmutation of the collateral.[12] If the revenue does not constitute "proceeds," this is injurious to the secured creditor's interest after a bankruptcy filing, because a security interest does not attach to post-petition revenue unless it constitutes "proceeds, products, offspring, or profits . . . ." of the pre-petition collateral.[13] Furthermore, if an "interest"[14] in this revenue cannot be established, a lender may be helpless to stop a casino from freely using cash on hand, despite the fact that such cash may have been earned through the use of encumbered gaming equipment.

Due to the uncertainty of these various legal issues, lenders are increasingly requiring that borrowers structurally separate the ownership of the real estate from the operation, and that borrowers operate pursuant to such leases.[15] As part of this structure, the lender generally requires the borrower to deposit cash into accounts controlled by the lender, which then "waterfalls" out to pay approved operating expenses and debt obligations.

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[8] *See* NEV. REV. STAT. § 463.510(1) (2009).

[9] U.C.C. § 9-313(a) (2001).

[10] *See* Nev. Gaming Comm'n Reg. 6.150 (Mar. 2006) (regulations of the Nevada Gaming Commission).

[11] "Gaming equipment" includes, gaming devices, cashless wagering systems, and associated equipment as defined in NEV. REV. STAT. §§ 463.0155, 463.014, 463.0136 (2009).

[12] *See, e.g., In re* S & J Holding Corp., 42 B.R. 249, 250 (Bankr. S.D. Fla. 1984) (cash revenues generated by video game machines and vending machines do not constitute "proceeds").

[13] *See* 11 U.S.C. §552(b)(1) (2006).

[14] *Id.* § 363(a).

[15] As of the July 28, 2009 filing date of the chapter 11 bankruptcy cases of Station Casinos, Inc, all of debtors' real estate was owned by separate entities from that of its operating entities, making for a jointly-administered case of seventeen separate debtors. *See In re* Station Casinos, Inc., No. BK-09-52477, 2010 Bankr. Lexis 5673 (Bankr. D.Nev. 2010).

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In addition to the issues that arise in connection with the grant and perfection of a lender's interest in collateral, loans to licensed gaming companies often create unique situations that impact a lender's ability to foreclose on the collateral. In Nevada, lenders cannot assume control of a Nevada gaming business without prior gaming regulatory approvals, generally requiring application and a finding as to the lender's suitability.[16] The issue of how much decision making power a lender can have over a casino or gaming company without being deemed to be in control is often complex and difficult to predict. Certain foreclosures of stock or equity also require prior approval of the lender by the gaming regulatory authorities.[17] Although gaming devices may be foreclosed upon without prior approval from regulators, approvals are required in order to sell or further transfer those gaming devices. When the devices are ultimately transferred, the transfer must be to someone who already holds a manufacturer's or distributor's license.[18] On the other hand, real property may be foreclosed upon without any gaming authority consent, which is why sophisticated lenders are requiring the bifurcation of the real estate from the operation.

For these reasons, sophisticated borrowers may attempt to use the gaming regulatory structure to their advantage against unsophisticated lenders. A borrower can use a lender's inability to take over and conduct gaming operations without the appropriate licenses as leverage to renegotiate the terms of a loan transaction after a borrower default. Accordingly, lenders do not want the borrowers to force their hand in such an instance, because the only quick way to gain control of a gaming borrower's business would be to cease gaming operations, which would decimate the value of the collateral.

Increasingly, with the new borrowing structures, lenders are finding ways to restructure without the cost and delay of a bankruptcy filing. Oftentimes, lenders use leverage against personal guarantors to gain negotiating power. For example, the parties to the senior secured loan on the M Resort agreed that, rather than a foreclosure or entering bankruptcy, the parties would market and auction the property.[19] Similarly, the Planet Hollywood lenders and owners agreed to sell the property to Caesars Entertainment, f.k.a. Harrah's Entertainment, rather than filing a chapter 11, which would have constituted yet another

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[16] *See*, e.g., NEV. REV. STAT. §§ 463.160-170 (2009). For example, on December 23, 2011, the Nevada Gaming Commission found Ronald Paul Johnson "suitable" to serve as receiver for the Las Vegas Hilton, including its gaming business, in advance of his appointment by the Court (see more detailed discussion, *infra*). An applicant cannot be found "suitable" unless the Commission is satisfied that the applicant is:

> (a) A person of good character, honesty and integrity;
> (b) A person whose prior activities, criminal record, if any, reputation, habits and associations do not pose a threat to the public interest of this State or to the effective regulation and control of gaming or charitable lotteries, or create or enhance the dangers of unsuitable, unfair or illegal practices, methods and activities in the conduct of gaming or charitable lotteries or in the carrying on of the business and financial arrangements incidental thereto; and
> (c) In all other respects qualified to be licensed or found suitable consistently with the declared policy of the State.

Id. § 463.170.

[17] *See* Nev. Gaming Comm'n Reg. 8.010 (2011).

[18] *See, e.g.*, NEV. REV. STAT. § 463.162.

[19] *See* Howard Stutz, *M Resort Facing Sale,* LAS VEGAS REV.-J., Aug. 16, 2010, http://www.lvrj.com/business/lloyds-banking-group-soliciting-bids-for-m-resort-100804429.html.

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bankruptcy for the former Aladdin property.[20] More recently, the Palms announced that the owners had sold 98% of the equity in a transaction that erased $400 million in debt.[21]

In the case of the Hard Rock, the senior secured lender and one of the mezzanine lenders made a deal to avoid property closure or bankruptcy.[22] Essentially, the mezzanine lender (which was secured by an upstream grant of the ownership of the borrower) contracted with a licensable casino tenant to take over casino operations once the mezzanine lender foreclosed on the borrower's equity interest.[23] The mezzanine lender filed applications with the Nevada State Gaming Control Board and obtained a temporary waiver of licensing so the foreclosure could take place and control of the casino operations could be passed along to a newly licensed casino tenant thereafter.[24] The licensure of the casino tenant by the Nevada Gaming Commission occurred at the same hearing in which the lender's temporary waiver was obtained.[25]

In the recent case of the Las Vegas Hilton ("LV Hilton"), the lenders applied to the district court for a receiver under the Nevada statutes.[26] After an evidentiary hearing at which the judge questioned the interplay between gaming and a secured lender's remedies, the district court judge appointed a receiver for the non-gaming properties.[27] The lenders obtained appointment of a receiver who had previously agreed to buy the LV Hilton, and the receiver concurrently filed for a gaming license under N.R.S. § 463.[28] The final order turned the LV Hilton's assets and operations over to the receiver, contingent upon the Nevada Gaming Commission's finding of suitability, which was determined subsequently.[29]

Nevertheless, if the borrower and the lenders cannot agree on a consensual restructuring,[30] borrowers will often file a chapter 11 bankruptcy petition in order to gain negotiating leverage over the lenders. The casino industry is naturally favored in this respect, simply because of the amount of cash it generates

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[20] *Harrah's Moves Ahead with Possible Planet Hollywood Acquisition,* LAS VEGAS SUN, Nov. 30, 2009, http://www.lasvegassun.com/news/2009/nov/30/harrahs-moves-ahead-possible-planet-hollywood-acqu/; *Harrah's Officially Takes Over Planet Hollywood*, LAS VEGAS SUN, Feb. 19, 2010, http://www.lasvegassun.com/news/2010/feb/19/harrahs-officially-takes-over-planet-hollywood/.

[21] Chris Sieroty, *Regulators Recommend Sale of Palms Majority Stake*, LAS VEGAS REV.-J., Nov. 2, 2011, http://www.lvrj.com/business/regulators-recommend-sale-of-palms-majority-stake-133108318.html.

[22] Chris Sieroty, *State Gaming Officials To Discuss Hard Rock Fate*, LAS VEGAS REV.-J., Feb. 4, 2011, http://www.lvrj.com/business/state-gaming-officials-to-discuss-hard-rock-fate-115298134.html.

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] Stipulation and Order for the Appointment of a Receiver, Goldman Sachs Mortgage Co. v. Colony Resorts LVH Acquisitions, LLC, No. A-11-648281-B (Nev. Dist. Ct. Jan. 6, 2012) [hereinafter Goldman Sachs Stipulation and Order].

[27] *Id.*

[28] *See, e.g.*, NEV. REV. STAT. § 463.160 (2009).

[29] Goldman Sachs Stipulation and Order, *supra* note 26.

[30] This might also be true if the granting of receivers over gaming properties becomes more accessible to lenders.

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and the difficulties lenders face with respect to perfection of their security interests. As they say in the industry, "he who has the cash wins."

Bankruptcy law generally eliminates a lender's ability to obtain new liens post-petition in "after-acquired" property.[31] Instead, a lender may only claim a security interest in property that constitutes "proceeds" of property encumbered pre-petition.[32] To qualify as a "proceed," the property must "necessarily derive[ ] from the sale, exchange or other dispensation of other encumbered property."[33] Stated another way, only property that is directly attributable to pre-petition collateral, without the addition of estate resources, can qualify as proceeds.[34] Courts addressing the general issue of what constitutes proceeds have consistently held that revenue derived from the use of collateral, as opposed to the disposition or diminution of collateral, are not "proceeds."[35]

As a result, once in bankruptcy, casinos generally argue that lenders have no interest in cash generated from the use of encumbered gaming equipment. There are no published opinions directly addressing the issue. Based on decisions that have been issued dealing with types of revenue generated by other kinds of machines, including the Las Vegas Monorail, it appears that it may be more difficult than ever for a lender to rebut such a contention successfully.[36] This point becomes clear by simply examining the day-to-day operations of a casino. Patrons enter casinos with the intention of using the equipment (slot machines, tables, video games, etc.) for the thrill of possibly realizing a big return on their wager. However, no matter how large the wager, no lease or ownership in the inventory or equipment of the casino is intended or expected to be granted to a gambler in exchange for his or her wager.

However, even if a lender could demonstrate that cash generated from gaming equipment qualified as proceeds, the hurdle of commingling would remain. In order to prohibit the use of cash collateral, a lender must demonstrate a legally cognizable interest in the collateral.[37] When an interest is claimed in proceeds, the proceeds must be reasonably identifiable.[38] In other words, "once a debtor deposits cash proceeds into an account and commingles it with other money, the [ability to identify] a secured creditor's proceeds is destroyed unless the secured creditor can prove the money currently in the debtor's account corresponds to its collateral."[39]

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[31] *See* 11 U.S.C. § 552(a) (2006); *In re* Stallings, 290 B.R. 777, 783 (Bankr. D. Idaho 2003).

[32] *See* 11 U.S.C. § 552(b) (2006).

[33] Philip Morris Capital Corp. v. Bering Trader, Inc. (*In re* Bering Trader), 944 F.2d 500, 502 (9th Cir. 1991); *see also,* U.C.C. § 9-102(a)(64) (2001) (defining proceeds as "whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral . . . .").

[34] *See* 5 COLLIER ON BANKRUPTCY ¶ 552.02[2][a] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011); *In re* Delco Oil, Inc., 365 B.R. 246, 249 (Bankr. M.D. Fla. 2007).

[35] *See In re* S & J Holding Corp., 42 B.R. 249, 250 (Bankr. S.D. Fla. 1984); CLC Equip. Co. v. Brewer (*In re* Value-Added Commc'n, Inc.), 139 F.3d 543, 546 (5th Cir. 1998); *In re* Las Vegas Monorail, 429 B.R. 317, 333-34 (Bankr. D. Nev. 2010).

[36] *See In re* Las Vegas Monorail, 429 B.R. at 342-45.

[37] 11 U.S.C. § 363(a).

[38] *See* NEV. REV. STAT. § 104.9315(b) (2009).

[39] Arkinson v. Frontier Asset Mgmt., LLC (*In re* Skagit Pac. Corp.), 316 B.R. 330, 338 (B.A.P. 9th Cir. 2004).

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Unlike many other businesses, casinos operate with money cages. Cash, coins, and chips obtained from patrons on the casino floor end up in these cages. Although gambling may account for the majority, this revenue is generated from a variety of sources. As such, difficulty arises with respect to identification of the specific proceeds generated from the use of gaming equipment.

Either way, a casino lender enters the bankruptcy process at a disadvantage. Without an encumbrance on cash collateral, a gaming business can use these funds for the administration of the bankruptcy.[40] This pool of cash, coupled with the fact that most casinos have positive EBITDA,[41] in many cases gives the borrower the leverage it needs over its lenders.

Despite this advantage, most parties recognize that a restructuring, whether done through the bankruptcy process or not, should allow the casino business to remain open, employees to remain employed, and provide a mechanism for the borrower and its creditors to explore ways by which to maximize the value of the bankrupt company to, in turn, maximize the return to creditors.

II. Impact of Gaming Issues in Bankruptcies

Increasingly, borrowers and senior lenders may have agreed to restructure the gaming company. However, pursuant to a structure that requires the borrower to file a bankruptcy petition to achieve the terms of the agreement, if there are non-consenting junior creditor groups who have claims that need to be addressed in order to allow the restructured company to have a fresh start and to get through their bankruptcy case quickly. Sometimes this is referred to as a "prepackaged plan" or "prepack," because the borrower and senior lenders agree on the terms of the plan before the case is filed. Such pre-packaged plans were seen in the Station Casinos and Riviera cases, among others.

Whether or not there is an attempt at a "prepackaged plan" under the umbrella of a restructuring deal, casino debtors are turning to bankruptcy filings in significant numbers to assist them in addressing financial difficulties. The bankruptcies of casino debtors typically follow three different paths:

1) *Chapter 11 reorganization with a debtor that generates enough cash flow, and/or has significant debtor-in-possession financing*. These two factors will in turn operate to justify the bankruptcy court in allowing the debtor-in-possession to continue operation during the bankruptcy, and to offer a plan of reorganization to its creditors and to the bankruptcy court. Examples of this type of bankruptcy were: Herbst Gaming,[42] Station Casinos,[43] the Riviera,[44] Stratosphere Casino and Hotel,[45] Fitzgeralds Gaming Corporation,[46] and the

[40] *See* 11 U.S.C. §552(a) (property acquired after commencement of case not covered by pre-petition security agreement).

[41] "EBITDA" stands for "earnings before interest, taxes, depreciation and amortization" and is often used as an indicator of a company's financial performance.

[42] Herbst Gaming, Inc. v. Insurcorp (*In re* Zante, Inc.), No. 3:10-cv-00231, 2010 WL 5477768 (Bankr. D. Nev. Dec. 29, 2010).

[43] *In re* Station Casinos Inc., No. 09-52477, 2011 WL 6813603 (Bankr. D. Nev. Dec. 21, 2011).

[44] *In re* Riviera Holdings Corp., No. 10-22910 (Bankr. D. Nev. 2010).

[45] Mcdonald's Corp. v. Stratosphere Corp. (*In re* Stratosphere Gaming Corp.), 23 F. App'x 749 (9th Cir. 2001).

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Aladdin Casino and Hotel.[47] In each of these instances, the casinos were able to stay open and continue operations, while a reorganization plan was circulated to the creditors and the court.

2) *Chapter 11 reorganization with a debtor that either (a) does not generate enough cash flow to continue operations, or (b) does not have adequate debtor-in-possession financing to finance the bankruptcy long enough to complete the required plan of reorganization process*. In this instance, the bankruptcy court may order a sale of the debtor's assets, pursuant to Bankruptcy Code section 363, which results in the property being marketed for sale.[48] In such an instance, a stalking horse bidder may be contracted with to make a minimum, opening bid of the assets at auction.[49] In any event, an auction will usually take place under the bankruptcy court's supervision. In this scenario, the debtor-in-possession's equity owners are able to participate in the auction and bid for the assets alongside non-owners. Examples of this type of bankruptcy were: The Resort at Summerlin,[50] Stateline Casino,[51] and the Siena Hotel Spa & Casino.[52] In the first two instances, the casinos stayed open with the agreement that a sale process would be immediately initiated. In the case of the Siena, the gaming business ran out of sufficient funds to operate under state regulations and voluntarily shut down before the sale was conducted.[53]

3) *Chapter 7 liquidation with a debtor that does not generate positive cash flow, and does not have the ability to obtain debtor-in-possession financing to continue operations*. In this type of situation, the bankruptcy court and the gaming regulators work together to appoint a trustee to take over operations and make efforts to liquidate the assets. Examples of this type of bankruptcy were: The Maxim Hotel and Casino[54] and Fitzgeralds Reno.[55]

Regardless of the type of casino bankruptcy, once a bankruptcy petition is filed, the casino operators' fiduciary duties shift from that of equity owners of the company to the bankruptcy estate itself (and more specifically to all of the creditors). Then, the debtor's duties (even if a trustee has not been appointed) become similar to those of a bankruptcy trustee to maximize the eventual distribution to the bankruptcy estate's creditors.[56] The focus then is on allowing the casino's operations to continue so as to maximize revenues in order to make it

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[46] *In re* Fitzgeralds Gaming Corp., No. 00-33467 (Bankr. D. Nev. 2011).
[47] *In re* Aladdin Gaming, LLC., No. 01-20141 (Bankr. D. Nev. 2011).
[48] 11 U.S.C. § 363 (2006).
[49] *See In re* Aladdin Gaming, LLC, No. 01-20141.
[50] *In re* The Resort at Summerlin Inc., No. 00-18878 (Bankr. D. Nev. 2011).
[51] Jorgenson v. State Line Hotel, Inc. (*In re* State Line Hotel, Inc.), 323 B.R. 703 (B.A.P. 9th Cir. 2005), *vacated* 242 F. App'x 460 (9th Cir. 2007).
[52] *In re* High-Five Enter., LLC , No. 10-54013 (Bankr. D. Nev. 2010) (jointly administered with *In re* One South Lake Street, LLC., No. 10-54065 (Bankr. D. Nev. 2010)).
[53] *Id.*
[54] *In re* Max Gaming, LLC., No. 99-19904 (Bankr. D. Nev. 2000).
[55] *In re* Fitzgeralds Reno, No. 00-33469 (Bankr. D. Nev. 2011) (The Reno casino was the sole remaining asset of Fitzgeralds Gaming Corporation that couldn't be sold when the buyer declined to purchase that property along with the other three.).
[56] 11 U.S.C. § 1107(a) (2006) ("a debtor in possession shall have all the rights, . . . powers, and shall perform all the functions and duties . . . of a trustee . . . ."); *In re* Reliant Energy Channel View LP, 594 F.3d 200, 210 (3d Cir. 2010) ("debtors-in-possession have a fiduciary duty to maximize the value of the estate").

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more likely that all creditor constituency groups are able to recover as much as possible. Generally, the prior owner's equity is wiped out and becomes worthless, as the equity is last in priority to be paid out under the Bankruptcy Code.[57]

Once the gaming borrower has filed for bankruptcy, the extensive state and local gaming regulatory schemes not only complicate, but are often at odds with the bankruptcy process. Federal bankruptcy law and state and local gaming regulations may present competing goals and requirements. Two goals underlying the federal bankruptcy process are: providing creditors with payment and allowing an ongoing business to emerge rehabilitated. On the other hand, gaming regulations are driven by numerous public policies not at issue in the bankruptcy process. These public policies include: 1) the protection of consumers; 2) the integrity of the gaming industry as a whole; 3) the control of the financial practices of gaming businesses; 4) the prevention of unsuitable persons from involvement in gaming; 5) establishing and maintaining appropriate accounting procedures for gaming enterprises; and 6) maintaining a stable source of revenue for state and municipalities through tax and licensing revenues.[58]

The impact of state regulators upon a gaming bankruptcy is made by its two-pronged regulatory scheme of controlling the businesses through both reporting and licensing requirements. The reporting requirements include the submission of periodic and detailed financing and operating reports, the maintenance of stock ledgers that disclose all beneficial owners, and the reporting and approval of most loans, leases, sales of securities and any other financing transactions of the gaming business.[59] On the other hand, extensive licensing requirements require, among other things, all officers, directors, and certain key employees to apply to be licensed or found "suitable" after comprehensive disclosure and investigation of detailed personal information at the great expense of the applicant.[60] These requirements are not waived or otherwise limited in any way by the filing of the bankruptcy case, because the automatic stay normally given to actions against a debtor in bankruptcy does not apply to the exercise of "police or regulatory power" by a "governmental unit" to enforce a non-monetary judgment.[61]

However, recent Nevada legislation may act to ease the overly burdensome licensing requirements by allowing entities to file applications for a "preliminary finding of suitability" before first being in a position in which licensing is mandatory under the Nevada Gaming Control Act.[62] As a result, a party without an existing involvement in Nevada's gaming industry or an agreement that gives it a right to such involvement, now has the opportunity to apply for a preliminary finding of suitability, thereby providing the party with a

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[57] *Id.* § 1129(b)(2)(B)(ii) (the so-called "Absolute Priority Rule," which requires that all unsecured creditors would need to be paid in full to allow any payment to the equity).

[58] *See* NEV. REV. STAT. § 463.0129 (2009).

[59] *See* Nev. Gaming Comm'n Reg. 8.130 (2)-(3). Additionally, other reporting requirements for licensees are contained in numerous regulation sections.

[60] *See* NEV. REV. STAT. § 463.170.

[61] 11 U.S.C. § 362(b)(4).

[62] *See* NEV. REV. STAT. § 463.1625(1).

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means to address and resolve licensing risks prior to entering into a major transaction or assuming an employment position requiring licensing.

III. Procedural Issues in Gaming Bankruptcies

In addition to the all-encompassing policy issues, there are also complicated procedural issues. When a debtor files a chapter 11 petition, the "automatic stay" goes into effect, which both prohibits creditors from pursuing actions against the debtor and prevents the debtor from paying any claims that arose prior to the filing.[63] This "stay" creates a myriad of problems for a gaming business due to the necessary, constant flow of cash and cash equivalents (vouchers, chips, and tokens) and in light of wagers on future events (as for keno and sporting events in the sports book). This is because one cannot count on them being paid out prior to the filing of the bankruptcy petition due to the nature of a casino's round-the-clock operations.

Therefore, a company beginning the chapter 11 process must immediately ask the court for certain orders that will allow it to continue uninterrupted operations during the bankruptcy proceeding—the so-called "first day orders." Although these motions are highly irregular in the bankruptcy process insofar as they request payment of pre-petition, unsecured obligations prior to distribution to other unsecured creditors (normally inviolate in a bankruptcy case), the motions are nonetheless essential to the continuation of the gaming enterprise. They are designed to ensure that the debtor can maintain normal business operations with customers, employees, suppliers, and other stakeholders and continue the necessary generation of revenue and compliance with state gaming laws. The ultimate goal is to allow the debtor to continue generating funds to support ongoing operations, which will, in turn, permit the debtor to satisfy creditors and successfully complete its plan of reorganization.

Typically, these "first day orders" allow the debtor to do the following: pay employees, pay certain important trade creditors or "critical vendors," pay taxing authorities, honor room reservations, convention contracts and deposits, use the existing cash management system already in place, retain attorneys and other advisors, use estate assets (including cash) to conduct business operations, and obtain financing to fund the administration of the bankruptcy.[64]

Because these orders are so crucial, gaming debtors normally arrange in advance with the bankruptcy court for a hearing date to occur shortly after the filing of their bankruptcy petition. Moreover, despite the short notice normally given to the creditors of the estate and other parties in interest, the bankruptcy courts routinely grant these motions on an interim basis, and then grant a series of final orders after additional notice time has been given and a continued hearing has occurred.

Gaming authorities may be able to exercise their "police power" to force the casino to honor obligations to its customers made prior to the bankruptcy

[63] 11 U.S.C. § 362.

[64] *See* Lynn P. Harrison & James V. Drew, *First Day Orders: A Survey of Critical Vendor Motions and Recent Developments*, *in* PLI's Course Handbook, 31st annual Current Development in Bankruptcy & Reorganization (2009), *available at* www.pli.edu/emktg/toolbox/SurVendor_Motions36.doc.

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filing and to honor the state and local taxes inherent in the business.[65] The Bankruptcy Code technically requires that, upon filing for bankruptcy protection, a casino is to cease issuing and honoring pre-petition chips and recognize only new "post-petition chips."[66] However, the bankruptcy court's "first day orders" will normally fix this problem and include a grant of authority to authorize payment of gaming chips and tokens (as well as ticket-in, ticket-out vouchers) in the ordinary course of business, address claims to casino cash, honor sports book wagers and deposits, authorize the debtor to retain pre-petition charge card accounts, honor tour and travel commitments and other pre-petition room deposits, honor customer incentive programs and other agreements like "Megabucks," and pay gaming taxes.

Practically, a debtor casino could not compete in the highly competitive gaming industry if it was required to follow certain requirements of the Bankruptcy Code strictly. Casino customers must be able to exchange their cash for gaming chips, and the race and sports book and keno operators must be allowed to accept bets on future events and pay winners on demand. To maintain operations and to comply with state gaming regulations the casino must honor each of those pre-petition obligations of the debt post-petition, and do so with no interruption upon the bankruptcy filing. Due to the role of the gaming authorities, in many cases, the debtor will normally inform the regulators about the bankruptcy and may even give them an opportunity to comment on certain relevant "first day orders."

Obviously, financing of the administration of the bankruptcy is usually of paramount importance in a gaming case. In the bankruptcy context, post-petition financing requires the approval of the bankruptcy court, pursuant to Bankruptcy Code section 364[67] and, once a petition is filed, lenders cannot be compelled to provide further loan advances based on pre-petition financing agreements.[68]

However, because this funding triggers the same kind of regulatory scrutiny as non-bankruptcy funding and is subject to the same constraints,[69] loans to gaming debtors are complex.[70] If a debtor needs financing, the senior

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[65] *See infra* Part III.

[66] Under Nev. Gaming Comm'n Reg. 12.060 of the Nevada Gaming Commission and State Gaming Control Board, chips and tokens constitute debt. In bankruptcy, chip holders are considered general unsecured creditors. Generally, casinos pay chip or token debt with cash reserves inside the gaming establishment. Often, lenders have a security interest in a casino's cash reserves or cash collateral. After the filing of a bankruptcy petition, pursuant to 11 U.S.C. § 363(c)(2)(B), a debtor may not use cash collateral without the creditor's consent or court order. Furthermore, as discussed *supra*, the absolute priority rule (11 U.S.C. §1129(b)(2)(B)(ii)) requires that higher priority creditors be paid in full before lower priority claimants receive any payment. Additionally, the automatic stay established by 11 U.S.C. § 362 prevents creditors from taking any act to collect a pre-petition debt. Taking all these factors together, a debtor casino is technically not supposed to honor pre-petition chips or gambling debts. Nevertheless, casinos usually avoid this restriction by filing first day motions seeking leave of the court to use cash collateral to maintain business operations.

[67] *See* 11 U.S.C. § 364(b)-(d) (2006).

[68] *See id.* § 365(c).

[69] Cash perfection issues, non-assignability of the gaming licenses, and regulatory approvals.

[70] Such financing is often called "DIP" financing or "debtor-in-possession" financing.

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secured lenders often provide it in return for the debtor making all encompassing agreements as to the use of cash, budgets, and the exit strategy of the debtor and the lenders. They may even require an agreement from the debtor as to the validity and extent of their liens against the debtor's property and require that the debtor give up claims against the lenders.

Unfortunately, this cooperation between the debtor and the senior secured lender may not be enough to ensure liens remain unchallenged or that claims will not eventually be pursued. A debtor in possession ("DIP") has all the rights and powers of a trustee, including the ability to avoid certain liens encumbering estate property.[71] However, if a debtor in possession neglects to take such action, courts can confer derivative standing upon a third party—assuming certain criteria can be demonstrated[72]—to bring actions to recover property for the benefit of the estate.[73]

A recent Delaware decision illustrates how derivative standing may arise in a case involving a debtor that is a gaming entity.[74] In *In re Centaur, LLC*, the Official Committee of Unsecured Creditors sought derivative standing to challenge the validity of various liens held by the senior secured lenders and the second lien holders.[75] The debtor was a holding company for a variety of entities operating gaming facilities in several states.[76] Among other things, the Committee challenged the senior secured lenders' perfection in "cage cash" at off-track betting locations operated by the debtor's affiliates.[77] Additionally, the Committee sought to avoid as fraudulent transfers certain liens associated with "upstream guaranties" from the affiliated gaming entities regarding the senior secured credit facility.[78] Overall, the Committee sought to avoid liens on estate property worth an estimated $192 million.[79]

As the primary basis for bringing its motion, the Committee contended that the debtor unjustifiably refused to bring these actions on behalf of the estate.[80] In support of this contention, the Committee offered expert testimony that identified a potential recovery for the unsecured creditors of over $85 million, if certain liens were avoided.[81] To rebut this, the debtor offered testimony that only $6.55 million would be recovered—just $1.55 million above the high end estimated litigation costs to pursue the claims.[82] Despite these disparities in

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[71] *See supra* Part III.
[72] *In re* YES! Entm't Corp., 316 B.R. 141, 145 (Bankr. D. Del. 2004) (stating that derivative standing requires: "(1) a colorable claim, (2) that the trustee unjustifiably refused to pursue the claim, and (3) the permission of the bankruptcy court to initiate the action.").
[73] *See* Fogel v. Zell, 221 F.3d 955 (7th Cir. 2000); Commodore Int'l Ltd. v. Gould (*In re* Commodore Int'l Ltd.), 262 F.3d 96 (2d Cir. 2001); Official Comm. Of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548 (3d Cir. 2003); *In re YES! Entm't Corp.*, 316 B.R. at 141; *In re* Centaur, LLC., No. 10-10799, 2010 WL 4624910 (Bankr. D. Del. Nov. 5, 2010).
[74] *In re Centaur,* 2010 WL 4624910, at *1.
[75] *Id.*
[76] *Id.* at *1-2.
[77] *Id.* at *4.
[78] *Id.*
[79] *Id.* at *1.
[80] *Id.* at *5-7.
[81] *Id.* at *5.
[82] *Id.* at *5-6.

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value, the *Centaur* court granted derivative standing to the Committee.[83] In reaching this determination, the court concluded:

> Under these circumstances, and understanding there may indeed be some benefit to the estate [itself] if some or all of the claims are prosecuted successfully, and to achieve the appropriate balance between allowing pursuit of colorable Claims and ensuring benefit to the estate, [the court] will grant the Committee's request for standing to prosecute the Claims . . . .[84]

Thus, as *Centaur* demonstrates, even if a debtor agrees to the validity of certain liens or the forfeiture of certain claims to obtain DIP financing, such agreements can still be challenged by other parties in interest in the case. Although these agreements benefit a debtor by allowing it to continue its operations, a strong argument exists that the forfeiture of such claims potentially harms other creditors by minimizing the bankruptcy estate. As expected, the greater the magnitude of the claim a debtor waives, the more likely a third party may be granted derivative standing to pursue the potential benefit for the estate.

Although derivative standing presents a potential difficulty in a casino reorganization, other obstacles are more certain. Like all casino financing, DIP financing requires the licensees to provide the appropriate notices to the gaming authorities.[85] If such notification is not done, state gaming regulators could attempt to rescind the financing arrangement or take other disciplinary action against the casino debtor, notwithstanding prior approval by the bankruptcy court.[86] However, in many bankruptcies, additional DIP financing is not needed because the debtor's operations still generate sufficient revenues to support its operations. Nevertheless, in such a case, there may still be negotiations over the definition and use of the lender's cash collateral, as both are instrumental to the success of the debtor's reorganization.

Additionally, and of key importance to a debtor, once the case is ongoing, the debtor has the ability to accept, assume, and assign, or reject executory contracts. Although the Bankruptcy Code does not define an "executory contract," the legislative history of section 365 adopts the Countryman[87] definition of such contracts as those "on which performance remains due to some extent on both sides."[88] In the context of a gaming business, executory contracts would include leases of gaming devices such as slot and video poker machines.

However, it must be noted that this key ability to accept or reject contracts in bankruptcy is limited by gaming regulations, which may impact the timing of any proposed assignment, as well as limiting the group of persons or entities to which those contracts are assigned.

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[83] *Id.* at *7.

[84] *Id.*

[85] *See* Nev. Gaming Comm'n Reg. 8.130 (2011).

[86] *See generally* NEV. REV. STAT. § 463 (2009).

[87] Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 447 (1973); 3 COLLIER ON BANKRUPTCY, *supra* note 34, at ¶ 365.02[1].

[88] 3 COLLIER ON BANKRUPTCY, *supra* note 34, at ¶ 365.02[1].

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IV. Exit Strategies

The goal of every bankruptcy debtor is to exit from bankruptcy. During a chapter 11 case the debtor will propose a plan of reorganization based on its negotiations with creditors in order to accomplish that exit. There are several restructuring alternatives available to casino debtors seeking protection under chapter 11 of the Bankruptcy Code. Among these alternatives is the refinancing of outstanding debt, selling assets pursuant to section 363 of the Bankruptcy Code or a plan of reorganization, a "friendly foreclosure" or converting debt to equity. Most plans of reorganization will include a combination of some or all of these restructuring alternatives.

In many cases, the easiest restructuring alternative available to a casino debtor is to refinance its existing debt. Lenders need to be aware that, as with the initial debt transaction itself, when a casino debtor proposes to refinance existing debt, the lenders are subject to being called forward by gaming regulators for full suitability investigations.[89] Gaming regulators generally have the discretion to call lenders forward for licensing, but this is rarely exercised so long as the lenders are bona fide banking institutions. In addition, the refinancing of debt may require the prior approval of the gaming authorities.[90] Thus, the debtor's ability to obtain the bankruptcy court's approval of its plan of reorganization will likely be dependent on the lender and/or the proposed transaction also being approved by the gaming authorities.

An equity swap is another restructuring option available to a casino debtor. In order to effectuate the equity swap, a significant amount of the debtor's creditors must accept the debtor's plan of reorganization (at least two-thirds in amount and a majority in number of those creditors voting in the class whose claims will be subject to conversion into equity of the reorganized entity).[91] An equity swap will likely create gaming licensing issues for the lenders, the result of which will vary depending upon the nature of the entity in bankruptcy (public or private) and the jurisdictions in which that company does business.[92]

A third restructuring option available to a casino debtor is to sell its assets to a third party. Any sale of assets by the casino debtor is subject to the bankruptcy court's approval, as well as gaming regulatory approval.[93] An asset sale may be very beneficial to a creditor who is either unwilling or unable to undergo the licensing or suitability scrutiny required in an equity swap. In the sale process, only the buyer and its insiders and affiliates will undergo such scrutiny. However, there are potential downsides for creditors with an asset sale. Most importantly, the asset sale is not guaranteed to yield the best recovery for creditors. Additionally, there is no assurance that the buyer will be able to obtain the required licenses in a timely manner and complete the sale.

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[89] Nev. Rev. Stat. §§ 463.165, 463.167 (2009).

[90] *See id.* § 463.165.

[91] *See* 11 U.S.C. § 1126(c) (2006).

[92] Nev. Gaming Comm'n Reg. 8.030 requires any new owner to obtain licensing from the Commission.

[93] 11 U.S.C. § 363; Nev. Gaming Comm'n Reg. 8.030 (1975).

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Lenders may be able to avail themselves of certain licensing exemptions (i.e., public company status of the bankrupt entity, institutional investor status for members of the lending group, non-voting stock), but if the lenders want to have an operational role with members of its constituency serving as officers, directors or key employees (or otherwise exercising control over casino operations), then these individuals would need to be identified and go through the full licensing process. Many large institutions and other creditors may not want their organizations or management to be subject to the intense regulatory review. Until a creditor is found to be suitable by the gaming authorities, it cannot receive as a distribution an equity interest in the reorganized debtor under the plan of reorganization.[94]

In regard to the various chapter 11 bankruptcy scenarios described above, any plan of reorganization or sale would need to be submitted to all applicable gaming regulatory agencies for a licensing investigation and approval, even after the bankruptcy court approval is obtained. This essentially means that the debtor retains control of the operation pending the license investigation and approval, thus stalling the progress of the reorganization.

The gaming license investigations that may be necessary in such instances can range from a full-blown, new gaming investigation of a company that has never been licensed before in a jurisdiction (which would take the most time), to an updated investigation of a company that is already licensed in a jurisdiction. Of course, the more jurisdictions in which a gaming company does business, the more gaming regulatory agencies that come into play.

V. Going Forward

Despite some slow growth in casino revenues over the last several years, the effects of the current economic climate are significant, from credit tightening to unemployment, and to limitations on discretionary income and spending. Yet, despite having to weather these storms, the casino industry is continuing to evolve as courts, regulators, lenders, casino companies, and equity owners still face the challenges posed by the ongoing financial crises and the difficulties that the necessary intersection between gaming regulations and bankruptcy statutes presents. As these conditions continually evolve, sophisticated restructuring professionals and advisors continue to innovate, providing the necessary strategic planning and support for finding new and creative ways to restructure gaming businesses in accordance with state and federal laws, and to keep them operating.

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[94] *See* Nev. Rev. Stat. § 463.160(1)(d).

Update: When Gaming Goes Heads Up with the Bankruptcy Code: Unique Restructuring Issues for Gaming Businesses in Difficult Economic Times[1]

Contested cash collateral issues

Debtors regularly grant post petition liens on unencumbered assets as adequate protection for use of cash collateral. In casino cases, the question as to whether cash generated from encumbered casino equipment is a "product" or "proceed" protected by 552(b) almost always arises.

Under section 552(a) of the Bankruptcy Code, "postpetition revenue is not cash collateral" unless it falls into one of the narrow exceptions set forth in section 552(b) of the Bankruptcy Code. Section 552(b) of the Bankruptcy Code allows a perfected prepetition security interest to extend to "proceeds, products, offspring, or profits" of prepetition collateral and "amounts paid as rents" of prepetition collateral if the prepetition interest expressly included such property — otherwise, the postpetition revenue is unencumbered. See 11 U.S.C. § 552(b).

Proceeds of collateral.

Debtors and unsecured creditor committees often argue that gaming receipts are revenue, not proceeds of collateral. To qualify as a "proceed," the property must "necessarily derive[] from the sale, exchange or other dispensation of other encumbered property." See e.g., In re Bering Trader, 944 F.2d 500, 502 (9th Cir. 1991). However that case is based on the definition of "proceeds" in the Uniform Commercial Code ("UCC") at the time which was limited to sale,

[1] This supplement by Dawn Cica is an update to footnotes 12 and 33 through 36 and accompanying text in the law review article: *When Gaming Goes Heads Up with the Bankruptcy Code: Unique Restructuring Issues for Gaming Businesses in Difficult Economic Times*, 3 UNLV Gaming L.J. 23 (2012) by Dawn M. Cica and Laury Macauley.

exchange or other dispensation of collateral. The UCC has since been amended to significantly expand the definition of proceeds and different states have adopted different versions. In New York, Proceeds "means the following property: (A) Whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral; (B) whatever is collected on, or distributed on account of, collateral; (C) rights arising out of collateral; (D) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or (E) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral. NY UCC § 9-102(a)(64). Cases decided after the amendment with respect to Section 552 of the bankruptcy code do not appear to focus on this expansion. See G. Ray Warner *Article 9's Bankruptcy Proceeds Rule: Amending Bankruptcy Code 552 Through the "Proceeds" Definition*, 46 Gonzaga L.Review 541 (2011). In general however, cases focusing on 552(b) adopt the UCC definition. *Id*.

There continue to be no reported cases specifically addressing whether the cash generated by encumbered gaming equipment in a casino constitutes "proceeds" under the UCC and protected by Section 552(b) or whether it is revenue excluded as collateral. However there are cases that make a distinction between revenue and proceeds protected under Section 552 in other contexts.

In re S & J Holding Corp., 42 B.R. 249, 250 (Bankr. S.D. Fla. 1984) - cash revenues generated by video game machines and vending machines do not constitute "proceeds".

In re Inman, 95 B.R. 479 (Bankr. W.D. Ky. 1988) - money generated by fast food restaurant from the sale of food as after-acquired property, rather than proceeds of the restaurant's

inventory, because the restaurant's earnings arose from the service provided, rather than the sale of inventory.

CLC Equip. Co. v. Brewer (In re Value-Added Commc'ns), 139 F.3d 543, 546 (5th Cir. 1998) - fees for use of pay phones not 'proceeds' of phones.

Johnston v. Cottonport Bank, 259 B.R. 125, 130 (W.D. La. 2000) - "proceeds" under Section 552(b) of the Bankruptcy Code does not include revenue "derived from [debtor's] post-bankruptcy labor or assets"; post-petition revenues are proceeds of prepetition collateral only if the right to payment on the petition date was a "complete and present right" on the petition date.

In re Timothy Dean Rest. & Bar, 342 B.R. 1 (Bankr. D.C. 2006) - room service charges were not "proceeds" attributable to the sale of food and beverage inventory on which secured creditor had a prepetition lien).

In re Las Vegas Monorail Co., 429 B.R. 317, 333-35 (Bankr. D. Nev. 2010) - holding that the term "proceeds" does not include business income generated from customer fares as the fares are not "collected on, or distributed on account of" the franchise agreement, nor do they "aris[e] out of the collateral".

In re Wright Group, Inc., 443 B.R. 795 (Bankr. N.D. Ind. 2011) - proceeds from postpetition admission payments to debtors' miniature golf park were unencumbered under section 552 of the Bankruptcy Code notwithstanding the fact that the lender had a perfected security interest in the tangible property used (*e.g.*, the putters, golf balls, scorecards, and pencils, among other tangible property.

In re Premier Golf Props., LP, 477 B.R. 767, 772 (B.A.P. 9th Cir. 2012) - holding that "revenue . . . is not produced from the [real property] as much as generated by other services that are performed on the [real property], and therefore, is not rents".

1st Source Bank v. Wilson Bank & Trust, 735 F.3d 500 (6th Cir. 2013) - noting that "'proceeds' does not refer to 'income generated from the debtor's own use and possession of goods' or to situations where there was 'no disposition of the goods by the security lease'" and noting that "[c]ases interpreting the UCC and the associated state statutes in other jurisdictions likewise uniformly support the proposition that revenues earned through the use of collateral are not proceeds."

In re Gamma Ctr. Inc., 489 B.R. 688, 696 (Bankr. N.D. Ohio 2013) - "[T]he court is not persuaded that accounts receivable or funds collected thereon as the result of using [medical] equipment collateral constitute proceeds under the UCC."

Products of collateral.

Similarly Debtors and unsecured creditor committees argue that gaming receipts are not products of collateral.

In re S & J Holding Corp., 42 B.R. 249, 250 (Bankr. S.D. Fla. 1984) - "The fact that the financing statement stated that 'products' of collateral are also covered is of no significance at all. Only the property specifically defined [under Florida state law] is given any unique protection, and the money here [i.e. the cash in the video games and vending machines] does not fit within the definition."

In re Jackels, 55 B.R. 67, 69 (Bankr. D. Minn. 1985) - interpreting "products" for purposes of section 552 of the Bankruptcy Code and concluding that the term only covers "such things as raw materials which are converted into inventory or other finished products after the filing of the petition.

In re Mintz, 192 B.R. 313, 320 (Bankr. D. Mass. 1996) - "The overall emphasis of the definition [of 'products'] is to physical items originating from other physical items, rather than

intangibles such as an income stream from a limited partnership interest. I find that 'product' is inapplicable."

In re Gamma Ctr., Inc., 489 B.R. 688, 697 (Bankr. N.D. Ohio 2013) - "Although the Security Agreement clearly provides for a security interest in proceeds and products of the Camera, the court finds that those terms do not reasonably describe Debtor's accounts receivable or the funds collected thereon. Neither the term 'proceeds' nor the term 'products' of the collateral, described only as the Camera and related equipment, constitute a sufficient description of accounts receivable."

In addition to those cases, debtors and committees point out that there is no provision in Article 9 designating "products" as collateral, the Uniform Commercial Code contains no general "products" concept and there is no definition of "products" therein. The word "product" is used only in connection with Section 9-324(d) of the Uniform Commercial Code – which provides a special priority to a purchase-money security interest in "products" if the products are "products" of livestock.

Lenders respond that the reading of "products" as being limited to inventory or other finished products is belied by section 363(a) of the Bankruptcy Code, which defines "cash collateral" to include "products."[2] They point out that unlike the cases distinguishing proceeds from revenue, and like the cases describing products, a casino floor is occupied and populated

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[2] Section 363(a) of the Bankruptcy Code provides, in pertinent part, that "cash collateral" includes:

> [C]ash, negotiable instruments, . . . deposit accounts or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

11 U.S.C. § 363(a).

with equipment for the specific purpose of producing cash. Cash is a casino's product, and lenders argue it is the proceeds and the product of the lender's collateral - thus the lenders' continuing interest in that cash product and cash proceeds are explicitly recognized under the Bankruptcy Code.

While the court in *Value-Added Communications* concluded that fees paid for the use of payphones were not "proceeds," it concluded instead that they were the "*product* of the use of the [phone] equipment," In re Value-Added Commc'ns, 139 F.3d at 546. Arguably then the funds collected by casino debtors for the use of gaming machines are, by analogy, "products" of the debtors' encumbered gaming equipment.

Unpledged collateral.

An additional wrinkle in these casino bankruptcies arises when the security agreement pledging the collateral specifically excepts certain gaming assets such as gaming licenses, cage cash and slot machines. Originally this was done because many gaming laws prohibited the pledge of licenses and cage cash (or bankroll), and the slot machines were often leased. Because of the increasing tolerance of gaming authorities in allowing bankroll to be "in bank" instead of "in vault", it is now possible for lenders to perfect their security interests in the "in bank" bankroll. Thus in newer security agreements gaming licenses are the only gaming asset that remains generally exempt and unpledged, although bankroll "in vault" is still not able to be perfected even though pledged.

Any cash generated postpetition by the casino debtors from the operation of unpledged assets would not be proceeds of collateral and would be unencumbered by the liens of the secured lenders. Accordingly, those secured lenders would not be entitled to adequate protection for the use of that cash. See In re Applied Theory Corp., Nos. 02-11868 – 02-11874,

2008 WL 1869770, at *9 (Bankr. S.D.N.Y. Apr. 24, 2008) (holding that a lender's lien cannot extend to proceeds of otherwise excluded collateral); McDaniel v. 162 Columbia Heights Housing Corps., 863 N.Y.S.2d 346, 351 (N.Y. Sup. Ct. 2008) ("[S]ince plaintiff does not possess a security interest . . . the fact that a security interest . . . continues in proceeds upon the disposition of collateral pursuant to UCC-9-315 is of no moment").

Attacking the liens.

Interestingly, while the fights described above occur in relation to the (usually) first-day cash collateral motion, challenging the validity of the secured lenders' liens must be done by adversary proceeding, not in the guise of an adequate protection hearing. Fed. R. Bankr. P. 7001(2). In the context of a contested cash collateral hearing secured lenders generally bear only the limited burden of establishing prima facie evidence of the validity of their liens. 11 U.S.C. 363(p). Secured lenders typically meet this burden by submission of documents and other evidence reflecting the grant and perfection of their liens. *See* COLLIER ¶ 363.05[5] ("As is the case under section 362, the less extensive nature of the contested matter form of litigation [under section 363(e)] will permit some examination of lien validity but not extensive litigation of counterclaims."); *see also In re Megan-Racine Assocs., Inc.*, 192 B.R. 321, 325 (Bankr. N.D.N.Y. 1995) ("The determination of lien validity [under section 363] is subject to informal examination and not extensive litigation.").

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Original Article

*278 THE HOUSE DOESN'T ALWAYS WIN

Gregg W. Zive [FNa1]

AN OVERVIEW

CASINO GAMBLING HAS BECOME ONE OF THE NATION'S fastest growing pastimes. As of 1988, casino gambling was legal only in Nevada and Atlantic City, New Jersey, but with the introduction of low-stakes casinos in Deadwood, South Dakota, that year, a casino revolution was launched. [FN1] Casinos have opened both on Indian reservations and in states that historically prohibited high-stakes gambling. Now one of this country's most popular leisure activities, the number of high-stakes casino visitors exceeds the attendance at all professional and college football games, arena and symphony concerts, and theatrical events combined. [FN2]

Some form of legalized gaming is now permitted in every state but two, Hawaii and Utah. [FN3] The correlation between legalized gaming and the increased number of bankruptcy filings is an issue of much debate, but statistics show that since the 1980s, bankruptcy courts have seen a gradual rise in the number of bankruptcy filings. [FN4] In fact, bankruptcy filings reached a record high for the first quarter of 2002. The number of bankruptcy filings in federal courts rose 15.1 percent in the 12-month period ending March 31, 2002. [FN5]

Despite a slow economy in 2001, casinos continued to be an important contributor to the U.S. economy, “growing by nearly 5 percent, providing more than 364,000 jobs with wages of $11.5 billion and paying $3.6 billion in taxes to state and local governments.” [FN6] There were 433 commercial casinos in the U.S. in 2001, operating in 11 states. [FN7] Individual states experienced widely disparate casino revenue results after the events of September 11. While Nevada experienced a drop in gross gaming revenue, nationwide the casino business continued a steady rate of growth from $24.5 billion in 2000 to $25.7 billion in 2001. [FN8]

Recently, gaming has been thrust into the computer world. Many gaming entities have turned to the Internet to expand their gaming operations. This business strategy has been a financial success. It is estimated that online casinos and bookmakers will bring in over $3 billion in annual revenue by 2002. [FN9] In May of 1999, there were over 250 online casino Internet sites and 139 online sports books. [FN10] It is only a matter of time before federal and state regulations seeking to restrict access to casino Web sites will be implemented.

Bankruptcy courts across the country have administered cases involving casino debtors. Nationwide, “big name” casinos have filed bankruptcy in recent history. Illustratively, in 1985, both the Atlantis Casino and the

Dunes ***279** Casino filed for Chapter 11 relief in the District of New Jersey; the Stratosphere (BK-N-97-20555) [FN11] filed for Chapter 11 relief in the District of Nevada in 1997; in 2000, Fitzgerald's (BK-N-00-33467) [FN12] and The Resort at Summerlin (BK-S-00-18878) filed in the District of Nevada; in 2001, Harrah's New Orleans Casino filed in the Eastern District of Louisiana and the Aladdin (BK-S-01-20141) [FN13] filed in the District of Nevada; and in 2002, the Tahoe Crystal Bay Club (BK-N-02-51375) [FN14] and Stateline (BK-N-02-50085) [FN15] filed in the District of Nevada.

Casino bankruptcies are unique because they involve issues that differ from "typical" Chapter 11 cases due to the highly-regulated nature of the industry. The following analysis will attempt to provide some insight into some of the most prevalent issues uniquely presented in casino bankruptcies. It is not intended to provide a general review of Chapter 11 concerns, such as use of cash collateral, debtor-in-possession financing, and the assumption and rejection of executory contracts and unexpired leases, which must be addressed and resolved together with the matters specifically applicable to casino bankruptcies.

REGULATORY ISSUES [FN16]

Gaming regulation has its genesis in various declarations of public policy that are concerned with, among other things: (1) the prevention of unsavory or unsuitable persons from having a direct or indirect involvement with gaming at any time or in any capacity; (2) the establishment and maintenance of responsible accounting practices and procedures; (3) the maintenance of effective control over the financial practices of a licensee, including establishing minimum procedures for internal fiscal affairs, safeguarding assets and revenues, providing reliable record keeping, and requiring the filing of periodic reports with Gaming Authorities; (4) the prevention of cheating and fraudulent practices; and (5) the creation of a source of state and local revenues through taxation and licensing fees. These statements of public policy are embodied in statutes, regulations, and supervisory procedures implemented at the state and local level by a variety of overlapping regulatory bodies (the "Gaming Authorities"). Regulation and licensing affects gaming properties ("casinos") and their owners and operators on several levels, many of which have a profound impact in the course of a casino bankruptcy.

Licensing and regulation of the casino

Only corporations organized under the laws of the forum state may hold a gaming license. [FN17] Accordingly, gaming enterprises are operated by domestic corporations, that in turn are often wholly-owned by out-of-state (and often publicly-traded) corporations. Because parent corporations are often required to guarantee the debts of subsidiaries, casino bankruptcies frequently involve two or more corporate entities. Regulation of a casino affects both the operating corporation (the "licensed" company) and the holding corporation (the "registered" company) and arises in at least three different forms: (1) licensing and registration; (2) financial reporting; and (3) gaming license fees and taxes.

Licensing and regulation. The mechanics of licensing vary by locality, but generally require detailed investigations of a licensee's business activities and financial status. [FN18] Although a parent corporation of a licensed corporate subsidiary is not required to obtain a license, it is ***280** required to be "registered," which in turn requires a parent corporation to obtain a "finding of suitability" from local Gaming Authorities. The investigations and requirements necessary to obtain a finding of suitability are quite similar to those necessary for li-

censing.

While the licensing and registration processes are outside the purview of the bankruptcy court, they nonetheless will affect many aspects of a casino reorganization. For instance, no person may become a stockholder of, or receive any percentage of profits from, a gaming licensee without first obtaining approvals from Gaming Authorities. A registered corporation may not make a public offering of its securities without the prior approval of Gaming Authorities if the securities or the proceeds therefrom are intended to be used to construct, acquire, or finance gaming facilities or to retire or extend obligations incurred for such purposes.

Reporting requirements. Regulation of both licensed and registered corporations involves stringent reporting requirements. A registered corporation is generally required to submit, upon application and on a periodic basis, detailed financial and operating reports to Gaming Authorities. It may also be required to furnish any other information requested by Gaming Authorities. A registered company is required to maintain a current stock ledger in the gaming state which may be examined by Gaming Authorities at any time. If any securities are held in trust by an agent or by a nominee, the record holder may be required to disclose the identity of the beneficial owner to Gaming Authorities. A failure to make such disclosure may be grounds for finding the record holder unsuitable. The registered company is also required to render maximum assistance in determining the identity of the beneficial owner. In Nevada, Gaming Authorities even have the power to require the registered company's stock certificates to bear a legend indicating that the securities are subject to the Nevada Gaming Act.

In addition to these requirements, the licensed corporation must report to and obtain approval from Gaming Authorities of substantially all loans, leases, sales of securities, and similar financing transactions. Failure to comply with these reporting requirements by either the registered or licensed corporation could result in a corporation's license being limited, conditioned, suspended, or even revoked, subject to compliance with certain statutory and regulatory procedures. The registered and licensed corporations, as well as the individuals involved, could be subject to substantial fines for each separate violation at the discretion of Gaming Authorities.

Gaming license fees and taxes. License fees and taxes that are computed in various ways and dependent upon the type of gaming activity involved, are payable to the state and to the counties and cities in which the licensee's respective operations are conducted. [FN19] Depending upon the particular fee or tax involved, these fees and taxes are payable either monthly, quarterly, or annually and are based upon either (a) a percentage of gross revenues received; (b) the number of gaming devices operated; or (c) the number of table games operated. A casino entertainment tax is also paid by casino operators where entertainment is furnished in connection with the selling of food or refreshments. Licensees that hold a license as an operator of a slot route or a manufacturer's or distributor's license also pay certain fees and taxes to the state.

Licensing and regulation of key personnel

Gaming Authorities may investigate any individual who has a material relationship to, or material involvement with, any registered company or its licensed subsidiary in order to determine whether such individual is suitable or should be licensed as a business associate of a gaming licensee. Officers, directors, and certain key employees of the licensed subsidiary must file applications with Gaming Authorities ***281** and may be required to be licensed or found suitable. Officers, directors, and key employees of the registered company who are actively and directly involved in the gaming activities of the licensed subsidiary also may be required to be licensed

or found suitable by Gaming Authorities. Gaming Authorities may deny an application for licensing for any cause deemed reasonable. A finding of suitability is comparable to licensing, and both require the submission of detailed personal and financial information, followed by a thorough investigation. An applicant for licensing or a finding of suitability must pay all of the costs of the investigation. Changes in licensed positions with the registered company or its licensed subsidiary must be reported to Gaming Authorities and may trigger further investigation and action by Gaming Authorities. In addition to their authority to deny an application for a finding of suitability or licensure, Gaming Authorities also have jurisdiction to disapprove a change in a corporate position.

If Gaming Authorities were to find an officer, director, or key employee unsuitable for licensing or unsuitable to continue having a relationship with the registered company or its licensed subsidiary, the companies involved would be required to sever all relationships with such person. Additionally, Gaming Authorities may require the registered company or its licensed subsidiary to terminate the employment of any person who refuses to file appropriate applications. Determinations of suitability or questions pertaining to licensing are not subject to judicial review in Nevada.

Licensing and regulation of casino ownership

Regulation of registered companies extends beyond key personnel as Gaming Authorities have a broad mandate to regulate the ownership of casinos.

Equity securities. The beneficial holder of the registered company's voting securities, regardless of the number of shares owned, may be required to file an application, be investigated, and have its suitability as a beneficial holder of the registered company's voting securities determined if Gaming Authorities have reason to believe that such ownership would otherwise be inconsistent with the declared policies of the State of Nevada. The applicant must pay all costs of the investigation incurred by Gaming Authorities in conducting such an investigation. Regulation of such ownership may not be limited to a single, state-level regulatory body. In Nevada, the Clark County Liquor Gaming Licensing Board and the City of Las Vegas have both taken the position that they have the authority to approve all persons owning or controlling the stock of any corporation controlling a gaming licensee within their jurisdictions.

There are certain exceptions to the requirement that shareholders obtain findings of suitability. For instance, under Nevada law, an "institutional investor," which acquires more than 10 percent but not more than 15 percent of the registered company's voting securities, may apply to Gaming Authorities for a waiver of a finding of suitability if such institutional investor holds the voting securities for investment purposes only. Activities which are not deemed to be inconsistent with holding voting securities for investment purposes only include: (1) voting on all matters voted on by stockholders; (2) making financial and other inquiries of management of the type normally made by securities analysts for informational purposes and not to cause a change in its management, policies, or operations; and (3) such other activities as Gaming Authorities may determine to be consistent with such investment intent.

Debt securities. Gaming Authorities may, in their sole discretion, require the holder of any debt security of a registered corporation to file applications, be investigated, and be found suitable to own the debt security of the registered corporation. If Gaming Authorities determine that a holder is unsuitable to own such security, the

registered corporation can be sanctioned, including the loss of its approvals, if, without the prior approval of Gaming Authorities, it: (1) pays to the unsuitable person any dividend, interest, or any distribution whatsoever; (2) recognizes any voting right by such unsuitable person in connection with such securities; (3) pays the unsuitable person remuneration***282** in any form; or (4) makes any payment to the unsuitable person by way of principal, redemption, conversion, exchange, liquidation, or similar transaction.

PROCEDURAL ISSUES REGARDING CASINOS IN BANKRUPTCY

Venue

In selecting a venue in which to file the bankruptcy case, a debtor has a number of options. It may file in the debtor corporation's state of incorporation, the district in which an affiliate has a pending bankruptcy case, its principal place of business, or where its principal assets are located. [FN20] However, a casino debtor's choice of venue might be somewhat limited due to regulatory implications. Gaming regulations may require a transfer of venue to the state in which the casino is subject to regulation pursuant to 28 U.S.C. § 1412. [FN21]

First day orders

Many courts have adopted local rules for what are often referred to as first day motions or orders. Generally, when an operating business files for Chapter 11 relief, the debtor immediately will ask the bankruptcy judge to rule on a variety of motions affecting the debtor's ability to maintain continuous business operations with minimal disruption. The relief sought will vary as a result of the nature of the debtor's business. Debtors' motions are particularly urgent in casino cases because of the large amount of cash involved as well as regulatory issues. In some cases, the relief requested will be authorized by existing law; in others, the debtor might seek modification of normal requirements due to the unique or critical circumstances presented in the case. The bankruptcy judge may be asked to rule on the various first day motions with little or no notice to other parties in interest. Hence the term, first day orders. The motions must be carefully reviewed to determine whether the relief is necessary and can be granted on such short notice. Of course, merely because they are filed on the petition date, or shortly thereafter, does not mean the relief must be allowed on short notice. Often, first day motions will not be ruled upon for weeks after filing.

In a non-gaming hotel case, the debtor will typically seek entry of the following first day orders: (1) authorization to pay pre-petition payroll, and honor pre-petition vacation and other benefit claims in an amount not to exceed the statutory limits of 11 U.S.C. §§ 507(a)(3), (a)(4) and (a)(8); (2) authorization to honor pre-petition room deposits, banquet deposits, convention deposits, and gift certificates, as well as to pay pre-petition travel agent commissions; (3) employment of debtor's professionals pursuant to §§ 327 and 1107; (4) designation of a responsible individual; (5) debtor-in-possession financing; and (6) payment of the pre-petition claims of "critical vendors." [FN22]

In a hotel/casino bankruptcy case, the first day orders must facilitate continued operation of the casino. Casino customers must be able to exchange their cash for gaming chips and tokens. Additionally, a casino race and sports book, as well as keno operators, must be allowed to accept bets on future events and be able to pay

winners upon demand. Many hotel/casinos maintain progressive slot machines that accrue a certain dollar amount prior to paying off the winners. Often, some of the amount accrued will occur pre-petition and the rest post-petition. Other hotel/casinos have established slot or players clubs for which registered players accrue points to be redeemed for cash or merchandise. In order for the casino to maintain operations, each of these pre-petition obligations of the debtor must be honored post-petition pursuant to an appropriate first day order. [FN23]

Through the issuance of first day orders, a hotel/casino is allowed to immediately honor these pre-petition obligations and continue with uninterrupted operations post-petition. The reorganization process would be greatly complicated if the hotel/casino were required ***283** to issue and receive approval from the Gaming Authorities for post-petition gaming tokens and coins, as well as to provide notice to holders of pre-petition gaming tokens and coins that they must file a proof of claim for their pre-petition claims against the debtor. Absent the creation of new tokens and coins, pre-petition gaming tokens and coins are generally indistinguishable from post-petition gaming tokens and coins. Further, the Gaming Authorities would most likely initiate regulatory action for the hotel/casino's failure to immediately honor pre-petition obligations. The hotel/casino industry is highly competitive, and the loss of existing and future gaming customers because of the non-payment of pre-petition obligations could jeopardize the success of the debtor's reorganization. [FN24]

An excellent example of relief sought on the petition date is the Aladdin case (BK-S-01-20141), [FN25] filed September 28, 2001, in the District of Nevada. The court heard the following First Day Motions, typical of a casino bankruptcy case: 1) applications for employment of attorneys and financial and restructuring advisors; 2) applications designating responsible persons; 3) a motion authorizing post-petition financing on a secure basis; 4) an application authorizing maintenance of pre-petition cash management systems and bank accounts; 5) an application authorizing the payment of wages, salaries, employee benefits, and reimbursable employee expenses; 6) an application permitting debtor to honor hotel room and other customer deposits and to honor travel agent commissions; 7) an application permitting the honoring of casino chips and other gaming liabilities; and 8) a motion to limit notice regarding motion hearings and proceedings. These motions were granted and the casino was allowed to maintain operations in order to facilitate a potentially successful reorganization.

"Debtor-in-Possession" v. Trustee

Upon the filing of a voluntary petition for relief under Chapter 11 or, in an involuntary case, the entry of an order for such relief, the debtor automatically assumes an additional identity as "debtor-in-possession." [FN26] Rarely is a trustee appointed in such cases, absent a strong showing of fraud or mismanagement by the debtor. [FN27] Accordingly, the debtor-in-possession must continue to operate the business and perform many of the functions a trustee normally performs under other chapters, i.e., accounting for property, examining and objecting to claims, and filing informational reports as requested by the court and the United States Trustee. [FN28] The debtor in possession also may employ, with court approval, professional persons in the course of reorganization. The United States Trustee is responsible for monitoring whether the debtor in possession has complied with the reporting requirements.

Although the Bankruptcy Code and Bankruptcy Rules allow for the appointment of trustees in Chapter 11 cases, see 11 U.S.C. § 1104(a) and (b), the Gaming Authorities may oppose such an appointment unless the trustee is licensed and approved as suitable within the context of the state's regulatory scheme. Gaming regula-

tions prohibit a casino from being operated by a trustee unless the trustee has been approved by the Gaming Authorities. As a result, the bankruptcy court's authority to order the appointment of trustees in casino bankruptcies may be somewhat limited. [FN29]

If a trustee is appointed, it is generally assumed he/she must comply with gaming regulations. Nevada State Gaming Control Board Regulation 9.030 allows the gaming trustee to use the casino debtor's existing license, but the trustee must file an application and it must be updated and approved before the trustee is permitted to operate the casino. In *In re Ormsby House Hotel Casino*, Case No. BK-N-97-30256, [FN30] a gaming trustee was appointed due to the resignation of the debtor's director, CEO, and general manager as well as because of concerns ***284** that new management could not be licensed. The appointment was conditioned upon the failure of the new management to obtain a gaming license. Debtor's new management was not approved by the Gaming Commission, and the Trustee was licensed in an emergency hearing. [FN31]

The office of the United States Trustee may take the position that the Gaming Authorities power in these cases has been preempted, but that issue has not been judicially resolved. That contention appears to be contrary to 28 U.S.C. § 959(b), which requires a debtor in possession, trustee, receiver, or manager to manage and operate the property in his/her possession according to the requirements of the valid laws of the state in which such property is situated and in the same manner that the owner or possessor thereof would be bound to do if still in possession.

Effect of the automatic stay

Upon the filing of a bankruptcy petition, the automatic stay prevents any entity from taking, among others, the following actions against the debtor: 1) collecting on pre-petition debts; 2) enforcing pre-petition judgments; 3) obtaining property of the bankruptcy estate; 4) creating or perfecting liens against the estate; or 5) collecting any claim against the debtor that arose pre-bankruptcy. [FN32]

Exceptions to the automatic stay of § 362(a) are found at § 362(b), and two are particularly relevant to a casino debtor. First, the automatic stay does not stay the commencement of a suit by a governmental unit to enforce its police or regulatory power. Second, the stay does not prevent the enforcement of a non-monetary judgment obtained by a governmental unit in an action to enforce its police or regulatory powers. [FN33]

Courts have not allowed the Gaming Authorities to assert the police power exception to the automatic stay to take away or deprive a casino of it license to operate during the reorganization process. Permitting such action would in essence negate the ability of the casino to operate or reorganize. This issue was litigated when the New Jersey Casino Commission tried to use the police power exception to deny a license renewal in *In re Elsinore Shore Associates*. [FN34] The bankruptcy court distinguished actions taken by a state entity to protect public health, safety, and welfare from actions taken to protect the state's pecuniary interests. The court found that the collection of pre-petition taxes was a pecuniary concern, and therefore, not subject to the police power exception to the automatic stay.

Payment of professionals

The court's goal, when paying professionals, is to preserve the assets of the estate while not unnecessarily penalizing the professionals who have provided valuable services to the estate. Pursuant to § 331 of the Bankruptcy Code, the debtor's attorney and other professionals are authorized to apply to the court for interim compensation "not more than once every 120 days." However, the professionals are allowed to apply for compensation more frequently if the court so allows. [FN35] Allowing payments on a more regular basis can be beneficial to the professionals employed by the debtor, especially in large casino cases where the legal issues are numerous and highly complicated, and fees generated are likely to be large. While granting authority to file interim applications on an expedited basis can be more burdensome on the court, it does serve to negate de facto financing of the case by the professional. As a compromise, some courts allow the payment of a reduced percentage of the amounts requested in the fee applications without conducting a hearing, reserving all objections for a final fee application hearing at the conclusion of the case as part of an overall case management order. [FN36]

*285 BANKRUPTCY OPERATING ISSUES COMMON TO GAMING CASES

A number of issues that occur in other types of bankruptcy cases are common to casino cases. However, attorneys and bankruptcy courts must be mindful of gaming regulations which often create interesting legal twists when a casino files bankruptcy.

Security interests in hotel revenues

Many casinos have hotels connected with their operation, and as a result, casino bankruptcy cases often contain numerous hotel issues. Conflicting case law regarding security interests in hotel revenues was finally settled in 1994, when 11 U.S.C. § 552 was amended to clarify the continuation of a lien in hotel rent:

> (2) Except as provided in sections 363, 506 (c), 522, 544, 545, 547, and 548 of this title, and notwithstanding section 546(b) of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payment for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise. [FN37]

From a casino debtor's standpoint, however, the problem with this statute is that it does not address the fact that hotel revenues might be intermingled with casino cash. Additionally, casinos may not be able to segregate hotel revenues because various non-gaming attractions in the hotel portion of the property may be operated intentionally at a loss to attract customers. [FN38] However, as a practical matter, casino and hotel revenues are almost never intermingled due to stringent gaming regulations, [FN39] thereby enhancing any tracing requirement a lender may have to satisfy in order to retain a lien.

Security interests in casino cash

Casinos generate substantial amounts of cash each day. The amount of cash constantly fluctuates and is located throughout the casino in cages and at various gaming attractions. Free hotel rooms, casino "comps," tokens, and chips are all considered part of the casino's cash collateral. [FN40]

While 11 U.S.C. § 552 has resolved the question of a lien in hotel revenues, no cases have yet addressed the manner in which a creditor may perfect a lien in casino cash. Courts have held that a security interest in cash may be perfected only by possession. [FN41] This is consistent with sections 9-312(b)(3) and 9-313(a) of the Uniform Commercial Code, which provide that a security interest in money is perfected by possession. [FN42] Possession of money via a writ of execution or writ of garnishment is not affected by licensing, though it may have an effect if cash is depleted below minimum levels. If it is the intention of a creditor to control the cash of a casino debtor with operations continuing, a receiver, that has been approved by the Gaming Authorities, must first be appointed. A receiver must undergo the same screening process as key casino personnel, receiving ***286** approval and licensing before given any authority with respect to the gaming operations. [FN43]

Loans

A non-restricted gaming licensee must report all loans to the State Gaming Control Board within thirty (30) days after the date of the loan. [FN44] If the Board finds the loan inappropriate, i.e., it was made for reasons that are detrimental to the public health, safety, morals, etc. of the people of Nevada, then the Gaming Commission may rescind the loan transaction. [FN45] Similar regulations apply in other jurisdictions.

When a Chapter 11 bankruptcy case is filed, the debtor-in-possession seldom has sufficient unencumbered cash reserves to continue the operation of its business and to pay the costs of the reorganization. Pre-petition financing is generally no longer available to the debtor, because 11 U.S.C. § 365(c) prohibits the debtor from assuming or compelling further advances under pre-existing financing agreements. The debtor will usually need post-petition credit immediately and will often file a motion seeking approval of such financing with the court. If the court does not authorize the debtor's request for additional financing or the use of cash collateral, the reorganization is unlikely to succeed. Accordingly, debtors, including casino debtors, will utilize 11 U.S.C. § 364 to obtain post-petition financing. [FN46]

Gaming agreements

In Nevada, gaming devices are common in locations other than casinos. For example, video poker machines, blackjack machines, and slot machines are frequently located in airports, bars, restaurants, convenience stores, and grocery stores. Gaming machines in locations other than casinos are operated under one of two types of contracts: a space lease contract or a participation contract. Under a space lease contract, a licensed slot operator actually leases space from the owner (or lessee) of a bar for a flat sum per week or month, and the slot operator retains all of the gaming revenue. Under a participation contract, the slot operator and owner (or lessee) share in the revenues. Accordingly, in a participation agreement, the owner (or lessee) must be licensed, while in a space lease agreement, only the slot operator must be licensed. [FN47] A slot operator is licensed per location.

Executory contracts and leases may be assumed, rejected, or assumed and assigned pursuant to § 365 of the Code. Both space lease and participation agreements are usually treated as executory contracts. Accordingly,

these contracts are subject to assumption, rejection, or assignment in accordance with § 365, just as they are in non-casino cases. Gaming regulations, however, profoundly impact the timing of an assignment and the persons or entities to whom an assignment may be made. For example, individuals assuming a lease under a space lease agreement must be licensed before the assignment can transpire. Because the licensing process can take several months, Nevada law provides for emergency licensing if a debtor's business is to be managed by a receiver, trustee, or assignee. [FN48]

Gaming equipment

In addition to the application of §§ 363 and 365 of the Code, just as in non-casino Chapter 11s, the distribution, sales, and use of gaming equipment in a casino case are subject to a myriad of comprehensive gaming regulations. In Nevada, a person is required to have a distributors license in order to sell, use, or distribute a piece of gaming equipment for use or play inside and outside Nevada. Violation of this provision***287** is a gross misdemeanor. Simple possession of one of these devices, improperly distributed, can be a misdemeanor. [FN49] Clearly, this restriction greatly complicates efforts to liquidate assets and enforce security agreements.

Nevada law, however, provides that in bankruptcy cases or foreclosures where gaming devices are held as security for liens, the Gaming Authorities may authorize the disposition of such devices without requiring a distributors license. [FN50] This exception serves to facilitate bankruptcy liquidations and reorganizations because the person disposing of the gaming devices will not have to fear liability. [FN51]

Vendor Implications

A myriad of vendors are affected by a casino filing for Chapter 11 relief. A typical casino contracts with vendors such as: dry-cleaning services, food and beverage providers, health-care providers, paper-product suppliers, uniform providers, dishware providers, security providers, and gaming equipment suppliers.

Upon the filing of a Chapter 11 bankruptcy petition, payments to unsecured vendors are suspended and vendors are entitled to assert claims for the unpaid value of their goods and services against the debtor. All collection efforts by a vendor against the debtor must cease pursuant to 11 U.S.C. § 362.

Once a casino files under Chapter 11, an unsecured vendor's individual efforts to collect on the delinquent account generally shifts to working with other vendors to collect on the pre-petition obligations and a committee of unsecured creditors is appointed. Hundreds, or even thousands, of unsecured vendors may be affected by a casino filing for bankruptcy. Many of these vendors hold claims of relatively modest amounts. A creditors' committee is intended to deal with the debtor in a more manageable fashion, allowing the vendors to speak with one voice. [FN52]

In certain circumstances, courts, in both casino and non-casino cases, may approve a debtor's payment of certain critical vendors' pre-petition unsecured claims during the pending bankruptcy or payment of pre-petition wage claims up to the priority amount found at § 507(a)(3), based on the “doctrine of necessity” or § 105. Pursuant to this doctrine, courts will approve such claims when necessary for a successful reorganization, or to at least preserve the potential for rehabilitation of the debtor's business or prevent a liquidation. [FN53] Allowing critic-

al vendor or employee payments is controversial and debtors will have to clearly establish the necessary evidentiary predicate for any such orders. [FN54]

Employment contracts--assumption and rejection

Employment contracts are executory contracts subject to assumption and rejection. This issue concerns two types of employees, highly compensated executives and employees covered under a collective bargaining agreement. "An executory contract is one under which the obligation of the bankrupt and the other party to the contract is so far unperformed that the failure of either to complete its performance would constitute a material breach excusing the performance of the other." [FN55] The determination as to whether an executive's employment contract is assumed or rejected is made pursuant to the business judgment test, whereby the debtor is required to demonstrate that assumption or rejection would benefit the estate. [FN56] The standard ***288** to determine whether a collective bargaining agreement may be rejected is set forth under 11 U.S.C. § 1113. [FN57]

Post-petition financing

Post-petition debtor-in-possession financing pursuant to 11 U.S. C. § 364 in a hotel/casino Chapter 11 case is usually provided by the existing, pre-petition lenders in the form of additional funds and permission to use cash collateral. [FN58] DIP financing is accompanied by a variety of lender protections, including replacement and priming liens. DIP financing for immediate cash needs must be in place prior to the filing of the Chapter 11 case. Typically, as part of a first day order, an emergency loan is approved on an interim basis to fund the first few weeks of the bankruptcy. [FN59] As noted earlier, the issues to be addressed in a casino case are the same found in non-casino Chapter 11s.

FRAUDULENT TRANSFERS AND EXCEPTIONS TO DISCHARGE

A significant trend involving gaming and bankruptcy law is the continued prevalence of litigation to determine the dischargeability of debts and to recover transfers relating to gambling. Pursuant to § 523(a)(2)(A) of the Code, an individual debtor is entitled to a discharge from any debt except "(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition ...." [FN60] "This exception to discharge furthers the policy that an honest but unfortunate debtor obtains a fresh start while a dishonest debtor does not benefit from his wrongdoing." [FN61]

A significant number of opinions address the § 523(a)(2)(A) exception in the context of gambling-related debts. These opinions frequently fall into the following two categories: (1) credit card company v. gambler and (2) casino v. gambler.

Credit Card Company v. Gambler

Several non-gaming related cases are particularly relevant to this discussion, as they are illustrative of issues that frequently impact credit card companies. For example, in *In re Hashemi*, [FN62] American Express argued

that the debtor's cash advances, totaling $60,000 during a six-week vacation immediately prior to filing bankruptcy, were obtained through "actual fraud," and therefore, should be declared non-dischargeable under section 523(a)(2)(A). [FN63] The court held that the debtor's lack of intent to repay credit card charges could be inferred, for nondischargeability purposes, from the surrounding circumstances. Accordingly, the court found debtor's credit card debt non-dischargeable. "[A] court may infer the existence ***289** of the debtor's intent not to pay if the facts and circumstances of a particular case present a picture of deceptive conduct by the debtor." [FN64]

In *In re Dougherty*, [FN65] the Bankruptcy Appellate Panel for the Ninth Circuit enumerated twelve non-exclusive factors relevant to examining a debtor's intent:

> (1) the length of time between the charges and the bankruptcy filing;
>
> (2) whether or not an attorney had been consulted concerning the filing of bankruptcy before the charges were made;
>
> (3) the number of charges made;
>
> (4) the amount of the charges;
>
> (5) the financial condition of the debtor at the time the charges were made;
>
> (6) whether the charges were above the credit limit of the account;
>
> (7) whether the debtor made multiple charges on the same day;
>
> (8) whether or not the debtor was employed;
>
> (9) the debtor's prospects for employment;
>
> (10) the financial sophistication of the debtor;
>
> (11) whether there was a sudden change in the debtor's buying habits; and
>
> (12) whether the purchases made were luxuries or necessities. [FN66]

This twelve-factor test was adopted as the law of the circuit in *In re Eashai*. [FN67] In addition to these twelve elements, *In re Eashai* also made clear that the elements of common law fraud, including false representation, justifiable reliance, and damages, must be proven. [FN68] The *Eashai* court held that making the minimum payment on one credit card with a cash advance from another is not actual fraud for purposes of the fraud discharge exception; rather, this action must also be coupled with a lack of intent to repay the debt. [FN69] The court emphasized that the proof of intent to deceive is the most important element and should be the focal point of the analysis. The court noted that "since a debtor will rarely admit to his fraudulent intentions, the creditor must rely on the twelve factors of Dougherty to establish the subjective intent of the debtor through circumstantial evidence." [FN70]

Gamblers can incur debt through both casino and credit card advances. Credit card advances are far more

common, and credit card companies, as do casinos, frequently seek to have those debts declared non-dischargeable. *In re Bartlett*, [FN71] for example, involved the question of the dischargeability of a debt owed to a credit card company based on cash advances used by the debtor for gambling. [FN72] The court found that the debtor incurred the debts with no intent to repay, and accordingly, excepted the debt from discharge. [FN73] The court inferred the intent element from the fact that the debtor accepted cash advances for the purpose of gambling and intended to repay the credit card company through either gambling winnings or income produced by an unsuccessful business. [FN74] The court found that the debtor did not possess a reasonable belief that she could repay these debts, and therefore, she was not able to establish an intent to repay. [FN75]

Numerous courts have held gambling debts non-dischargeable. However, due to the fact-intensive nature of the inquiry required by § 523(a)(2)(A), it is not surprising that other courts have also found such debts dischargeable. For example, in *In re Landen*, [FN76] the debtor admittedly used cash advances on his debit card to gamble. [FN77] The plaintiff argued that the debtor's use of his card implied that he had the ability and the intent to repay and that his misrepresentation of this intent constituted fraud. [FN78] The court considered the totality of the circumstances and found the debtor possessed the requisite intent to repay when he took the cash advances. [FN79] The court considered the amount of time between the advances and ***290** the filing of the bankruptcy petition as well as the debtor's employment situation in finding the debt dischargeable. [FN80]

Casino v. Gambler

The quintessential casino-friendly non-dischargeability case is presented by In re Poskanzer. [FN81] This case involved a debtor who amassed a personal fortune in the 1970s and '80s. The debtor was an experienced businessman and had an established history of satisfying his gambling debts. The court found debtor's gambling debts non-dischargeable because, less than one month prior to filing Chapter 7, the debtor obtained hundreds of thousands of dollars in credit from casinos in Las Vegas and Atlantic City based upon a bank account with assets "grossly inadequate to meet his newly incurred casino debts." [FN82] Additionally, the court found that debtor knew at the time he obtained the credit that his bank account contained insufficient funds to repay debts. [FN83] The debtor's scienter was amplified on each occasion that he provided the same credit information to obtain casino credit after having lost thousands of dollars on the same account. The court found it undisputed that the debtor incurred these casino debts on the eve of his bankruptcy without any knowledge as to how he would repay the debts. Quoting *In re D'Ettore*, [FN84] the court held the following: "'[d]ebtors in bankruptcy are presumed to intend the natural consequences of their acts. Thus, a debtor who makes a false representation is presumed to have intent to deceive.'" [FN85] Accordingly, the court found that debtor's gambling debts were non-dischargeable. [FN86]

PLAN CONFIRMATION ISSUES

Competing plans

In *Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership*, [FN87] the Supreme Court put a stop to non-consensual bankruptcy plans filed by insiders which exclude (1) competing

plans of reorganization or liquidation, (2) competing offers for the debtor's business or assets, and (3) unsolicited third party investments in the reorganized entity. In light of this decision, bankruptcy courts must provide the opportunity for competitive bidding or competing plans of reorganization unless all impaired creditors consent to a debtor's plan. [FN88] If more than one plan emerges, impaired creditors must have the right to vote on all competing proposals. As a practical consequence, this forces all future debtors to propose better repayment terms to their creditors and it will create numerous opportunities for third parties interested in purchasing a debtor's business or assets. When competing plans are presented to the court, the court must consider the preference of the creditors and equity security holders in determining which plans to confirm.

Licensing requirements

Gaming regulations have a significant impact on plan confirmation issues. These regulations can restrict the application of basic bankruptcy principles. Licensing restrictions imposed by Gaming Authorities are integral to the plan confirmation process. For example, if a plan proposes to vest a creditor with a substantial portion of the equity in debtor casino, the plan cannot be consummated until the acquiring creditor obtains a gaming license. [FN89]

In order to complete the plan confirmation process as well as satisfy the requirements of the Gaming Authorities, casino plans will occasionally contain a separate confirmation date, effective date, and revesting date (when purchaser takes control). Additionally, bankruptcy courts will be presented with plans that provide for licensed interim management to keep ***291** the casino operating for the period between the confirmation date and the revesting date. [FN90]

Equity holders

Claim holders in a hotel/casino could become equity holders in a reorganized debtor under a plan of reorganization. Pursuant to gaming regulations, the hotel/casino cannot distribute its stock until each future equity holder has become licensed by the Gaming Authorities. The inability of a creditor to hold equity might prevent confirmation of the plan. [FN91]

FEDERALISM CONCERNS

Constitutional provisions

The Eleventh Amendment of the United States Constitution provides as follows:

> The Judicial power of the United States shall not be construed to extend to any suit in any law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

The pertinent provisions of Section 1 and Section 5 of the Fourteenth Amendment to the United States Constitution are as follows:

> Section 1 ... No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.
>
> Section 5 ... The congress shall have power to enforce, by appropriate legislation, the provisions of this article.

The bankruptcy courts are given their power in Article I, Section 8, Clause 4 of the Constitution, which provides in pertinent part that Congress has the power:

> [t]o establish a uniform Rule of Naturalization, and uniform laws on the subject of Bankruptcies throughout the United States.

Sovereign immunity

The Supreme Court's 1996 decision in *Seminole Tribe of Florida v. Florida* [FN92] and its progeny cast doubt upon the enforceability of federal statutes against states. The Seminole Tribe brought suit against the State of Florida for refusing to enter into negotiations regarding certain gaming activities in a tribal-state compact. The Tribe brought the suit pursuant to the Indian Gaming Regulatory Act (IGRA), which imposes a duty upon a state to negotiate in good faith toward the formation of a compact and which authorizes a tribe to bring suit in federal court against the state to enforce that duty. Florida moved for dismissal, arguing that the Eleventh Amendment protected it from being sued in federal court. The motion was denied, [FN93] and Florida filed an interlocutory appeal. The Court of Appeals disagreed with the district court, and found that the Eleventh Amendment barred the suit. As a result, the Court of Appeals dismissed the suit for lack of subject matter jurisdiction. [FN94] Ultimately, the Supreme Court held that the IGRA unconstitutionally abrogated Florida's immunity under the Eleventh Amendment because it was impermissibly predicated on a Congressional statute enacted pursuant to Article I of the United States Constitution. [FN95]

Impact of Seminole on the Bankruptcy Code

The Bankruptcy Code was enacted pursuant to Article I of the Constitution. Article I, § 8, cl. 4, gives Congress the power to establish bankruptcy***292** laws throughout the United States. Section 106(a) of the Bankruptcy Code serves to expressly abrogate the sovereign immunity of states. It grants bankruptcy courts the power to enter money judgments against states and to enforce any order, process, or judgment against any governmental unit under applicable non-bankruptcy law. [FN96] As such, this provision is at odds with the principle of sovereign immunity guaranteed to the states through the Eleventh Amendment.

Most circuits have ruled that the abrogation of sovereign immunity provided in § 106(a) is unconstitutional. For example, the Fourth Circuit in *Scholossberg v. Maryland Comptroller of the Treasury* (*In re Creative Goldsmiths, Inc.*), [FN97] reasoned that Congressional power to enact legislation pursuant to the Bankruptcy Clause is no greater than its authority to enact legislation pursuant to either the Commerce Clause or the Indian Commerce Clause and that, as a result, there is "no reason to treat Congress' power under the Bankruptcy Clause any differently" from the explicated powers under the Commerce Clause. This position was adopted by the Third Circuit in *In re Sacred Heart Hospital*, [FN98] the Fifth Circuit in *In re Fernandez*, [FN99] and the Ninth Circuit in In re Mitchell. [FN100] A small minority of circuits have found § 106(a) to be constitutional. The

court in *In re Headrick* [FN101] found § 106(a) validly enforceable against states through § 5 of the Fourteenth Amendment. Similarly, In re Southern Star Foods, Inc., [FN102] held that § 106(a) is constitutional because it was enacted pursuant to Article I, § 8 and enforceable through § 5 of the Fourteenth Amendment. Because *Seminole* reaffirmed Congress' power to abrogate sovereign immunity when acting pursuant to § 5 of the Fourteenth Amendment, it appears a few courts have found that § 106(a) is constitutional on this basis, notwithstanding the fact that the Code was enacted pursuant to Article I.

State immunity from the authority of federal courts makes the orderly administration of bankruptcy cases untenable. After the *Seminole* decision, the fate of § 106(a) of the Code has been questioned, and the power of governmental units, i.e., the Gaming Authorities, and the jurisdiction of the bankruptcy courts are at odds. Therefore, it is critical that counsel coordinate the reorganization effort with the Gaming Authorities because of the substantial interest all parties have in maintaining the integrity of the gaming business and the reorganization process.

Waiver of sovereign immunity

A state may waive its Eleventh Amendment immunity and thereby subject itself to the jurisdiction of the federal courts. [FN103]

> A state waives its right to sovereign immunity "if the State consents to the jurisdiction of the particular court." (Citation omitted). Waiver is a voluntary act "made by either invoking federal jurisdiction or by a clear declaration." (Citations omitted). Waiver of this immunity must unequivocally express the state's intention to consent to federal jurisdiction. (Citation omitted). A stringent test is applied to determine whether a state has waived its right to claim sovereign immunity. (Citations omitted). Constructive or "implied" waiver is insufficient to defeat the important right of Eleventh Amendment sovereign immunity. (Citations omitted). However, a state may certainly waive its right "through its affirmative conduct in litigation." (Citation omitted). This type of intentional, active conduct differs from the type of indirect acts the Supreme Court discounted in rejecting the implied waiver theory. For example, "calling upon a federal***293** court's jurisdiction is fundamentally different, for purposes of the Eleventh Amendment, from merely conducting commercial activity." (Citation omitted).
>
> Waiver is "triggered by some affirmative activity of a state," (citation omitted), and the most common way in a bankruptcy case to waive immunity is by filing a claim. (Citations omitted). Clearly, "it is long-established that a state's participation in a bankruptcy proceeding can trigger a waiver of immunity." (Citation omitted). [FN104]

The Bankruptcy Code also addresses waiver of sovereign immunity. 11 U.S.C. § 106(b) states, in part, the following: "[a] governmental unit that has filed proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." Section 106(b) is a codification of the U.S. Supreme Court's holding in *Gardner v. New Jersey*, [FN105] which held that a state waives its sovereign immunity when it files a proof of claim in a bankruptcy proceeding. [FN106] Moreover, in *In re Jerry C. and Donna L. Harleston*, [FN107] the Ninth Circuit Bankruptcy Appellate Panel found waiver of sovereign immunity by filing a proof of claim in a bankruptcy case extends to an adversary proceeding.

The purpose behind § 106(b) is to prevent the inequity of allowing a state to receive a distribution from the

bankruptcy estate without subjecting itself to liability within the scope of compulsory counterclaims. [FN108] "If a state desires to participate in the assets of a bankrupt, it must submit to appropriate requirements by the controlling power." [FN109] This furthers the purpose of the Code by providing efficient, orderly, and expeditious proceedings, while respecting state sovereign immunity.

Sovereign immunity of Indian tribes and tribal casinos

Indian tribal gaming is spreading throughout the country. As a result of the recent court decisions regarding sovereign immunity, concerns have been raised regarding the power of the state to regulate this type of gaming as well as the authority of the Bankruptcy Code to address the reorganization of the estate, including utilization of assets for reorganization and distribution to creditors.

General Acts of Congress apply to Indian tribes in the absence of a clear expression to the contrary. [FN110] This rule would not apply, however, if the interest sought to be affected were a specific right reserved to the Indian tribes. [FN111] Statutes presumptively apply to Indian tribes unless such application would: 1) abrogate rights guaranteed under an Indian treaty; 2) interfere with intramural matters regarding the tribe's right to self-governance; or 3) contradict the intent of Congress. [FN112] The Bankruptcy Code has broad application and presumptively applies to Indian tribes. [FN113] The issue is whether an Indian tribe fits within the definition of a debtor, pursuant to §§ 101(13) [definition of "debtor"] and (41) [definition of "person"]. However, while the Bankruptcy Code may or may not permit an Indian tribe to be a debtor, the tribe can retain its sovereign immunity from suit under the Code. [FN114]

Tribal sovereignty is the core of an Indian tribe's power to govern itself and is recognized by the federal government. *In re National Cattle Congress* [FN115] raised a sovereign immunity issue***294** dealing with the Sac and Fox Tribe of Mississippi, Iowa. The debtor's Chapter 11 plan proposed to terminate a mortgage held by the Tribe in exchange for a covenant prohibiting gambling on the property. The court upheld the Tribe's assertion of sovereign immunity. [FN116] It appears the issues relating to tribal sovereign immunity and state sovereign immunity are similar, in that neither a state nor a tribe can be forced into a bankruptcy case against its will. It follows, then, that like a state, a tribe can waive its sovereign immunity and voluntarily yield to the jurisdiction of the Bankruptcy Court. Clearly, a tribe's sovereign immunity limits a court's ability to administer such cases and limits a creditor's ability to compel payment from the debtor.

In 1987, the U.S. Supreme Court, in *California et. al. v. the Cabazon Band of Mission Indians*, [FN117] held that gambling on reservations is legal provided that the same kind of gambling is legal in the state in which the reservation is located. The Court also held that states had no authority to regulate gaming on Indian Reservations if such gaming is permitted outside the reservation. This decision caused much controversy, and as a result, Congress passed the IGRA in 1988. Under the IGRA, in order for tribes to conduct casino-style gaming, which includes blackjack and slot machines, the states are required to negotiate "in good faith" with the tribes and enter into compacts. [FN118]

In 1995, Indian tribal gaming reportedly represented only about nine percent (9%) of all legal gambling in the United States. [FN119] With the continuous introduction of new tribal casinos, this figure is steadily increasing. Twenty-nine (29) states now house Native American casinos. [FN120]

Tribes are considered sovereign nations, and for this reason, they are not required to report gambling revenues generated in their casinos to the Internal Revenue Service. [FN121] Under the IGRA, tribes are limited in their use of tribal gaming revenues. They must use gaming revenues to pay for tribal government operations, provide for the general welfare of the tribe, support economic growth and development, make charitable donations, and fund local government agencies. [FN122]

CONCLUSION

Many of the matters discussed in this article are to some extent dependent upon state statute and regulation. This article has emphasized the Nevada regulatory process because it is the oldest and most developed, and of course, the one with which the author has some familiarity. A thorough investigation of each state's statutory and regulatory provisions must be done prior to seeking relief in bankruptcy court, especially in regard to licensing, debt and equity securities, the appointment of a trustee, and regulation of personnel. Most, if not all, of the courts that have had casino cases have Web sites that allow access to pleadings. It would be advisable to review those pleadings for useful authorities and local procedure. Good luck.

[FNa1]. Gregg W. Zive is Chief U.S. Bankruptcy Judge, U.S. Bankruptcy Court, District of Nevada, Reno, Nevada.

[FN1]. *See* Nicholas S. Goldin, Note, *Casting a New Light on Tribal Casino Gaming: Why Congress Should Curtail the Scope of High Stakes Indian Gaming*, 84 CORNELL L. REV. 798 (1999).

[FN2]. *See id*.

[FN3]. *See* National Gambling Impact Study Commission, Casino Gambling (http://www.casino-gambling-reports.com/GamblingStudy/).

[FN4]. *See* Bankruptcy Statistics, May 16, 2002 (http:www.bankruptcyaction.com).

[FN5]. *See id*.

[FN6]. The AGA Survey of Casino Entertainment, State of the States (2002) (http://www.americangaming.org).

[FN7]. *See id*.

[FN8]. *See id*.

[FN9]. See Michael E. Hammond, Internet Gambling Regulation, April 17, 2000 (http://www.geocities.com/mehamm0/netgambling.htm).

[FN10]. *See id*.

[FN11]. *See* (http://nvb.uscourts.gov).

[FN12]. *See id.*

[FN13]. *See id.*

[FN14]. *See id.*

[FN15]. *See id.*

[FN16]. This section is taken in large part from the following article: Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming, Note, *Bankruptcy Trends in the Gaming Field*, 10 J. BANKR. L. & PRAC. 293, 299-300 (2001).

[FN17]. Though gaming-licensed casinos may be owned and operated by individuals, limited liability companies, partnerships and trusts, for ease of this overview, the discussion is limited to corporations.

[FN18]. For example, in Nevada, payoff tables on slot machines must be continually and conspicuously displayed on or near every gaming machine or table. NGC Reg. 5.012 (1). Additionally, casinos must record the amount shown on each progressive slot meter at least once each day. Nevada State Gaming Control Board Regulation 5.110(2).

[FN19]. The major sources of gaming tax on casino revenues in Nevada are the following: 1) license fees on gross revenue, 2) flat fees on slot machines in restricted and non-restricted locations, 3) quarterly flat fees on games, 4) annual state fees on games, and 5) smaller miscellaneous fees. LIONEL, SAWYER & COLLINS, NEVADA GAMING LAW: THE AUTHORITATIVE GUIDE TO NEVADA GAMING LAW 360 (Dave Palermo ed., Lionel Sawyer & Collins 1995) (1991).

[FN20]. *See* 28 U.S.C. § 1408.

[FN21]. *See, e.g.*, In re Consolidated Equity Properties, Inc., 136 B.R. 261, 267 (D. Nev. 1991).

[FN22]. *See* Honorable Gregg W. Zive and Laurel E. Davis, Esq., Hotel/Casino Bankruptcy Cases, Norton Bankruptcy Litigation Institute II, 2002.

[FN23]. *See id.*

[FN24]. *See id.*

[FN25]. *See* (http://www.nvb.uscourts.gov).

[FN26]. 11 U.S.C. § 1101.

[FN27]. *See* 11 U.S.C. § 1104.

[FN28]. *See* 11 U.S.C. § 1106; Fed. R. Bankr. P. 2015(a).

[FN29]. *See* Honorable Margaret Mahoney, Honorable Linda B. Riegle, William R. Urga, Gerald R. Gordon, and Frank A. Merola, Gaming Issues in Bankruptcy, National Conference of Bankruptcy Judges, 1998.

[FN30]. *See* (http://www.nvb.uscourts.gov).

[FN31]. *See* Honorable Gregg W. Zive and Laurel E. Davis, Esq., Hotel/Casino Bankruptcy Cases, Norton Bankruptcy Litigation Institute II, 2002.

[FN32]. *See* 11 U.S.C. § 362(a)(1), (2), (3), (4) and (5); John M. Czarnetzky, Note, *When the Dealer Goes Bust: Issues in Casino Bankruptcies*, 18 MISS. C. L. REV. 459, 461 (1998).

[FN33]. *See* 11 U.S.C. § 362(b)(4).

[FN34]. In re Elsinore Shore Associates, 66 B.R. 723 (Bankr. D. N.J. 1986).

[FN35]. *See* 11 U.S.C. § 331.

[FN36]. *See, e.g.*, In re Knudson Corp., 84 B.R. 668 (B.A.P. 9th Cir. 1988).

[FN37]. 11 U.S.C. § 552(b)(2).

[FN38]. *See* Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming, Note, *Bankruptcy Trends in the Gaming Field*, 10 J. BANKR. L. & PRAC. 293, 299-300 (2001).

[FN39]. *See* Nevada State Gaming Control Board Regulation 6A.050.

[FN40]. *See* Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming, Note, *Bankruptcy Trends in the Gaming Field*, 10 J. BANKR. L. & PRAC. 293, 299-300 (2001).

[FN41]. *See, e.g.*, In re Ventura-Louise Properties, 490 F.2d 1141 (9th Cir. 1974).

[FN42]. A security interest in deposit accounts is perfected by control under Section 9-104, 9-105, or 9-107 when the secured party obtains control and remains perfected by control only while the secured party retains control. UCC 9-314(b).

[FN43]. *See* Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming, Note, *Bankruptcy Trends in the Gaming Field*, 10 J. BANKR. L. & PRAC. 293, 299-300 (2001).

[FN44]. *See* Nevada State Gaming Control Board Regulation 8.120.

[FN45]. Honorable Gregg W. Zive and Laurel E. Davis, Esq., Hotel/Casino Bankruptcy Cases, Norton Bankruptcy Litigation Institute II, 2002.

[FN46]. See Linda Grant Williams, *Obtaining Credit Under the Bankruptcy Code*, in REAL ESTATE WORKOUTS AND BANKRUPTCIES 263, 263 (1991).

[FN47]. *See* Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming, Note, *Bankruptcy Trends in the Gaming Field*, 10 J. BANKR. L. & PRAC. 293, 300-301 (2001).

[FN48]. *See id.*

[FN49]. *See id.*

[FN50]. *See id.*

[FN51]. *See id.*

[FN52]. Sec. 1102 of the Code governs the selection of Creditors' Committee members. Sec. 1102(a)(1) states that "as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate."

[FN53]. *See* Bruce S. Nathan, *Critical Vendors*, 21 AM. BANKR. INST. J. 14, 14 (2002).

[FN54]. *See, e.g.*, In re CoServ LLC, et. al., 273 B.R. 487 (Bankr. N.D. Tex. 2002).

[FN55]. Vern Countryman, Note, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973).

[FN56]. *See* Group of Institutional Investors v. Chicago, Milwaukee, St. Paul, Pacific, R.R. Co., 318 U.S. 523, 550 (1943).

[FN57]. The test under 11 U.S.C. § 1113 can be summarized as follows: 1) The debtor in possession must make a proposal to the union to modify the collective bargaining agreement; 2) the proposal must be based on the most complete and reliable information available at the time of the proposal; 3) the proposed modifications must be necessary to permit the reorganization of the debtor; 4) the proposed modifications must assure that all creditors, the debtor, and all of the affected parties are treated fairly and equitable; 5) the debtor must provide to the union such relevant information as is necessary to evaluate the proposal; 6) between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union; 7) at the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement; 8) the union must have refused to accept the proposal without good cause; and 9) the balance of the equities must clearly favor rejection of the collective bargaining agreement.

[FN58]. The filing of a Chapter 11 petition automatically creates an estate consisting of all property, including cash, owned by the debtor at the time of filing. Sec. 363(a) defines cash and cash equivalents as "cash collateral." Often a secured creditor holds a security interest in the cash collateral. Under § 363(c)(2), the debtor is prohibited from spending cash collateral without the consent of all parties that have an interest in the collateral or a court order.

[FN59]. Honorable Gregg W. Zive and Laurel E. Davis, Esq., Hotel/Casino Bankruptcy Case, Norton Bankruptcy Litigation Institute II, 2002.

[FN60]. 11 U.S.C. § 523(a)(2)(A).

[FN61]. In re Eashai, 87 F.3d 1082, 1086 (9th Cir. 1996) (citing Grogan v. Garner, 498 U.S. 279, 286-87 (1991)).

[FN62]. In re Hashemi, 104 F.3d 1122 (9th Cir. 1996), *cert. denied*, 520 U.S. 1230 (1997).

[FN63]. *See id.*

[FN64]. In re Eashai, 87 F.3d. at 1087.

[FN65]. In re Dougherty, 84 B.R. 653 (B.A.P. 9th Cir. 1988).

[FN66]. *Id.* at 657.

[FN67]. In re Eashai, 87 F.3d 1082, 1087 (9th Cir. 1996).

[FN68]. *See id.* at 1088.

[FN69]. *See id.* at 1089-90.

[FN70]. *See id.* at 1090.

[FN71]. In re Bartlett, 128 B.R. 775 (Bankr. W.D. Mo. 1991).

[FN72]. *See id.*

[FN73]. *See id.* at 776.

[FN74]. *See id.* at 779.

[FN75]. *See id.*

[FN76]. In re Landen, 95 B.R. 826 (Bankr. M.D. Fla. 1989).

[FN77]. *See id.* at 827.

[FN78]. *See id.* at 827-28.

[FN79]. *See id.* at 829.

[FN80]. *See id.*

[FN81]. In re Poskanzer, 143 B.R. 991 (Bankr. D. N.J. 1992).

[FN82]. *Id.* at 999.

[FN83]. *See id.*

[FN84]. In re D'Ettore, 106 B.R. 715 (Bankr. M.D. Fla. 1989).

[FN85]. In re Poskanzer, 143 B.R. at 999 (quoting In re D'Ettore, 106 B.R. 715 (Bankr. M.D. Fla. 1989).

[FN86]. *See id.*

[FN87]. Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership, 526 U.S. 434 (1999).

[FN88]. *See id.*

[FN89]. *See id.*

[FN90]. *See id.*

[FN91]. *See id.*

[FN92]. Seminole Tribe of Florida v. Florida, 517 U.S. 44 (1996).

[FN93]. Seminole Tribe of Florida v. Florida, 801 F. Supp. 655 (S.D. Fla. 1992).

[FN94]. Seminole Tribe of Florida v. Florida, 11 F.3d 1016 (11th Cir. 1994).

[FN95]. *See* Seminole Tribe of Florida v. Florida, 517 U.S. 44 (1996).

[FN96]. Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming, Note, *Bankruptcy Trends in the Gaming Field*, 10 J. BANKR. L. & PRAC. 293, 306 (2001).

[FN97]. Scholossberg v. Maryland Comptroller of the Treasury (In re Creative Goldsmiths, Inc.), 119 F.3d 1140, 1145-46 (4th Cir. 1997), *cert. denied*, 523 U.S. 1075 (1998).

[FN98]. In re Sacred Heart Hospital, 133 F.3d 237, 243 (3rd Cir.1998).

[FN99]. In re Fernandez, 123 F.3d 241, 243 (5th Cir. 1997).

[FN100]. In re Mitchell, 209 F.3d 1111 (9th Cir. 2000).

[FN101]. In re Headrick, 200 B.R. 963, 967 (Bankr. S.D. Ga. 1996).

[FN102]. In re Southern Star Foods, Inc., 190 B.R. 419, 426 (Bankr. E.D. Ok. 1995). Although this case is a pre-*Seminole* case, it is illustrative of the reasoning of post-*Seminole* courts that have found § 106(a) constitutional.

[FN103]. *See* Aer-Aerotron, Inc. v. Texas Dep't of Transp., 104 F.3d 677, 678 (1997).

[FN104]. In re Pegasus Gold Corp., 275 B.R. 902, 916-17 (Bankr. D. Nev. 2002).

[FN105]. Gardner v. New Jersey, 329 U.S. 565 (1947).

[FN106]. *See id.*

[FN107]. In re Jerry C. and Donna L. Harleston, 275 B.R. 546 (B.A.P. 9th Cir. 2002).

[FN108]. Katrina A. Kelley, Note, *In the Aftermath of Seminole: Waiver of Sovereign Immunity Under Section*

106(b) of the Bankruptcy Code, 15 BANKR. DEV. J. 151, 170 (1998).

[FN109]. *Id.* (quoting New York v. Irving Trust Co., 288 U.S. 329, 333 (1933)).

[FN110]. *See* Federal Power Comm'n v. Tuscarora Indian Nation, 362 U.S. 99, 120 (1960).

[FN111]. *See* E.E.O.C. v. Fond du Lac Heavy Equip. & Constr. Co., 986 F.2d 246, 248 (8th Cir. 1993).

[FN112]. *See* Florida Paraplegic Assoc., Inc. v. Miccosukee Tribe, 166 F.3d 1126 1129 (11th Cir. 1999).

[FN113]. *See* In re National Cattle Congress, 247 B.R. 259, 265 (N.D. Iowa 2000).

[FN114]. *See id.*

[FN115]. *Id.*

[FN116]. *See id.*

[FN117]. California et al. v. the Cabazon Band of Mission Indians, 480 U.S. 202 (1987).

[FN118]. *See* Jim Stembridge, Basics About ... Tribal Gaming, Oregon Legislative Policy & Research Office (1996).

[FN119]. *See id.*

[FN120]. *See* Joshua Kulantzick, *Gambling's Royal Flush*, U.S. NEW & WORLD REPORT, May 20, 2002, at 34.

[FN121]. *See id.*

[FN122]. *See id.*
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*293 BANKRUPTCY TRENDS IN THE GAMING FIELD

Gerald M. Gordon, Rudy J. Cerone, Scott Fleming [FNa1]

Gaming has exploded exponentially in the last decade. Forty-eight states now permit some form of legalized gambling. This has also resulted in an increased number of bankruptcy filings.

Such cases involve issues that differ from a "typical" chapter 11 case due to the highly regulated nature of the debtor and the possible implications of the state's police powers, the unique emphasis on cash, and the one-dimensional approach to valuation. The following review identifies some of the issues presented by bankruptcy filings of gaming operations. [FN1]

I. FIRST DAY ORDERS

It is typical in a large bankruptcy case for the debtor to obtain numerous "first day orders," including such common bankruptcy orders as authorization for payment of payroll and related employee expenses, emergency use of cash collateral, and appointment of debtor's bankruptcy counsel. The most unique "first day order" applicable to a casino bankruptcy is an order authorizing the payment of gaming chips and tokens in the ordinary course of business.

Casino gaming chips and tokens represent liabilities of the casino. (While these terms are used interchangeably, chips relate to table games and tokens to coin-operated machines.) Gamblers exchange money for chips, which represent an obligation of the casino to repay. Occasionally, a patron will "walk away" from the gaming table with such tokens (chips) in his pocket. The right to exchange his chips for money constitutes, at worst, a general *294 unsecured claim and, at best, a priority consumer claim up to the amount of $1,800.00 per individual. [FN2] However, bankruptcy judges inevitably issue a "first day order" permitting the casino to pay such gaming chips upon demand. As a technical matter, the Code would require that the casino filing bankruptcy stop issuing and honoring "prepetition chips" as of the moment of the bankruptcy, issue only new "postpetition chips" from that moment on, and require players possessing "prepetition chips" to file their claims in the bankruptcy and await distribution through a plan of reorganization. As a practical matter, it is universally recognized that such a move would sound the death knell for the casino. Judge Cosetti, discussing "first day orders," noted that "[t]he purpose of first day orders is to benefit creditors, by maximizing reorganization values. Many times they are in conflict with other provisions of the Bankruptcy Code. Such orders carry a heavy burden." [FN3]

The statutory basis for the entry of such an order is found in the "catch-all" provision of § 105(a), which permits the bankruptcy court to issue any order necessary to carry out the provisions of the Bankruptcy Code. Furthermore, the Doctrine of Necessity, which is an outgrowth of the Necessity of Payment rule first recognized in conjunction with railroad cases dating to at least 1882, also would support such a ruling although no published

decisions exist in this context. It should be noted, however, that while the Doctrine of Necessity has become more widely recognized, it has not been universally accepted. [FN4] Even courts authorizing payments pursuant to the Doctrine of Necessity find that those particular payments are required for the debtor to continue operations and, generally, limit the payment to a particular creditor receiving payment rather than a specific type of debt. This is not the case in honoring casino tokens. Because the gaming chips are indistinguishable from each other, all debt evidenced by these tokens are afforded the same treatment, whether they be held by individual casino patrons or other casino properties which have accepted these chips in exchange for chips to be used at their facility. There may be no "necessity" for allowing competitors to redeem these chips for full face value; however, the distinction between the types of creditors benefitted apparently has not been drawn by the courts.

Similarly, the court usually will approve the honoring of sports book wagers and deposits and progressive games liabilities as necessary to casino operations. Other "first day orders" which are routinely granted include an order permitting the debtor to retain prepetition charge card accounts, and to ***295** honor tour and travel commitments and other prepetition room deposits. All of these "first day orders" typically are granted to permit the debtor to continue uninterrupted operations, and justified as being necessary in a casino bankruptcy.

II. OVERVIEW OF REGULATORY ISSUES

Gaming regulation has its genesis in various declarations of public policy which are concerned with, among other things: (1) the prevention of unsavory or unsuitable persons from having a direct or indirect involvement with gaming at any time or in any capacity; (2) the establishment and maintenance of responsible accounting practices and procedures; (3) the maintenance of effective controls over the financial practices of a licensee, including the establishment of minimum procedures for internal fiscal affairs and the safeguarding of assets and revenues, providing reliable record keeping and requiring the filing of periodic reports with Gaming Authorities; (4) the prevention of cheating and fraudulent practices; and (5) the creation of a source of state and local revenues through taxation and licensing fees. These statements of public policy are embodied in statutes, regulations and supervisory procedures implemented at the state and local level by a variety of overlapping regulatory bodies (the "Gaming Authorities"). Regulation and licensing affects gaming properties (hereinafter, "Casinos") [FN5] and their owners and operators on several levels, many of which have a profound impact in the course of a Casino bankruptcy. [FN6]

A. Licensing and Regulation of the Casino

Only corporations organized under the laws of the forum state may hold a ***296** gaming license. [FN7] Accordingly, gaming enterprises are operated by domestic corporations, that in turn are often wholly-owned by out-of-state (and often publicly-traded) corporations. Because parent corporations routinely guarantee the debts of subsidiaries, Casino bankruptcies frequently involve two or more corporate entities. [FN8] Regulation of a Casino affects both the operating corporation (the "licensed" company) and the holding corporation (the "registered" company) and occurs in at least three different forms: (1) licensing and registration, (2) financial reporting, and (3) gaming license fees and taxes.

1. Licensing and Registration

The mechanics of licensing vary by locality, but generally require detailed investigations of a licensee's busi-

ness activities and financial status. Although a parent corporation of a licensed corporate subsidiary is not required to obtain a license, it is required to be "registered", which in turn requires a parent corporation to obtain a "finding of suitability" from local Gaming Authorities. The investigations and requirements necessary to obtain a finding of suitability are quite similar to those necessary for licensing.

While the licensing and registration processes are outside the purview of the bankruptcy court, they nonetheless will affect many aspects of a Casino reorganization. For instance, no person may become a stockholder of, or receive any percentage of profits from, a gaming licensee without first obtaining approvals from Gaming Authorities. A registered corporation may not make a public offering of its securities without the prior approval of Gaming Authorities if the securities or the proceeds therefrom are intended to be used to construct, acquire or finance gaming facilities or to retire or extend obligations incurred for such purposes. [FN9]

2. Reporting Requirements

Regulation of both licensed and registered corporations involves stringent reporting requirements. A registered corporation generally is required to submit, upon application and on a periodic basis, detailed financial and ***297** operating reports to Gaming Authorities. It may also be required to furnish any other information requested by Gaming Authorities. A registered company is required to maintain a current stock ledger in the gaming state which may be examined by Gaming Authorities at any time. If any securities are held in trust by an agent or by a nominee, the record holder may be required to disclose the identity of the beneficial owner to Gaming Authorities. A failure to make such disclosure may be grounds for finding the record holder unsuitable. The registered company also is required to render maximum assistance in determining the identity of the beneficial owner. In Nevada, Gaming Authorities even have the power to require the registered company's stock certificates to bear a legend indicating that the securities are subject to the Nevada [Gaming] Act. [FN10]

In addition to these requirements, the licensed corporation must report and obtain approval from Gaming Authorities of substantially all loans, leases, sales of securities and similar financing transactions. [FN11] Failure to comply with reporting requirements by either the registered or licensed corporation could result in a corporation's license being limited, conditioned, suspended or revoked subject to compliance with certain statutory and regulatory procedures. Moreover, at the discretion of Gaming Authorities, the registered and licensed corporations, as well as the individuals involved, could be subject to substantial fines for each separate violation.

3. Gaming License Fees and Taxes

License fees and taxes, computed in various ways dependent upon the type of gaming activity involved, are payable to the state and to the counties and cities in which the licensee's respective operations are conducted. Depending upon the particular fee or tax involved, these fees and taxes are payable either daily, monthly, quarterly or annually and are based upon either: (1) a percentage of gross revenues received; (2) the number of gaming devices operated; or (3) the number of table games operated. [FN12] A casino entertainment tax is also paid by casino operators where entertainment is furnished in connection with the selling of food or refreshments. Licensees that hold a license as an operator of a slot route or a manufacturer's or distributor's license also pay certain fees and taxes to the state.

B. Licensing and Regulation of Key Personnel

Gaming Authorities may investigate any individual who has a material relationship to, or material involvement with, any registered company or its licensed subsidiary in order to determine whether such individual is suitable ***298** or should be licensed as a business associate of a gaming licensee. [FN13] Officers, directors and certain key employees of the licensed subsidiary must file applications with Gaming Authorities and may be required to be licensed or found suitable. Officers, directors and key employees of the registered company who are actively and directly involved in the gaming activities of the licensed subsidiary may be required to be licensed or found suitable by Gaming Authorities. Gaming Authorities may deny an application for licensing for any cause deemed reasonable. A finding of suitability is comparable to licensing, and both require the submission of detailed personal and financial information followed by a thorough investigation. An applicant for licensing or a finding of suitability must pay all of the costs of the investigation. Changes in licensed positions with the registered company or its licensed subsidiary must be reported to Gaming Authorities. In addition to its authority to deny an application for a finding of suitability or licensure, Gaming Authorities also have jurisdiction to disapprove a change in a corporate position.

If Gaming Authorities were to find an officer, director or key employee unsuitable for licensing or unsuitable to continue having a relationship with the registered company or its licensed subsidiary, the companies involved would be required to sever all relationships with such person. Additionally, Gaming Authorities may require the registered company or its licensed subsidiary to terminate the employment of any person who refuses to file appropriate applications. Determinations of suitability or questions pertaining to licensing are not subject to judicial review in Nevada.

C. Licensing and Regulation of Casino Ownership

1. Equity Securities

Regulation of registered companies may extend beyond key personnel. The beneficial holder of the registered company's voting securities, regardless of the number of shares owned, may be required to file an application, be investigated and have its suitability as a beneficial holder of the registered company's voting securities determined if Gaming Authorities have reason to believe that such ownership would otherwise be inconsistent with the declared policies of the State. [FN14] The applicant must pay all costs of the investigation incurred by Gaming Authorities in conducting such an investigation. Regulation may not be limited to State Gaming Authorities. In Nevada, the Clark County Liquor Gaming Licensing Board and the City of Las Vegas have both taken the position that they have the authority to approve***299** all persons owning or controlling the stock of any corporation controlling a gaming licensee within their jurisdictions. [FN15]

2. Debt Securities

Gaming Authorities may, in their sole discretion, require the holder of any debt security of a registered corporation to file applications, be investigated and be found suitable to own the debt security of the registered corporation. If Gaming Authorities determine that a holder is unsuitable to own such security, the registered corporation can be sanctioned, including the loss of its approvals, if without the prior approval of Gaming Authorities, it: (1) pays to the unsuitable person any dividend, interest or any distribution whatsoever; (2) recognizes any voting right by such unsuitable person in connection with such securities; (3) pays the unsuitable person remuneration in any form; or (4) makes any payment to the unsuitable person by way of principal, redemption, con-

version, exchange, liquidation or similar transaction. [FN16]

III. BANKRUPTCY OPERATING ISSUES COMMON TO GAMING CASES

A number of issues that occur in other types of bankruptcy cases are common to Casino cases (although the comprehensive regulations imposed by Gaming Authorities often add interesting additional elements and complications).

A. Hotel Issues

Many Casinos have hotels connected with their operation. Accordingly, issues raised in ordinary hotel cases frequently arise in Casino cases. For years, there were conflicting cases regarding security interests in hotel revenues. In 1994, however, 11 U.S.C. Section 552 was amended to clarify the split the of authority concerning the continuation of a lien in hotel rent:

> (2) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, and notwithstanding section 546(b) of this title, if the debtor and an entity entered into a security agreement before the commencement of the case ***300** and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.
>
> 11 U.S.C. § 552(b)(2).

While the amendments to Section 552 may resolve a number of issues in ordinary hotel cases, this section does not address the fact that in Casino cases, hotel revenues often are intermingled with Casino cash. To further complicate matters, Casinos may not be able to segregate hotel revenues because the hotel portion of the Casino (and often its restaurants and non-gaming attractions) may be operated intentionally at a loss to attract customers.

B. Cash Collateral Issues

Although the question of hotel rents has been resolved, no cases yet have addressed the manner in which a creditor may perfect a lien in Casino cash. By its very nature, a Casino generates substantial amounts of cash on a daily basis. The amount of cash constantly fluctuates, and unlike ordinary bank accounts, cash is located throughout the casino. Substantial cash may be held in the Casino “cage”, but an even greater amount may reside within gaming devices and floor banks and on tables. Free hotel rooms, casino “comps”, markers, chips, tokens and customer deposits also figure in the mix.

IV. BANKRUPTCY OPERATING ISSUES UNIQUE TO GAMING CASES

A. Agreements re Electronic Gaming Devices

In Nevada, gaming devices are common in locations other than casinos. For instance, video poker machines, and to a lesser extent slot machines, are frequently located in bars, restaurants, convenience stores, and grocery stores. [FN17] Gaming machines in locations other than casinos frequently are owned by third parties and placed under contract. These contracts fall into two types: space lease and participation. Under a space lease, a licensed slot operator actually leases space from the owner (or lessee) of a bar, for ***301** instance, for a flat sum per week or month. The slot operator retains 100% of the gaming revenue. Under a participation, the slot operator and the debtor share in the revenues. In a participation, the owner or lessee must be licensed, while in the space lease situation, only the slot operator is licensed.

Both space leases and participation agreements generally are treated as executory contracts, subject to assumption, rejection or assignment in accordance with Section 365 of the Code. Gaming law, however, may profoundly affect the timing of an assignment and limit the persons or entities to whom an assignment may be made. For instance, in a participation agreement, a debtor owner or lessee has the ability to change slot operators very quickly. Any slot route operator may provide machines. In a space lease, however, the slot route operator has the license and consequently to bring in a new slot operator would require a new license to be issued for the location. This can take several months unless Gaming Authorities are willing to handle an application on an expedited "emergency basis." Nevada law provides for an emergency approval if the debtor's business is to be managed by a receiver, trustee or assignee.

B. Security Interests in Casino Revenues and Gaming Devices

1. Casino Cash

While Section 552 may resolve certain issues regarding perfection of a security interest in hotel rents, there is no settled law respecting perfection of liens in other Casino cash.

Section 552, as amended, is consistent with earlier decisions holding that an assignment of rents is perfected upon recordation of a deed of trust without further action. *See e.g.* In re Scottsdale Medical Pavilion, 159 B.R. 295, 302, 24 Bankr. Ct. Dec. (CRR) 1218, Bankr. L. Rep. (CCH) ¶ 75504 (Bankr. 9th Cir. 1993), aff'd, 52 F.3d 244, Bankr. L. Rep. (CCH) ¶ 76466 (9th Cir. 1995). Excepting rents, however, courts have held that a security interest in cash may be perfected only by possession. *See, e.g.*, In re Ventura-Louise Properties, 490 F.2d 1141 (9th Cir. 1974); Matter of Charles D. Stapp of Nevada, Inc., 641 F.2d 737, 8 Bankr. Ct. Dec. (CRR) 397 (9th Cir. 1981). This is, of course, consistent with Section 9-304 of the Uniform Commercial Code, which provides a security interest in cash is perfected by possession. A security interest in proceeds, however, may be created by filing under Section 9-305.

Taking possession of cash pursuant to a writ of execution or garnishment is not affected by licensing, though it may have an effect if cash is depleted below minimum levels. If it is the intention to control the cash of the Casino with operations continuing, the appointment of a receiver is required. However, gaming law provides that an individual may not exercise control over a licensed company without first obtaining the prior approval of Gaming***302** Authorities. A receiver must obtain a license and undergo the same screening process required of the Casino's key personnel.

No decision respecting perfection of a security interest in Casino cash has ever been published. [FN18] These matters are seldom, if ever, litigated. The reason is that there is level of comfort in uncertainty, and in al-

most all cases, the Casino and hotel is worth more in an operating mode than with the Casino closed. Creditors who arguably have security interests in Casino cash generally object to use of cash collateral. Rather than risking having the bankruptcy court make an all-or-nothing ruling which may result in the closing of the Casino and hotel, creditors and debtors-in-possession usually stipulate to use of cash collateral and adequate protection.

2. Gaming Equipment

Distribution, sales and use of gaming devices is closely regulated. In Nevada, one is required to have a distributors license in order to sell, use or distribute a gaming devices either for use or play both inside and outside Nevada. Violation of this provision is a gross misdemeanor. Simple possession of one of these devices, improperly distributed, can be a misdemeanor. Obviously, these restrictions would greatly complicate efforts to liquidate assets or enforce security agreements.

Nevada law, however, provides that in cases of bankruptcy or foreclosure of a lien by a bank or other person holding a security interest for which gaming devices are security in whole or in part for the lien, Gaming Authorities may authorize the disposition of the gaming devices without requiring a distributors license. Otherwise, the enforcement of a security interest in gaming equipment, or even a sale in the ordinary course, may result in a third party or creditor owning (and perhaps criminally possessing) a warehouse full of slots without any ability to sell them or move them out-of-state. [FN19]

3. Riverboats

Riverboat gaming operations also implicate federal law governing the perfection of a security interest in a vessel. Section 31321 of the Ship Mortgage Act [FN20] requires that a conveyance, mortgage or related instrument, including any part of a documented vessel or a vessel for which the application for documentation is filed, be filed with the Secretary of Transportation ***303** in order to be valid against any persons except the grantor or a person having actual notice of the security instrument. The statute further provides that each conveyance, mortgage or related instrument that is filed in substantial compliance with § 31321 is valid against any person from the time it is filed with the Secretary. A preferred ship mortgage attaches to the vessel and all the equipment and appurtenances on board owned by the vessel's owner. [FN21]

In the event that the vessel is not a documented vessel as defined at 46 U.S.C. § 12101, *et seq*., it is necessary to look to the applicable state law where the vessel is titled to determine the perfection of the security interest in the vessel and the equipment and appurtenances on board. Under state law, perfection is governed by the Uniform Commercial Code. [FN22]

Several cases have found that Mississippi dockside Casinos do not constitute "vessels" for purposes of Federal admiralty and maritime matters. [FN23] In the case of Mississippi Casinos, ordinary barges are converted into floating dockside Casinos. The Casinos are not designed, intended, nor capable of being used as a means of water transportation. The Casinos are not equipped with standard marine equipment but, instead, are permanently moored and positioned in non-navigable waterways. Because the Casinos were not "vessels," the courts have found that the documentation filed by a lender, purportedly to perfect a ship mortgage under Federal law, was invalid and, therefore, the lender did not possess a valid first ranking security interest enforceable in the bankruptcy case. [FN24] Conversely, if the Casino is required to sail in order to conduct gaming operations, [FN25] then it undoubtedly would be a "vessel" under Federal law, and security interests therein would be gov-

erned by the Ship Mortgage Act. [FN26]

V. FEDERALISM CONCERNS

A. Tensions During Pendency of the Case

The automatic stay provided by Section 362 expressly excludes the ability ***304** of a governmental unit to enforce its "police or regulatory powers, other than obtaining or enforcing a money judgment." Conversely, Perez v. Campbell, 402 U.S. 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971) and 11 U.S.C. § 525(a) prohibit discrimination against a debtor in possession. Section 525 provides, in pertinent part:

> (a) ... a governmental unit may not deny, revoke, suspend, or refuse to renew *a license, permit, charter, franchise, or other similar grant to*, condition such a grant to, discriminate with respect to such a grant against ... a person that is or has been a debtor under this title or a bankrupt or a debtor under the bankruptcy act ... *solely because* such bankrupt or debtor has been a debtor under this title or a bankrupt or debtor under the bankruptcy act ...
>
> 11 U.S.C. 525(a) [emphasis added].

The Judiciary Committee, in its report to the House of Representatives, stated that § 525 prohibits actions by governmental organizations that can seriously affect the debtor's livelihood or fresh start, and that Section 525's enumeration of the various forms of discrimination is not an exhaustive list. *In re Rath Packing Co*., 35 B.R. at 618, *quoting* H.R. Rep. No. 525, 95th Cong., 1st Sess. 367 (1977), U.S.C.C.A.N. pp. 5787, 6323. Certainly, gaming licensure will seriously affect a Casino debtor's livelihood and opportunity for a fresh start.

There appears to be only one reported case addressing the interplay between State gaming law and Section 525. In In re Elsinore Shore Associates, 66 B.R. 723, 15 Bankr. Ct. Dec. (CRR) 420, 15 Collier Bankr. Cas. 2d (MB) 1128, Bankr. L. Rep. (CCH) ¶ 71553 (Bankr. D.N.J. 1986), the bankruptcy court permanently enjoined the New Jersey Gaming Commission from attempting to enforce a statute that allowed for the renewal of a gaming license to be conditioned upon payment of all outstanding state fees and taxes. The bankruptcy court rejected the commission's argument that Section 525 was not designed to confer a benefit upon debtors and that by enforcing the statute (which would require payment of pre-petition taxes and fees), the commission was treating the debtor in the same manner as all other gaming licensees. The court emphasized that the New Jersey statute created a clear conflict between the state regulatory scheme and the priorities contained in the Bankruptcy Code. The court did note, however, that Section 525 would not prohibit a governmental unit from requiring a debtor to prove future financial responsibility. [FN27]

*305 B. Tensions in the Plan Process

A plan of reorganization that contemplates cancellation of existing stock and reissuance of new stock may result in a change of control that will require the prior approval of Gaming Authorities. Sales of gaming equipment requires prior approval. Assumption and assignment of a agreement relating to gaming devices may require approval of Gaming Authorities. The granting of any registrations, amendment of orders of registration, findings of suitability, approvals or licenses to be sought in connection with a plan of reorganization are discretionary with Gaming Authorities. The burden of demonstrating the suitability or desirability of certain business transactions is at all times upon the applicant. Any licensing or approval process requires the submission of de-

tailed financial, business and personal information, as well as the completion of a thorough investigation. The time and manner in which each application is investigated and considered is entirely within the discretion of Gaming Authorities. Additionally, Gaming Authorities have absolute authority to limit, restrict or condition any application or request for withdrawal filed in any manner deemed reasonable by Gaming Authorities. These matters all may affect the plan and confirmation process, taking certain critical decisions and the timing of the effective date of a confirmed plan out of the hands of a Casino debtor or bankruptcy court and placing them in the hands of Gaming Authorities.

Tensions may exist, as well, among the various branches of State government and the bankruptcy actors, especially in emerging jurisdictions. In Jordan v. La. Gaming Control Board, 712 So. 2d 959 (La. App. 1st Cir. 1988), aff'd in part, rev'd in part, 712 So. 2d 74 (La. 1998), the Louisiana courts were asked to referee a dispute between certain legislators, on the one hand, and the Gaming Control Board and the Governor (supported by the Casino debtor and its creditors), on the other hand, over who in the State government had the authority to approve and execute the amended New Orleans Casino operating contract which had been negotiated as part of the confirmed plan in In re: Harrah's Jazz Company, Case No. 95-14545 (Bankr. E.D. La. 1995).

C. Sovereign Immunity

1. Seminole Tribe

In the landmark case of ***306**Seminole Tribe of Florida v. Florida, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252, 34 Collier Bankr. Cas. 2d (MB) 1199, 42 Env't. Rep. Cas. (BNA) 1289, 67 Empl. Prac. Dec. (CCH) ¶ 43952 (1996), the Supreme Court invalidated a Congressional waiver of sovereign immunity under the Indian Commerce Clause. Although *Seminole* did not address bankruptcy law, commentators immediately questioned the decision's affect on the Bankruptcy Code. Indeed, a number of courts, including three U.S. Circuit Courts of Appeal, already have relied upon *Seminole* in holding that Section 106 of the Code is unconstitutional. *See, e.g.*, In re Elias, 218 B.R. 80, 32 Bankr. Ct. Dec. (CRR) 2, 39 Collier Bankr. Cas. 2d (MB) 782 (Bankr. 9th Cir. 1998), decision aff'd, 216 F.3d 1082 (9th Cir. 2000); In re Sacred Heart Hosp. of Norristown, 133 F.3d 237, 245, 31 Bankr. Ct. Dec. (CRR) 1246, 32 Collier Bankr. Cas. 2d (MB) 238, Bankr. L. Rep. (CCH) ¶ 77604 (3d Cir. 1998), as amended, (Feb. 19, 1998); Matter of Estate of Fernandez, 123 F.3d 241, 31 Bankr. Ct. Dec. (CRR) 601, 38 Collier Bankr. Cas. 2d (MB) 1249, Bankr. L. Rep. (CCH) ¶ 77514 (5th Cir. 1997), amended on denial of reh'g, 130 F.3d 1138 (5th Cir. 1997); In re Creative Goldsmiths of Washington, D.C., Inc., 119 F.3d 1140, 1145, 31 Bankr. Ct. Dec. (CRR) 218, 38 Collier Bankr. Cas. 2d (MB) 574, Bankr. L. Rep. (CCH) ¶ 77457 (4th Cir. 1997).

Section 106 is a Congressional waiver of state sovereign immunity with respect to virtually every substantive provision of the Bankruptcy Code (60 sections in all). Section 106 grants bankruptcy courts the power to enter money judgments against states and to enforce *any* order, process or judgment against *any* governmental unit under applicable non-bankruptcy law. In light of *Seminole*, the power of Gaming Authorities and the jurisdiction of the bankruptcy courts appear to be on a collision course. There has already been a near miss.

In In re National Cattle Congress, Inc., 179 B.R. 588, 33 Collier Bankr. Cas. 2d (MB) 401, Bankr. L. Rep. (CCH) ¶ 76455 (Bankr. N.D. Iowa 1995), a debtor-in-possession who operated a pari-mutual dog racing facility moved the bankruptcy court to declare that the Iowa Racing & Gaming Commission's attempt to revoke their gaming license was a violation of the automatic stay. The commission argued that revocation of the gaming license was an exercise of their regulatory power, and thus exempt from the automatic stay under Section

362(b)(4). The bankruptcy court concluded that the commission's resolution to revoke the license was an exempt exercise of its regulatory powers, but that revocation of the license itself was an impermissible attempt to exercise control over property of the estate. *Id*. at 597-98. The District Court affirmed the decision. In In re National Cattle Congress, Inc., 91 F.3d 1113 (8th Cir. 1996), the Eighth Circuit Court of Appeals noted the recent *Seminole* decision:

> While this case was pending on appeal, the Supreme Court decided [[*Seminole*]. *Seminole* holds that the Indian Commerce Clause, U.S. Const. art. I, § 8, ***307** cl. 3, does not grant Congress the power to abrogate a State's immunity under the Eleventh Amendment. Seminole expressly overrules Pennsylvania v. Union Gas Co., 491 U.S. 1, 109 S. Ct. 2273, 105 L. Ed. 2d 1, 29 Env't. Rep. Cas. (BNA) 1657, 19 Envtl. L. Rep. 20974 (1989) (overruled by, Seminole Tribe of Florida v. Florida, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252, 34 Collier Bankr. Cas. 2d (MB) 1199, 42 Env't. Rep. Cas. (BNA) 1289, 67 Empl. Prac. Dec. (CCH) ¶ 43952 (1996)), which held that the Interstate Commerce Clause, U.S. Const. art. I, § 8, cl. 3 , granted Congress the power to abrogate Eleventh Amendment immunity. The Commission suggests that an order enforcing the automatic stay against the Commission violates the State of Iowa's Eleventh Amendment immunity as construed in *Seminole*. ... Accordingly, without reaching the merits of the bankruptcy and district court orders under review, and without expressing a view as to the Eleventh Amendment issue, we remand this case to the district court with instructions to remand to the bankruptcy court for further consideration in light of *Seminole*.
>
> *Id*. at 1114.

Although the case was remanded, no other decisions in *In re National Cattle Congress, Inc*. on this issue were ever published. No further appeals followed. Inevitably, however, bankruptcy courts will be called on to resolve the conflicts between the automatic stay and the regulatory power of Gaming Authorities. Although not raised in *In re National Cattle Congress, Inc*., gaming law and Section 525 of the Bankruptcy Code also present obvious federalism concerns.

The tension between state gaming law and bankruptcy law is sometimes apparent when a claimant argues that a state court judgment is entitled to res judicata effect in a subsequent bankruptcy. For instance, in In re Leroux, 216 B.R. 459 (Bankr. D. Mass. 1997), two casinos had obtained pre-petition default judgments in New Jersey based upon gambling debts. In his Chapter 11 case, the debtor had objected to the claims, arguing that the gambling debts were void as against the public policy of the State of Massachusetts. The court rejected the argument, noting that 28 U.S.C. 1738 provides that judicial proceedings in other states are entitled to "the same full faith and credit in every court within the United States and its Territories and Possessions ..." After determining that New Jersey law applied to the gambling debts, and that the default judgments were appropriately obtained, the court overruled the objections, notwithstanding Massachusetts public policy. One can only speculate as to the result, however, where a gambling debt has not been reduced to judgment or where there are issues respecting the choice of law and a claims proceeding results. [FN28]

***308 2**. *Ex Parte Young* and Other Exceptions to *Seminole* [FN29]

An exception to State sovereign immunity against suits in Federal court is set forth in Ex parte Young, 209 U.S. 123, 28 S. Ct. 441, 52 L. Ed. 714 (1908), and its progency. *Young* permits Federal court suits against individual state officers, in their capacities as such, for prospective injunctive or declaratory relief. Thus, in certain instances, State Gaming Authorities may be sued in bankruptcy court to further the purposes of reorganization

under the Bankruptcy Code.

Additionally, States may waive their sovereign immunity defense, either expressly or through conduct. An explicit waiver can occur if the State participates in a Federal program that conditions its receipt of Federal funds upon a waiver of sovereign immunity. [FN30] Indeed, Congress easily can overrule the effect of *Seminole* on bankruptcy cases simply by conditioning the States' receipt of sought-after Federal funds on their waiver of sovereign immunity in bankruptcy cases, [FN31] much as the Feds now coerce States to adopt certain laws to receive highway funds. Submission by the State of a proof of claim in a bankruptcy case also will effect a waiver of sovereign immunity, not only on the merits of the claim, but also for related dischargeability, automatic stay, plan confirmation and other issues. [FN32]

Finally, certain bankruptcy matters do not implicate a State's sovereign immunity because they are not "suits" against the State within the meaning of the Eleventh Amendment. A discharge order clears all dischargeable debts, including those owed to a State, because the order is based on the bankruptcy court's jurisdiction over the debtor and his estate, and not over the State. [FN33] Similarly, a bankruptcy court proceeding for determination of the scope of the automatic stay and whether the stay precluded a state administrative***309** proceeding against the debtors and their officers, although it affected the State's rights, was not an Eleventh Amendment "suit" against the State. [FN34]

3. Indian Tribes Are Sovereigns, Too

The *National Cattle Congress* [FN35] case, once again, raised a sovereign immunity issue, only this time it dealt with the Sac and Fox Tribe of the Mississippi in Iowa, and not the State of Iowa. The debtor's chapter 11 plan proposed to extinguish a real estate mortgage lien held by the Tribe in exchange for a restrictive covenant prohibiting gambling on the property. The bankruptcy court upheld the Tribe's assertion of sovereign immunity. Thus, it appears that the same issues raised above vis-a-vis States are applicable to attempts to drag an Indian tribe into a bankruptcy case against its will.

VI. CLAIMS PROCEEDINGS AND AVOIDANCE ACTIONS

As discussed above, gaming law may have a profound impact upon the administration of Casino's bankruptcy estate. Bankruptcy courts are far more likely, however, to encounter gaming issues in the course of claims proceedings and avoidance actions. If there is one obvious trend involving gaming and bankruptcy law, it is that the continued prevalence of litigation to determine the dischargeability of debts and to recover transfers relating to gambling. [FN36] The cases generally fall into three categories: (1) Casino v. Gambler; (2) Cash advancing credit card company v. Gambler; and (3) Chapter 7 Trustee v. Casino.

A. Casino v. Gambler

No clear winner has emerged in the seemingly endless battles between Casinos and their patrons regarding the dischargeability of gambling debts. The results in these cases appear to depend more upon how the courts view the parties and gambling, rather than upon any particular legal principal. The quintessential casino-friendly non-dischargeability case is presented by In re Poskanzer, 143 B.R. 991 (Bankr. D.N.J. 1992). This case involved a debtor who in the 1970's and 80's had "amassed a personal fortune" developing hundreds of properties throughout the northeastern part of the United States. The debtor was "experienced businessman", and in fact

had been "celebrated***310** as an icon in the real estate business in New Jersey". Moreover, the debtor had an "established history of satisfying his gambling debts". Less than one month prior to his Chapter 7 filing, the debtor had obtained hundreds of thousands of dollars in credit from casinos in Las Vegas and Atlantic City based upon a bank account with assets "grossly inadequate to meet his newly incurred casino debts." Given these facts, it was a foregone conclusion that the gambling debts would be deemed non-dischargeable.

A more interesting case is presented by In re Anderson, 181 B.R. 943, 33 Collier Bankr. Cas. 2d (MB) 967, Bankr. L. Rep. (CCH) ¶ 76539, 28 U.C.C. Rep. Serv. 2d 606 (Bankr. D. Minn. 1995). In that case, a casino had accepted dozens of bad checks (59 to be precise) totaling more than $11,000.00 over roughly a two-week period. In response to the debtor's argument that he had hoped to make good his losses, the court stated: "Rather than responding prudently, however, he continued to play, to pass checks, and to play again, on the increasingly-fantastical hope that his luck would turn and that he could beat the outstanding checks to his bank with a deposit of winnings." The court deemed the entire principal debt non-dischargeable, as well as interest, attorneys' fees and even civil penalties. Interestingly, in its twelve-page decision, the court devoted only one brief paragraph to its discussion of the casino's reliance upon the debtor's implied representations regarding the validity of his checks, stating: "The Plaintiff also has proved up the forth element, reliance, though it did so more by invoking the universal understanding of transactions by check in our consumer-based economy than it did by producing direct evidence." Conspicuously absent was any discussion regarding the reasonableness of the casino in accepting nearly 60 checks in two weeks from a patron less than two months past his eighteenth birthday.

Other cases emphasize that the these types of cases often turn on the court's perception of the debtor. In In re Vianese, 195 B.R. 572 (Bankr. N.D.N.Y. 1995), the bankruptcy court awarded attorneys' fees to a debtor couple after it dismissed a complaint by a casino to have a $16,500.00 gambling debt determined non-dischargeable. The court noted that the debtors were an assistant county superintendent of business and a sales manager for a local real estate company and stated that the check returned to the casino for non-sufficient funds "should be viewed as 'an excess similar to other excesses associated with living beyond one's means."'

In In re Hall, 228 B.R. 483 (Bankr. M.D. Ga. 1998), the bankruptcy court rejected a casino's argument that the debtor's gambling debts were non-dischargeable because they were for "luxury goods and services" Although the court earlier noted that the debtor had essentially engaged in a marker-kiting scheme, using money obtained from one casino upon the execution of a marker to pay debts to other casinos, the court held that the gambling was not a "luxury". The debtor had lost hundreds of thousands of dollars over ***311** the past 15 years and his recent gambling activities reflected "a spirit of desperation, not pleasure." The court also rejected the casino' argument that the debt had been procured through actual fraud. Although the debtor had signed the subject marker less than ten days before filing bankruptcy and had as his sole source of income a business he described as a "sinking ship," the court found that the debtor "honestly, though unreasonably, believed that he would one day get lucky and be able to satisfy his debts." In stark contrast to *In re Anderson*, the court further concluded that the casino had taken insufficient steps to examine the debtor's credit worthiness (requesting a six-month average balance on the debtor's bank account) and thus failed to demonstrate that it reasonably relied upon the debtor's representations respecting his credit worthiness. [FN37]

B. Cash-Advancing Credit Card Company v. Gambler

Markers are the not the only means by which gamblers incur debt. Cash advances from credit card companies are far more common, and like casinos, credit card companies frequently seek to have such debts determined

to be non-dischargeable. The lengthiest opinion on this subject in at least the past two years (49 pages) comes from the Middle District of Louisiana. In re Melancon, 223 B.R. 300 (Bankr. M.D. La. 1998) involved a couple who had obtained cash advances of nearly $8,000.00 and borrowed $5,000.00 purportedly to purchase an automobile (they instead gave the loan proceeds to their son and daughter-in-law to purchase a new car). When applying for the $5,000.00, the debtors not only misrepresented the purpose of the loan, but also failed to mention a second mortgage on their home and more than $25,000.00 in credit card debt, most of which was for cash advances to support one debtor's gambling habit. In deeming the debt non-dischargeable, the court confronted a common defense in such cases: the subjective hope a debtor's luck would turn. The court's comments are memorable:

> Debtors in the credit card/gambling cases have, about unanimously, offered the following: "I believed I was going to pay the money back because I believed, albeit unreasonably (debtor's lawyer intelligent enough to throw the bait, hoping the judge involved will bite at the intelligent-sounding objective/subjective discussion—how does it go? "We find the debtor, however, unreasonably, believed she was going to win at gambling. Therefore, because of the subjective intention we are after, ... the debtor intended to pay back.") ***312** ... Of course, only the most self-destructive person would go a-gambling hoping or believing they were going to lose. Hello? Don't all people (except this distressed few) who gamble believe they are going to win, or, at least break even? Or, put another way, will any bankruptcy judge ever hear the following testimony: "I knew there was no way I was going to win, and I do not believe myself to be overly self-destructive; I simply enjoyed going to the casino (video poker establishment, racetrack, gambling boat, etc.) because they, during certain hours, give you free drinks and food, and I like the flashing bright lights—besides, I feel important when the valet parks my car." Answer, No. We will never see it. So where do the courts, who stop asking themselves what to do when the debtor testifies that he believed he was going to win, go wrong?
>
> It appears to us that they go wrong by failing to consider the following line of inquiry. Q. Had you ever won before (over what you borrowed or came with)? A. Yes. Q. What did you do with your money? A. (1) put it back up to try to double it; (2) took it home and saved it until next time; (3) counted it, set it aside, and gambled only a small portion of it while applying the remainder of my winnings to the creditor from whom I borrowed the money. If the answer is (1), the follow-up inquiry is "Did you win more, keep what you had won, lose what you had won, or lose more than you had won?" A. (1) I won more (then we are back to the aforementioned questions); A. (2) I kept what I had won (again, back to the aforementioned questions); A. (3) I lost what I had won (which generates the aforementioned questions regarding the use to which he was to put the amount that constituted the break-even money); A. (4) I lost more than I had won (which generates the follow-up—where did you get the money that you had to bet with after your losses exceeded your winnings?). All of this is a long way of suggesting that before a court believes a debtor who claims to have had a plan to win and use the winnings to pay back the amount borrowed, shouldn't there be evidence—if the debtor ever had won (and what debtor hasn't)—that winnings had been used before? In other words, don't we know that we do not have to believe what witnesses say they believed and hoped just because they say so?

The outcome in *In re Melancon* is largely a result of the court's position that a credit card company has no duty to investigate the credit worthiness of a customer in order to reasonably rely upon an implied representation that the debtor will repay the debt. Other courts, however, have held in favor of the gambler for precisely this reason. In In re Reynolds, 221 B.R. 828 (Bankr. N.D. Ala. 1998), for example, the court held that the debtor's reckless disregard respecting their ability to repay cash advances used for gambling established the requisite intent for the debt to be determined non-dischargeable as having been procured by false pretenses. The credit card

company's complete lack of investigation, however, rendered any reliance on its part unreasonable. Judgment was entered for the debtors.

Other courts continue to accept the "subjective intent to repay" test so criticized in *In re Melancon*. Their reasoning, however, may be no less compelling (and involve far less moralizing). In In re Scocozzo, 220 B.R. 850 (Bankr. M.D. Pa. 1998), the court held that the credit card company had failed to establish that a cash advance had been procured by false pretenses, ***313** false representation or actual fraud, simply by proving that the only source of repayment was gambling winnings. According to the court, "[The debtor's] gambling created a large and needless financial obligation. Rarely, however, are the bills of debtors limited to expenditures for necessities. The fact remains that gambling has been largely legitimized and currently represents no greater a lack of frugality than many other examples of contemporary lifestyle. If Congress wishes to shut the door on the dischargeability of debts of this nature, they are quite able to articulate the language to accomplish that objective." [FN38]

C. Chapter 7 Trustee v. Casino

One would imagine that question of whether a debt to a casino is avoidable as a fraudulent transfer would have been resolved years ago. Nonetheless, Chapter 7 trustees continue to pursue actions against casinos seeking to recover gambling losses, arguing that the debtor did not receive reasonably equivalent value for the debt incurred. For instance, in In re Armstrong, 231 B.R. 739 (Bankr. E.D. Ark. 1999), judgment vacated, 259 B.R. 338 (E.D. Ark. 2001), a Chapter 7 trustee sued Harrah's casino in Shreveport, Louisiana, seeking to recover $377,000.00 in gambling losses over the one-year period prior to the debtor's bankruptcy. The trustee argued (and the bankruptcy court found) that the debtor knew that the debts he incurred to Harrah's would "hinder, delay or defraud" numerous other creditors, including victims of a Ponzi scheme. The trustee did not prevail, however, ***314** on either his actual or constructive fraudulent conveyance claims. The actual fraudulent conveyance claim failed because the casino successfully demonstrated that it gave value for the transfer and had acted in good faith. The constructive fraudulent conveyance claim failed because the court concluded that by permitting a wager (regardless of the likelihood of a positive outcome), the casino had provided reasonably equivalent value. On appeal, however, the District Court found that the casino did not act in good faith when it extended credit to the debtor, and thus was not protected by the "good faith transferee for value" defense to the trustee's fraudulent transfer claim; the casino did not engage in a diligent inquiry regarding the debtor's assets, liabilities, and income before initially extending credit and subsequently increasing the debtor's credit limit, and the casino became aware of circumstances placing it on inquiry notice of the debtor's potential insolvency within the relatively short span of time after approving the debtor's credit application.

The Harrah's casino in Robinsonville, Mississippi, fared no better against the Armstrong trustee than did its cousin in the Bayou State, albeit losing on a different theory. In In re Armstrong, 231 B.R. 723 (Bankr. E. D. Ark. 1999), aff'd, 2001 WL 332920 (E. D. Ark., Mar. 30, 2001), the debtor signed 26 markers totalling $50,000, which his bank honored approximately thirty days later. The debtor was placed into involuntary bankruptcy within the 90-day preference period. The trustee sued Harrah's to recover the payments made on the markers as preferential. The bankruptcy court agreed, rejecting the Casino's new value and ordinary course of business defenses.

VII. CONCLUSION

Many unique issues are raised in Casino bankruptcy cases due to their highly regulated nature. Although Casino cases tend to be fact-specific, we hope that the above provides insight into some of the issues presented in Casino bankruptcies.

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[FN1]. Another article that explores many of the same issues is John M. Czarnetzky, *When the Dealer Goes Bust: Issues in Casino Bankruptcies*, 18 Miss. C.L. Rev. 459 (1998).

[FN2]. 11 U.S.C. § 507(a)(6).

[FN3]. In re U.S. Metalsource Corp., 163 B.R. 260, 266, 25 Bankr. Ct. Dec. (CRR) 215, 28 Fed. R. Serv. 3d 854 (Bankr. W.D. Pa. 1993).

[FN4]. *See* In re Revco D.S., Inc., 91 B.R. 777 (Bankr. N.D. Ohio 1988).

[FN5]. There are, of course, other types of gaming properties besides the traditional Las Vegas style casino. Riverboat gaming has become popular throughout much of the Midwest and along the Gulf Coast and occasionally presents conflicts (or at least an interesting convergence) of state gaming and federal bankruptcy and admiralty law. Some of these issues are addressed below. Other types of gaming of include horse and greyhound racing, jai alai, and bingo. (As state-sponsored programs, lotteries are unlike other forms of gaming.) Each type of gaming will naturally present unique issues in bankruptcy. Many of the regulatory issues that are likely to be encountered in a bankruptcy involving a horse or dog racetrack, a jai alai facility or bingo hall, however, are likely to parallel those encountered in a traditional casino. Moreover, cases involving traditional casinos are more common than cases involving other forms of gaming. For these reasons, this article will focus primarily on the traditional casino.

[FN6]. Regulatory schemes obviously vary by locality. The State of Nevada, however, has the longest history of legalized gaming and has established the most comprehensive regulations respecting gaming activities. Because Nevada law frequently serves as a basis for gaming regulation in other states, general discussions of gaming law are based upon Nevada law. Emerging gaming jurisdictions often have a more ambiguous legislative policy towards gaming issues. Louisiana law will be cited to illustrate a non-Nevada approach.

[FN7]. Though gaming licensed Casinos may be owned and operate by individuals, limited liability companies, partnerships and trusts, for ease of this overview, the discussion is limited to corporations.

[FN8]. This common structure, dictated at least in part by gaming concerns, may have a significant impact upon both case administration and claims litigation. For instance, in In re Elsinore Corp., 228 B.R. 731, 33 Bankr. Ct. Dec. (CRR) 850, 41 Collier Bankr. Cas. 2d (MB) 321 (Bankr. 9th Cir. 1998), the appellate panel upheld a determination by the bankruptcy court that workers at the Atlantis Hotel & Casino in New Jersey were not entitled to priority treatment under Section 507(a)(3) for wages earned within 90 days of the cessation of business at the Atlantis. The wage claimants were employed at the parent/holding company level, and the parent corporation

had not ceased doing business as a holding company.

[FN9]. See La. R.S. § 27:236(C).

[FN10]. See also La. R.S. § 27:236(D).

[FN11]. See La. R.S. §§ 27:236 and 277.

[FN12]. See La. R.S. § 27:271.

[FN13]. See La. R.S. §§ 27:233-236.

[FN14]. La. R.S. § 27:236(E).

[FN15]. There are certain exceptions to the requirement that shareholders obtain findings of suitability. For instance, under Nevada law an "institutional investor," which acquires more than ten percent (10%), but not more than fifteen percent (15%) of the registered company's voting securities may apply to Gaming Authorities for a waiver of a finding of suitability if such institutional investor holds the voting securities for investment purposes only. See also La. Admin. Code § 42:1X.2143. Activities which are not deemed to be inconsistent with holding voting securities for investment purposes only include: (1) voting on all matters voted on by stockholders; (2) making financial and other inquiries of management of the type normally made by securities analysts for informational purposes and not to cause a change in its management, policies or operations; and (3) such other activities as Gaming Authorities may determine to be consistent with such investment intent.

[FN16]. See also La. Admin. Code §§ 42:1X.2145 and 2147.

[FN17]. Gaming devices, regardless of type (i.e. video poker, video blackjack, or traditional slot machines) are generally referred to as "slots". Businesses that provide gaming machines to numerous businesses are known as "slot route operators". See also La. R.S. § 27:301 *et seq*. re: video draw poker devices.

[FN18]. However, In re S & J Holding Corp., 42 B.R. 249, 39 U.C.C. Rep. Serv. 668 (Bankr. S.D. Fla. 1984), held that money from video arcade machines was not proceeds, was not subject to a filing-perfected security interest in proceeds and, therefore, was not subject to a prepetition security interest in the machines and their proceeds.

[FN19]. See also La. R.S. § 27:275 *et seq*.

[FN20]. 46 U.S.C. § 31321

[FN21]. Estate of Rhyner v. Farm Credit Bank of Spokane, 780 P.2d 1001, 1005, 1990 A.M.C. 1185 (Alaska 1989); U. S. v. F/V Golden Dawn, 222 F. Supp. 186 (E.D.N.Y. 1963) *quoted in*, First National Bank Trust Company of Escanaba v. Oil Screw Olive L. Moore, Barge Wiltranco I, 521 F.2d 1401 (6th Cir. 1975).

[FN22]. See La. R.S. § 10:9-101 *et seq*.

[FN23]. Pavone v. Mississippi Riverboat Amusement Corp., 52 F.3d 560, 1995 A.M.C. 2038, 32 Fed. R. Serv. 3d 271 (5th Cir. 1995); King v. Grand Casinos of Mississippi, Incorporated-Gulfport, 697 So. 2d 439 (Miss. 1997); *accord* Chase v. Louisiana Riverboat Gaming Partnership, 709 So. 2d 904 (La. Ct. App. 2d Cir. 1998), writ denied, 719 So. 2d 1057 (La. 1998).

[FN24]. In re Biloxi Casino Belle Inc., 176 B.R. 427, 435 (Bankr. S.D. Miss. 1995).

[FN25]. See La. R.S. § 27:65(B).

[FN26]. See Kathy Benetrix v. Louisiana Riverboat Gaming Partnership, d/b/a Isle of Capri Casino, 1995 WL 867854 (W.D. La. 1995).

[FN27]. There is also authority which supports the conclusion that Section 525 of the Bankruptcy Code prohibits a state from revoking a debtor's self-insured certificate, under a state's applicable workers' compensation act. *See* In re Rath Packing Co., 35 B.R. 615, 11 Bankr. Ct. Dec. (CRR) 595, 9 Collier Bankr. Cas. 2d (MB) 1295 (Bankr. N.D. Iowa 1983) (Iowa State Insurance Commissioner's revocation of debtor's self-insured status violated 11 U.S.C. § 525); *accord*, In re Hillcrest Foods, Inc., 10 B.R. 579, 7 Bankr. Ct. Dec. (CRR) 735, Bankr. L. Rep. (CCH) ¶ 67999 (Bankr. D. Me. 1981) (the suspension of debtor's status as self-insurer under Maine Workers' Compensation Act may be a violation of 11 U.S.C. § 525); *see also* In re Blue Diamond Coal Co., 145 B.R. 895 (Bankr. E.D. Tenn. 1992) (Tennessee Workers' Compensation Board motion to dismiss adversary complaint by debtors alleging improper revocation of debtor's certificate of self-insurance denied, because such action by Board may constitute a violation of 11 U.S.C. § 525).

[FN28]. For instance, in Carnival Leisure Industries, Ltd. v. Aubin, 53 F.3d 716 (5th Cir. 1995), the Court of Appeals held that an unpaid gambling debt arising in the Bahamas, previously held to be unenforceable as against Texas public policy, could not be used to support action for fraud against gambler who was extended credit by casino). Inevitably, similar facts will arise in the context of a claims proceeding.

[FN29]. For an excellent discussion of *Seminole Tribe, Young* and the other sovereign immunity issues, see 2 *Collier on Bankruptcy* ch. 106 (15th ed. rev. 2000).

[FN30]. In re Innes, 184 F.3d 1275, 1281, 34 Bankr. Ct. Dec. (CRR) 1143, 42 Collier Bankr. Cas. 2d (MB) 857, 137 Ed. Law Rep. 185, Bankr. L. Rep. (CCH) ¶ 77976 (10th Cir. 1999), cert. denied, 529 U.S. 1037, 120 S. Ct. 1530, 146 L. Ed. 2d 345 (2000).

[FN31]. The Supreme Court has said as much: College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 119 S. Ct. 2219, 2230-31, 144 L. Ed. 2d 605, 135 Ed. Law Rep. 362, 51 U.S.P.Q.2d (BNA) 1065 (1999).

[FN32]. In re Rose, 187 F.3d 926, 930, 34 Bankr. Ct. Dec. (CRR) 1046, 42 Collier Bankr. Cas. 2d (MB) 899, 137 Ed. Law Rep. 885, Bankr. L. Rep. (CCH) ¶ 77977 (8th Cir. 1999) (and cases cited therein); *accord* In re MCA Financial Corp., 237 B.R. 338, 342, 42 Collier Bankr. Cas. 2d (MB) 1193 (Bankr. E.D. Mich. 1999) (motion for relief from stay).

[FN33]. In re Collins, 173 F.3d 924, 930, 34 Bankr. Ct. Dec. (CRR) 211, Bankr. L. Rep. (CCH) ¶ 77917 (4th Cir. 1999), cert. denied, 528 U.S. 1079, 120 S. Ct. 785, 145 L. Ed. 2d 663 (2000); *accord* In re Phelps, 237 B.R. 527, 533-34 (Bankr. D.R.I. 1999).

[FN34]. In re International Heritage, Inc., 239 B.R. 306, 310-11, 35 Bankr. Ct. Dec. (CRR) 59, 42 Collier Bankr. Cas. 2d (MB) 1986, Blue Sky L. Rep. (CCH) ¶ 74193 (Bankr. E.D.N.C. 1999).

[FN35]. In re National Cattle Congress, 247 B.R. 259, 35 Bankr. Ct. Dec. (CRR) 251, 43 Collier Bankr. Cas. 2d (MB) 1685 (Bankr. N.D. Iowa 2000).

[FN36]. Because most bankruptcy cases involve debtors with "no-asset" estates, the battleground revolves around non-dischargeability. Whether a gaming debt is an allowable claim is, of course, an issue of applicable state law.

[FN37]. There are, of course, numerous other examples of casinos succeeding in claims litigation against gambling customers. *See, e.g.*, Matter of Wegener, 186 B.R. 692, 27 U.C.C. Rep. Serv. 2d 923 (Bankr. D. Neb. 1995) (bankruptcy court rejected argument that keno operator's employee's debt for unpaid keno tickets was unenforceable based upon purported public policy prohibiting employee of gaming company to participate in employer's game). Gambling debts may also be relevant in a confirmation setting. *See* In re Famisaran, 224 B.R. 886 (Bankr. N.D. Ill. 1998) (denying confirmation of Chapter 13 plan based, in part, on debtor's expenditures at local casino).

[FN38]. *In re Melancon* is one of the very few cases in which a court has sided with a credit card company. The overwhelming majority of cases in the last few years have held in favor of the debtor. *See* In re Cron, 241 B.R. 1 (Bankr. S.D. Iowa 1999) (Chapter 7 debtors who had obtained cash advances for gambling 60 days prior to bankruptcy successfully rebutted presumption of non-dischargeability where she and her co-debtor husband were both employed and not hopelessly insolvent, had earmarked winnings for repayment of debt, and had repaid previous cash advances; debtors' bankruptcy had been necessitated by unforeseen change of circumstances resulting from loss of job); In re McLeroy, 237 B.R. 901 (Bankr. N.D. Miss. 1999) ($9,000.00 Cash advance was dischargeable where debtor testified that she intended to repay issuer, had history of making payments, paid $1,250.00 towards debt, and had not consulted with bankruptcy attorney until several months later.); In re Stearns, 241 B.R. 611, 35 Bankr. Ct. Dec. (CRR) 311 (Bankr. D. Minn. 1999) (Credit card company failed to demonstrate actual reliance upon implied representation of debtor regarding ability re repay debt and failed to show that debtor's belief that she could repay cash advance from gambling "big win" was not genuine); In re Kong, 239 B.R. 815, 35 Bankr. Ct. Dec. (CRR) 1, Bankr. L. Rep. (CCH) ¶ 78017 (Bankr. 9th Cir. 1999) (Finding that debtor lacked fraudulent intent was not clearly erroneous, even though debtor made no attempt to repay cash advance for gambling and consulted with bankruptcy attorney 2 or 3 days after loss; debtor had prior history of success at gambling and had previously paid back cash advances.); and Rembert v. Citibank South Dakota, N.A., 219 B.R. 763 (E.D. Mich. 1996), aff'd, 141 F.3d 277, 32 Bankr. Ct. Dec. (CRR) 531, Bankr. L. Rep. (CCH) ¶ 77666, 1998 FED App. 106P (6th Cir. 1998) (Reversing judgment holding cash advance for gambling non-dischargeable where evidence was undisputed that the debtor subjectively believed that she would win sufficient funds to repay debt.).

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Riverboat Casinos and Tribal Sovereignty Issues in Gaming Bankruptcy Cases

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The following is an update of the **Riverboat Casinos** and **Tribal Sovereignty** issues first addressed by Mr. Cerone in the article *Bankruptcy Trends in the Gaming Field,* 10 J. BANKR. L. & PRAC. 293 (May/June 2001) (copy attached).

IV. BANKRUPTCY OPERATING ISSUES UNIQUE TO GAMING CASES

A. Security Interests in Casino Revenues and Gaming Devices

*Pages 302-03, delete the entire section "**3. Riverboats**" and replace with the following:*

3. Riverboat Casinos

Riverboat gaming operations also implicate federal law governing the perfection of a security interest in a vessel. Section 31321 of the Ship Mortgage Act[1] requires that a conveyance, mortgage or related instrument, including any part of a documented vessel or a vessel for which the application for documentation is filed, be filed with the Secretary of Transportation in order to be valid against any persons except the grantor or a person having actual notice of the security instrument. The statute further provides that each conveyance, mortgage or related instrument that is filed in substantial compliance with § 31321 is valid against any person from the time it is filed with the Secretary. A preferred ship mortgage attaches to the vessel and all the equipment and appurtenances on board owned by the vessel's owner.[2]

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[1] The Ship Mortgage Act is essentially codified and amended in 46 U.S.C. § 31301, *et. seq.*, titled "Commercial Instruments and Maritime Liens." Ship mortgage filings are made with the United States Coast Guard's National Vessel Documentation Center in Falling Waters, West Virginia.

[2] *Estate of Rhyner v. Farm Credit Bank of Spokane*, 780 P.2d 1001, 1005 (Alaska 1989); *U.S. v. F/V Golden Dawn*, 222 F.Supp. 186 (E.D. N.Y. 1963) *quoted in, First Nat. Bank & Trust Co. v. Oil Screw Olive L. Moore Barge Wiltranco I*, 521 F.2d 1401 (6th Cir. 1975).

In the event that the vessel is not a documented vessel as defined at 46 U.S.C. § 12101, *et seq*., it is necessary to look to the applicable state law where the vessel is titled to determine the perfection of the security interest in the vessel and the equipment and appurtenances on board. Under state law, perfection is governed by the Uniform Commercial Code.[3]

Where casinos are not "vessels," the courts have found that the documentation filed by a lender, purportedly to perfect a ship mortgage under federal law, was invalid and, therefore, the lender did not possess a valid first ranking security interest enforceable in the bankruptcy case.[4]

Conversely, if the casino is required to sail in order to conduct gaming operations[5] or is otherwise considered to be a "vessel" under federal law,[6] security interests therein would be governed by the Ship Mortgage Act, which would preempt any conflicting state security interest statutes and invalidate any existing security interests recorded under the state law.[7] In sum, "when an application for documentation for a vessel is filed with the Coast Guard in substantial compliance with the statute and regulations, the vessel drops out of the perfection regime of article 9. In fact, when the application for documentation is filed, previously perfected security interests under article 9 become unperfected."[8] As such, the classification of a riverboat casino as a vessel or non-vessel under federal law can have a substantial effect on the perfection and priority of a creditor's security interests in that casino.

Classification of moored, dockside casinos has been the subject of much discussion by the courts. In 1995, the early days of Mississippi's dockside casinos, the Fifth Circuit in *Pavone v. Miss. Riverboat Amusement Corp*. held that casinos built on indefinitely moored barges did not constitute "vessels" for purposes of federal admiralty and maritime matters.[9] In the case of these Mississippi casinos, ordinary barges were converted into floating dockside casinos. The casinos were not designed, intended nor capable of being used as a means of water transportation. The casinos were not equipped with standard marine equipment but, instead, were permanently moored and positioned in non-navigable waterways.

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[3] See La. R.S. § 10:9-101 *et seq*.

[4] *In re Biloxi Casino Belle, Inc*., 176 B.R. 427, 435 (Bankr. S.D. Miss. 1995); *Matter of Treasure Bay Corp*., 205 B.R. 490, 497 (Bankr. S.D. Miss. 1997).

[5] *See* La. R.S. § 27:65(B).

[6] *Credit Suisse First Boston Mortgage Capital LLC v. DORIS*, 102 F. Supp. 2d 709, 713 (N.D. Miss. 2000).

[7] *See Benetix v. Riverboat Gaming Partnership*, 1995 WL 867854 (W.D. La., Nov. 7, 1995).

[8] Bruce A. King, *Ships As Property: Maritime Transactions in State and Federal Law*, 79 TUL. L. REV. 1259, 1277 (2005).

[9] *Pavone v. Miss. Riverboat Amusement Corp*., 52 F.3d 560 (5th Cir. 1995); *King v. Grand Casino of Miss. Inc. - Gulfport*, 697 So.2d 439 (Miss. 1997); *accord Chase v La. Riverboat Gaming*, 709 So. 2d 904 (La. App.), *writ den*., 719 So.2d 1057 (La. 1988).

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The Supreme Court has altered the test for determining if something is a vessel for the purposes of maritime law through its decision in *Stewart v. Dutra Constr. Co.*, which seemingly expanded the definition of "vessel" to include anything that is practically capable of sailing, whether or not it was intended to sail or sailing was its primary purpose.[10] Such language was given a broad interpretation by some courts, which read *Stewart* as implementing an "anything that floats" approach to defining "vessel."[11]

Despite the seemingly broad language of *Stewart*, the Fifth Circuit re-affirmed its *Pavone* holding that "indefinitely moored" barge-based casinos are not "vessels."[12] In contrast, the Seventh Circuit drew a distinction between "indefinitely moored" and "permanently moored" barges, finding that for a barge to cease being a vessel, it must be permanently incapacitated from sailing, becoming the equivalent of landfill.[13] Additionally, the Eleventh Circuit adopted perhaps the broadest interpretation, holding that a barge must be rendered "practically incapable of transportation or movement" over water at the time vessel is moored in order to avoid "vessel" status.[14]

Partially out of concern for the "anything that floats" interpretation of *Stewart*, the Supreme Court again altered the "vessel" test in *Lozman v. City of Riviera Beach*, where the Court implemented a four-part test, which considers whether a (1) reasonable observer (2) looking at the physical characteristics and activities of the structure determines that (3) the structure was designed to a practical degree for the (4) transportation on water of things or people.[15]

While the Court's stated intention in *Lozman* was to narrow the *Stewart* test, in practice, its impact is still uncertain and particularly so in the realm of riverboat casinos. That uncertainty perhaps is illustrated best by a series of cases in Louisiana state court pre- and post-*Lozman*. Prior to *Lozman*, Louisiana state courts had largely adopted the Fifth Circuit's rational in *De La*

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[10] 543 U.S. 481, 490 (2005).

[11] *See Lozman v. City of Riviera Beach, Fla.*, 133 S. Ct. 735, 743, 184 L. Ed. 2d 604 (2013).

[12] *De La Rosa v. St. Charles Gaming Co.*, 474 F.3d 185, 187 (5th Cir. 2006); *see also In re Complaint of Am. Milling Co., Unlimited*, 2008 WL 2727257, at *6 (E.D. Mo. July 10, 2008) (finding that where the "entire physical construction" of a once-vessel had been "modified to carry out its sole purpose as an indefinitely moored floating casino" it was no longer a "vessel").

[13] *Tagliere v. Harrah's Illinois Corp.*, 445 F.3d 1012, 1016 (7th Cir. 2006); *but see Howard v. S. Illinois Riverboat Casino Cruises, Inc.*, 364 F.3d 854, 858 (7th Cir. 2004) (holding that an "indefinitely" moored casino was not a vessel under *Stewart*).

[14] *Bd. of Comm'rs of Orleans Levee Dist. v. M/V BELLE OF ORLEANS*, 535 F.3d 1299, 1312 (11th Cir. 2008) *abrogated by Lozman v. City of Riviera Beach, Fla.*, 133 S. Ct. 735, 184 L. Ed. 2d 604 (2013); see also *Luckhart v. S. Ill. Riverboat/ Casino Cruises, Inc.*, 2010 WL 2137451, at *5 (S.D. Ill. 2010).

[15] 133 S.Ct. 735, 741 (2013). For a more comprehensive analysis of the evolution of the "vessel" definition up to and since *Lozman*, see Stewart F. Peck and David B. Sharpe, *What Is A Vessel?: Implications for Marine Finance, Marine Insurance, and Admiralty Jurisdiction*, 89 TUL. L. REV. 1103, 1104 (2015).

Rosa to find that indefinitely moored casinos were not vessels.[16] Further, Louisiana courts noted that Louisiana's gaming statute actually prohibited riverboat casinos from engaging in excursions or cruises unless they were specifically licensed to do so.[17] Therefore, riverboats that were licensed to operate only as moored casinos were considered non-vessels almost as a matter of Louisiana law.[18]

However, Louisiana's seemingly well-settled precedent was potentially disrupted when the United States Supreme Court, on the same day it issued the *Lozman* opinion, vacated the judgment in *Lemelle v. St. Charles Gaming Co*. *Lemelle* was an opinion of the Louisiana Court of Appeals for the Third Circuit wherein the court relied on *De La Rosa* and Louisiana statutes to find that a riverboat casino was not a vessel.[19] Further, the riverboat casino in *Lemelle* was the exact same casino that had been at issue, and declared a non-vessel, by the U.S. Fifth Circuit in *De La Rosa* and previously by the Louisiana Third Circuit in *Breaux v. St. Charles Gaming Co*.[20] By vacating *Lemelle* and remanding the case for further consideration under the *Lozman* standard, the U.S. Supreme Court seemed to indicate that *Lozman* had altered the status quo in Louisiana (and perhaps the U.S. Fifth Circuit) in such a way that some previously non-vessel casino riverboats now might be considered vessels under the new four-part test.[21]

Therefore, as the definition of "vessel" continues to evolve and the courts begin to interpret *Lozman*'s four-part test, this shifting area of law could threaten seriously to undercut the perfection and priority of existing and future security interests in riverboat casinos.

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V. FEDERALISM CONCERNS

C. Sovereign Immunity

Page 310, insert a new section as follows:

[16] *See Breaux v. St. Charles Gaming Co*., 2010-1349 (La. App. 3 Cir. 6/22/11), 68 So. 3d 684, 687 writ denied, 2011-1661 (La. 10/7/11), 71 So. 3d 322 (citing *De La Rosa v. St. Charles Gaming Co*., 474 F.3d 185, 187 (5th Cir. 2006)).

[17] *Id*. (citing La. Rev. Stat. Ann. 27:65(c)); *see also Bourgeois v. Boomtown, L.L.C*., 09-243 (La. App. 5 Cir. 5/21/09) (La. Ct. App. May 21, 2009) *writ denied sub nom. Bourgeois v. Boomtown, L.L.C. of Delaware*, 2009-1357 (La. 9/25/09), 18 So. 3d 68.

[18] *Breaux*, 68 So. 3d at 687.

[19] *Lemelle v. St. Charles Gaming Co., Inc*., 2011-255 (La. App. 3 Cir. 1/4/12), 118 So. 3d 1, 5 *writ denied sub nom. Lemelle v. St. Charles Gaming Co*., 2012-0339 (La. 4/27/12), 86 So. 3d 627 and *cert. granted, judgment vacated sub nom. Lemelle v. St. Charles Gaming Co*., 133 S. Ct. 979, 184 L. Ed. 2d 759 (2013).

[20] *Id*. at 5.

[21] *Lemelle* later settled and was never heard on remand, adding to the uncertainty over *Lozman*'s true impact on Louisiana and U.S. Fifth Circuit precedent.

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4. Tribal Sovereignty and the Bankruptcy Code

Native American Tribes are important players in the gaming industry and their special status as sovereigns can raise a host of complicated issues, including the interplay between sovereign immunity and the Bankruptcy Code and questions as to whether a tribe's immunity extends to commercial arms of the tribal governments, including tribal gaming corporations. Further, there is ongoing uncertainty as to whether the same factors that provide tribes with immunity from the Bankruptcy Code also prohibit tribes and tribal entities from seeking bankruptcy protection.

Section 106 provides a Congressional waiver of sovereign immunity of all "governmental units" with respect to virtually every substantive provision of the Bankruptcy Code (60 sections in all).[22] Through Section 106, Congress granted bankruptcy courts the power to enter money judgments against and to enforce *any* order, process or judgment against *any* governmental unit under applicable non-bankruptcy law.

While the Constitutionality of Section 106's reach was seemingly threatened by the Supreme Court's language in *Seminole Tribe of Florida v. Florida, et al.*, the Court since has reversed course and re-affirmed that the waiver provision in Section 106 was a valid exercise of Congress's authority under the Bankruptcy Clause of the Constitution.[23] Thus, the question of whether Section 106 acts as a valid waiver of a state's sovereign immunity seems to be settled, for the moment.

However, uncertainty still remains as to the application of Section 106 to tribal entities, which are defined as "domestic dependent nations" with "inherent sovereign authority" that is distinct from the immunity granted to states.[24] Rather than flowing from the 11th Amendment, tribal sovereign immunity is a common law doctrine that governs unless and until Congress takes action that expresses a "clear" and "unequivocal" intent to limit or otherwise abrogate that immunity.[25]

For the Bankruptcy Code, the question then becomes one of statutory interpretation—does the "all governmental units" language in Section 106 express Congress's clear and unequivocal intent to abrogate tribal sovereign immunity? To determine the intent behind "governmental units," courts look to Section 101(27), which defines "governmental unit" as "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States, a State, a Commonwealth, a District,

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[22] 11 U.S.C.A. § 106 (West).

[23] *Cent. Virginia Cmty. Coll. v. Katz*, 546 U.S. 356, 378 (2006).

[24] *Michigan v. Bay Mills Indian Cmty.*, 134 S. Ct. 2024, 2027 (2014).

[25] *C & L Enterprises, Inc. v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 532 U.S. 411, 418, 121 S. Ct. 1589, 1594, 149 L. Ed. 2d 623 (2001); *see also In re Mayes*, 294 B.R. 145, 149 (B.A.P. 10th Cir. 2003) (discussing the distinction between states' 11th Amendment immunity and tribes' common law immunity).

a Territory, a municipality, or a foreign state; or other foreign or domestic government."[26] On this question, the courts are split.

Despite the inclusive language of the "governmental units" definition, some courts have found that Section 101, and by extension Section 106, does not sufficiently express Congress's "clear and unequivocal" intent to abrogate tribal immunity, because neither of the statutory provisions expressly identify tribal governments by name. [27] Even though tribal governments logically might be included under the broad wording of "domestic government," such an inclusive interpretation does not satisfy the special "unequivocal" standard for Congressional actions to abrogate tribal immunity. Under such an interpretation, tribes fall into an uncertain territory where they are neither foreign governments nor domestic governments, but a unique no-man's land that is beyond the reach of the Bankruptcy Code.

Alternatively, several courts have read the "other foreign or domestic government" wording of Section 101(27) as a purposeful catch-all term that clearly expresses Congress's intent that "government unit" be interpreted as all-encompassing for the purposes of the sovereign immunity waiver.[28] In the most prominent such case, the Ninth Circuit reasoned that:

> Had Congress simply stated, "sovereign immunity is abrogated as to all parties who otherwise could claim sovereign immunity," there can be no doubt that Indian tribes, as parties who could otherwise claim sovereign immunity, would no longer be able to do so. Similarly here, Congress explicitly abrogated the immunity of *any* "foreign or domestic government." Indian tribes are domestic governments." Therefore, Congress expressly abrogated the immunity of Indian tribes.[29]

Further complicating matters is the question of whether and to what extent tribal corporations fit under the tribal sovereign immunity doctrine. Generally, tribal sovereign immunity extends its protection to divisions of the tribal government. That extension also may apply to commercial entities related to the tribe, so that even when a bankruptcy court is dealing with a corporation, rather than directly with the sovereign tribe, the Bankruptcy Code's reach may be limited or non-existent due to sovereign immunity.[30] In fact, the Supreme Court has explicitly held that tribal sovereign immunity includes immunity from suits or actions arising

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[26] 11 U.S.C.A. § 101(27) (West).

[27] *See In re Whitaker*, 474 B.R. 687, 695 (B.A.P. 8th Cir. 2012); *In re Greektown Holdings, LLC*, No. 14-14103, 2015 WL 3632202, at *8 (E.D. Mich. June 9, 2015); see also *In re Mayes*, 294 B.R. 145, 149 (B.A.P. 10th Cir. 2003) (holding that an avoidance motion against a tribe was barred by sovereign immunity, but not engaging in an in-depth interpretation of Section 106 or 101's definition of "government unit").

[28] *See Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055, 1057 (9th Cir. 2004); *In re Platinum Oil Properties, LLC*, 465 B.R. 621, 643 (Bankr. D.N.M. 2011).

[29] *Krystal Energy Co.*, 357 F.3d at 1058.

[30] *In re Whitaker*, 474 B.R. 687, 697 (B.A.P. 8th Cir. 2012).

from a tribe's, or a tribal entity's, commercial activities—including commercial activities that take place outside of tribal lands.[31]

As support for the extension of immunity, courts often cite to the principal that "the immunity of [a casino] directly protects the Tribe's treasury, which is one of the historic purposes of sovereign immunity in general."[32] As stated by the Ninth Circuit, "the question is not whether the activity may be characterized as a business . . . but whether the entity acts as an arm of the tribe so that its activities are properly deemed to be those of the tribe."[33] Therefore, if a gaming corporation is tied sufficiently to the tribal government, it may be protected under tribal immunity.

To evaluate the closeness of the tribe-tribal entity relationship, courts look primarily to the Tenth Circuit's *Chuckansi* factors: (1) the method of creation of the entity; (2) the entity's purpose; (3) the entity's structure, ownership and management, including the level of tribal control; (4) the tribes intent regarding whether the entity should share in the tribe's immunity; (5) the financial relationship between the tribe and the entity; and (6) the underlying policy concerns regarding tribal economic development.[34] However, at least one court has found that the creation and operation of tribal casinos under the Indian Gaming Regulatory Act are such that tribal casinos are *de facto* arms of the tribal government sufficient to satisfy the *Chuckansi* factors, qualifying them for tribal immunity.[35]

As a practical matter, individuals and entities dealing directly with tribes and tribal corporations can protect themselves through the inclusion of immunity waivers as part of their contract agreements.[36] However, contractual waivers offer only limited relief in the context of a bankruptcy proceeding, as is illustrated in perhaps the most recent case to take up the issue—*In re Greektown Holdings, LLC*. There the tribal entity was not the primary debtor, but the recipient of an alleged fraudulent transfer from the debtor.[37] When the trustee brought an

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[31] *Michigan v. Bay Mills Indian Cmty.*, 134 S. Ct. 2024, 2031 (2014) (citing *Kiowa Tribe of Oklahoma v. Mfg. Technologies, Inc.*, 523 U.S. 751, 760, (1998)).

[32] *Mastro v. Seminole Tribe of Florida*, 2013 WL 3350567, at *5 (M.D. Fla. July 2, 2013) *aff'd*, 578 F. App'x 801 (11th Cir. 2014) (quoting *Allen v. Gold Country Casino*, 464 F.3d 1044, 1047 (9th Cir. 2006)). Additionally, courts may also utilize a similar set of factors established by the Ninth Circuit in *Donovan v. Coeur D'Alene Tribal Farm*, 751 F.2d 1113, 116 (9th Cir. 1985).

[33] *Allen v. Gold Country Casino*, 464 F.3d 1044, 1046 (9th Cir. 2006).

[34] *Breakthrough Mgmt. Grp., Inc. v. Chukchansi Gold Casino & Resort*, 629 F.3d 1173, 1181 (10th Cir. 2010).

[35] *Mastro v. Seminole Tribe of Florida*, 2013 WL 3350567, at *6. For a more in-depth analysis of this issue and an argument for why casinos should not be granted tribal immunity, *see* Emir Aly Crowne et. al., *Not Out of the (Fox)woods Yet: Indian Gaming and the Bankruptcy Code*, 2 UNLV GAMING L.J. 25 (2011).

[36] In fact, this is the method that was specifically prescribed by the Supreme Court in *Bay Mills*. *Bay Mills Indian Cmty.*, 134 S. Ct. at 2036.

[37] *In re Greektown Holdings, LLC*, 2015 WL 3632202, at *2 (E.D. Mich. June 9, 2015).

adversary proceeding against the tribe for avoidance and recovery of the transferred assets, the district court barred the proceeding based on the tribe's sovereign immunity.[38]

Therefore, until Congress clarifies its intent regarding tribes under the Section 106 waiver provision, or until the Supreme Court reverses its current *laissez-fare* approach to tribal matters, uncertainty as to the status of tribes, and particularly tribal casinos, within the context of the Bankruptcy Code is going to continue to be a source of confusion and litigation for debtors, creditors, courts and trustees.

Finally, the classification issues that potentially place tribes in the no-man's land as far as sovereign immunity also might serve to foreclose tribes and tribal entities from seeking protection under the Bankruptcy Code when they face insolvency.[39]

Section 109 of the Bankruptcy Code limits who can be a debtor for the purpose of seeking bankruptcy protection to persons or municipalities.[40] "Person" is defined as any "individual, partnership, and corporation."[41] Government units are specifically excluded from the Bankruptcy Code's definition of "person."[42] "Municipality" is defined as a political subdivision, public agency, or instrumentality of a State.[43]

Under the Section 109 limitations, therefore, a tribe itself cannot be a debtor under the Bankruptcy Code and, to date, no tribe has filed successfully for bankruptcy protection.[44] Even in court opinions that find that tribal immunity is not abrogated by Section 106, the courts have found that tribes, generally, fall under the classification of a "government unit," but that the general phrase is not sufficient to satisfy the heightened standard of specificity required for the abrogation of tribal sovereign immunity.[45] Because interpretation of a "debtor" under Section 109 does not involve a question of abrogation of immunity, that heightened standard and the need for specificity does not apply. Therefore, courts may find that tribes are "governmental units" for the purposes of exclusion from bankruptcy protection under Section 109, while

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[38] *Id*.

[39] For more in-depth analysis on this issue, *see* Blake F. Quackenbush, *Cross-Border Insolvency & the Eligibility of Indian Tribes to Use Chapter 15 of the Bankruptcy Code*, 29 T.M. COOLEY L. REV. 61, 64 (2012).

[40] 11 U.S.C.A. § 109(a) (West).

[41] 11 U.S.C.A. § 101(41) (West).

[42] *Id*.

[43] 11 U.S.C.A. § 101(52) (West).

[44] *But see* Blake F. Quackenbush, *Cross-Border Insolvency & the Eligibility of Indian Tribes to Use Chapter 15 of the Bankruptcy Code*, 29 T.M. COOLEY L. REV. 61, 64 (2012) (discussing a path by which tribes could conceivably utilize Chapter 15 of the Bankruptcy Code).

[45] *See In re Whitaker*, 474 B.R. 687, 695 (B.A.P. 8th Cir. 2012); *In re Greektown Holdings, LLC*, No. 14-14103, 2015 WL 3632202, at *8 (E.D. Mich. June 9, 2015).

simultaneously maintaining that tribes are not included in the definition of "governmental units" for the purposes of the immunity waiver in Section 106.

But, once again, the question becomes much more complicated when it concerns tribal entities such as gaming corporations. That question will come down to an interpretation of whether the tribal entity is sufficiently distinct from the tribal government—creating a double-edge result where tribal entities would have to shed the protection of sovereign immunity in exchange for the protection of the Bankruptcy Code. Additionally, as discussed by the Ninth Circuit in *Gold Country* and the Middle District of Florida in *Mastro*, the regulatory framework of tribal casinos creates a particularly close bond between the tribe and the casino entity such that any tribal casino would have a hard time escaping from the gravity of the tribal government and distinguishing itself as a distinct entity for the purposes of the Bankruptcy Code.[46]

To date, no binding judicial opinion has been issued regarding whether a tribal entity is eligible to be a debtor under the Bankruptcy Code.[47] Thusfar, the closest any court has come to addressing the issue came in the Bankruptcy Court for the Southern District of California heard the bankruptcy of the Santa Ysbal Resort and Casino, where a tribal casino argued that it was an "unincorporated entity" and, therefore, eligible as a debtor. Three parties in interest challenged the tribal casino's eligibility, but the bankruptcy court dismissed their challenge without a written opinion.[48]

[46] *Mastro v. Seminole Tribe of Florida*, 2013 WL 3350567, at *5 (M.D. Fla. July 2, 2013) *aff'd*, 578 F. App'x 801 (11th Cir. 2014) (quoting *Allen v. Gold Country Casino*, 464 F.3d 1044, 1047 (9th Cir. 2006)).

[47] *See* Ji Hun Kim & Christoper S. Koenig, *Rolling the Dice on Debtor Eligibility*, 34 A.B.I. J. 18 (June 2015).

[48] *Id*.at 18, 66.

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BANKRUPTCY TRENDS IN THE GAMING FIELD

Gerald M. Gordon, Rudy J. Cerone, Scott Fleming [a1]

Gaming has exploded exponentially in the last decade. Forty-eight states now permit some form of legalized gambling. This has also resulted in an increased number of bankruptcy filings.

Such cases involve issues that differ from a "typical" chapter 11 case due to the highly regulated nature of the debtor and the possible implications of the state's police powers, the unique emphasis on cash, and the one-dimensional approach to valuation. The following review identifies some of the issues presented by bankruptcy filings of gaming operations. [1]

I. FIRST DAY ORDERS

It is typical in a large bankruptcy case for the debtor to obtain numerous "first day orders," including such common bankruptcy orders as authorization for payment of payroll and related employee expenses, emergency use of cash collateral, and appointment of debtor's bankruptcy counsel. The most unique "first day order" applicable to a casino bankruptcy is an order authorizing the payment of gaming chips and tokens in the ordinary course of business.

Casino gaming chips and tokens represent liabilities of the casino. (While these terms are used interchangeably, chips relate to table games and tokens to coin-operated machines.) Gamblers exchange money for chips, which represent an obligation of the casino to repay. Occasionally, a patron will "walk away" from the gaming table with such tokens (chips) in his pocket. The right to exchange his chips for money constitutes, at worst, a general ***294** unsecured claim and, at best, a priority consumer claim up to the amount of $1,800.00 per individual. [2] However, bankruptcy judges inevitably issue a "first day order" permitting the casino to pay such gaming chips upon demand. As a technical matter, the Code would require that the casino filing bankruptcy stop issuing and honoring "prepetition chips" as of the moment of the bankruptcy, issue only new "postpetition chips" from that moment on, and require players possessing "prepetition chips" to file their claims in the bankruptcy and await distribution through a plan of reorganization. As a practical matter, it is universally recognized that such a move would sound the death knell for the casino. Judge Cosetti, discussing "first day orders," noted that "[t]he purpose of first day orders is to benefit creditors, by maximizing reorganization values. Many times they are in conflict with other provisions of the Bankruptcy Code. Such orders carry a heavy burden." [3]

The statutory basis for the entry of such an order is found in the "catch-all" provision of § 105(a), which permits the bankruptcy court to issue any order necessary to carry out the provisions of the Bankruptcy Code. Furthermore, the Doctrine of Necessity, which is an outgrowth of the Necessity of Payment rule first recognized in conjunction with railroad cases dating to at least 1882, also would support such a ruling although no published decisions exist in this context. It should be noted, however, that while the Doctrine of Necessity has become more widely recognized, it has not been universally accepted. [4] Even courts authorizing payments pursuant to the Doctrine of Necessity find that those particular payments are required for the debtor to continue operations and, generally, limit the payment to a particular creditor receiving payment rather than a specific type of debt. This is not the case in honoring casino tokens. Because the gaming chips are indistinguishable from each other, all debt evidenced by these tokens are afforded the same treatment, whether they be held by individual casino patrons or other casino

properties which have accepted these chips in exchange for chips to be used at their facility. There may be no "necessity" for allowing competitors to redeem these chips for full face value; however, the distinction between the types of creditors benefitted apparently has not been drawn by the courts.

Similarly, the court usually will approve the honoring of sports book wagers and deposits and progressive games liabilities as necessary to casino operations. Other "first day orders" which are routinely granted include an order permitting the debtor to retain prepetition charge card accounts, and to ***295** honor tour and travel commitments and other prepetition room deposits. All of these "first day orders" typically are granted to permit the debtor to continue uninterrupted operations, and justified as being necessary in a casino bankruptcy.

II. OVERVIEW OF REGULATORY ISSUES

Gaming regulation has its genesis in various declarations of public policy which are concerned with, among other things: (1) the prevention of unsavory or unsuitable persons from having a direct or indirect involvement with gaming at any time or in any capacity; (2) the establishment and maintenance of responsible accounting practices and procedures; (3) the maintenance of effective controls over the financial practices of a licensee, including the establishment of minimum procedures for internal fiscal affairs and the safeguarding of assets and revenues, providing reliable record keeping and requiring the filing of periodic reports with Gaming Authorities; (4) the prevention of cheating and fraudulent practices; and (5) the creation of a source of state and local revenues through taxation and licensing fees. These statements of public policy are embodied in statutes, regulations and supervisory procedures implemented at the state and local level by a variety of overlapping regulatory bodies (the "Gaming Authorities"). Regulation and licensing affects gaming properties (hereinafter, "Casinos")[5] and their owners and operators on several levels, many of which have a profound impact in the course of a Casino bankruptcy.[6]

A. Licensing and Regulation of the Casino

Only corporations organized under the laws of the forum state may hold a ***296** gaming license.[7] Accordingly, gaming enterprises are operated by domestic corporations, that in turn are often wholly-owned by out-of-state (and often publicly-traded) corporations. Because parent corporations routinely guarantee the debts of subsidiaries, Casino bankruptcies frequently involve two or more corporate entities.[8] Regulation of a Casino affects both the operating corporation (the "licensed" company) and the holding corporation (the "registered" company) and occurs in at least three different forms: (1) licensing and registration, (2) financial reporting, and (3) gaming license fees and taxes.

1. Licensing and Registration

The mechanics of licensing vary by locality, but generally require detailed investigations of a licensee's business activities and financial status. Although a parent corporation of a licensed corporate subsidiary is not required to obtain a license, it is required to be "registered", which in turn requires a parent corporation to obtain a "finding of suitability" from local Gaming Authorities. The investigations and requirements necessary to obtain a finding of suitability are quite similar to those necessary for licensing.

While the licensing and registration processes are outside the purview of the bankruptcy court, they nonetheless will affect many aspects of a Casino reorganization. For instance, no person may become a stockholder of, or receive any percentage of profits from, a gaming licensee without first obtaining approvals from Gaming Authorities. A registered corporation may not make a public offering of its securities without the prior approval of Gaming Authorities if the securities or the proceeds therefrom are intended to be used to construct, acquire or finance gaming facilities or to retire or extend obligations incurred for such purposes.[9]

2. Reporting Requirements

Regulation of both licensed and registered corporations involves stringent reporting requirements. A registered corporation generally is required to submit, upon application and on a periodic basis, detailed financial and ***297** operating reports to Gaming Authorities. It may also be required to furnish any other information requested by Gaming Authorities. A registered company is required to maintain a current stock ledger in the gaming state which may be examined by Gaming Authorities at any time. If any securities are held in trust by an agent or by a nominee, the record holder may be required to disclose the identity of the beneficial owner to Gaming Authorities. A failure to make such disclosure may be grounds for finding the record holder unsuitable. The registered company also is required to render maximum assistance in determining the identity of the beneficial owner. In Nevada, Gaming Authorities even have the power to require the registered company's stock certificates to bear a legend indicating that the securities are subject to the Nevada [Gaming] Act. [10]

In addition to these requirements, the licensed corporation must report and obtain approval from Gaming Authorities of substantially all loans, leases, sales of securities and similar financing transactions. [11] Failure to comply with reporting requirements by either the registered or licensed corporation could result in a corporation's license being limited, conditioned, suspended or revoked subject to compliance with certain statutory and regulatory procedures. Moreover, at the discretion of Gaming Authorities, the registered and licensed corporations, as well as the individuals involved, could be subject to substantial fines for each separate violation.

3. Gaming License Fees and Taxes

License fees and taxes, computed in various ways dependent upon the type of gaming activity involved, are payable to the state and to the counties and cities in which the licensee's respective operations are conducted. Depending upon the particular fee or tax involved, these fees and taxes are payable either daily, monthly, quarterly or annually and are based upon either: (1) a percentage of gross revenues received; (2) the number of gaming devices operated; or (3) the number of table games operated. [12] A casino entertainment tax is also paid by casino operators where entertainment is furnished in connection with the selling of food or refreshments. Licensees that hold a license as an operator of a slot route or a manufacturer's or distributor's license also pay certain fees and taxes to the state.

B. Licensing and Regulation of Key Personnel

Gaming Authorities may investigate any individual who has a material relationship to, or material involvement with, any registered company or its licensed subsidiary in order to determine whether such individual is suitable ***298** or should be licensed as a business associate of a gaming licensee. [13] Officers, directors and certain key employees of the licensed subsidiary must file applications with Gaming Authorities and may be required to be licensed or found suitable. Officers, directors and key employees of the registered company who are actively and directly involved in the gaming activities of the licensed subsidiary may be required to be licensed or found suitable by Gaming Authorities. Gaming Authorities may deny an application for licensing for any cause deemed reasonable. A finding of suitability is comparable to licensing, and both require the submission of detailed personal and financial information followed by a thorough investigation. An applicant for licensing or a finding of suitability must pay all of the costs of the investigation. Changes in licensed positions with the registered company or its licensed subsidiary must be reported to Gaming Authorities. In addition to its authority to deny an application for a finding of suitability or licensure, Gaming Authorities also have jurisdiction to disapprove a change in a corporate position.

If Gaming Authorities were to find an officer, director or key employee unsuitable for licensing or unsuitable to continue having a relationship with the registered company or its licensed subsidiary, the companies involved would be required to sever all relationships with such person. Additionally, Gaming Authorities may require the registered company or its licensed

subsidiary to terminate the employment of any person who refuses to file appropriate applications. Determinations of suitability or questions pertaining to licensing are not subject to judicial review in Nevada.

C. Licensing and Regulation of Casino Ownership

1. Equity Securities

Regulation of registered companies may extend beyond key personnel. The beneficial holder of the registered company's voting securities, regardless of the number of shares owned, may be required to file an application, be investigated and have its suitability as a beneficial holder of the registered company's voting securities determined if Gaming Authorities have reason to believe that such ownership would otherwise be inconsistent with the declared policies of the State. [14] The applicant must pay all costs of the investigation incurred by Gaming Authorities in conducting such an investigation. Regulation may not be limited to State Gaming Authorities. In Nevada, the Clark County Liquor Gaming Licensing Board and the City of Las Vegas have both taken the position that they have the authority to approve ***299** all persons owning or controlling the stock of any corporation controlling a gaming licensee within their jurisdictions. [15]

2. Debt Securities

Gaming Authorities may, in their sole discretion, require the holder of any debt security of a registered corporation to file applications, be investigated and be found suitable to own the debt security of the registered corporation. If Gaming Authorities determine that a holder is unsuitable to own such security, the registered corporation can be sanctioned, including the loss of its approvals, if without the prior approval of Gaming Authorities, it: (1) pays to the unsuitable person any dividend, interest or any distribution whatsoever; (2) recognizes any voting right by such unsuitable person in connection with such securities; (3) pays the unsuitable person remuneration in any form; or (4) makes any payment to the unsuitable person by way of principal, redemption, conversion, exchange, liquidation or similar transaction. [16]

III. BANKRUPTCY OPERATING ISSUES COMMON TO GAMING CASES

A number of issues that occur in other types of bankruptcy cases are common to Casino cases (although the comprehensive regulations imposed by Gaming Authorities often add interesting additional elements and complications).

A. Hotel Issues

Many Casinos have hotels connected with their operation. Accordingly, issues raised in ordinary hotel cases frequently arise in Casino cases. For years, there were conflicting cases regarding security interests in hotel revenues. In 1994, however, 11 U.S.C. Section 552 was amended to clarify the split the of authority concerning the continuation of a lien in hotel rent:

> (2) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, and notwithstanding section 546(b) of this title, if the debtor and an entity entered into a security agreement before the commencement of the case ***300** and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

11 U.S.C. § 552(b)(2).

While the amendments to Section 552 may resolve a number of issues in ordinary hotel cases, this section does not address the fact that in Casino cases, hotel revenues often are intermingled with Casino cash. To further complicate matters, Casinos may not be able to segregate hotel revenues because the hotel portion of the Casino (and often its restaurants and non-gaming attractions) may be operated intentionally at a loss to attract customers.

B. Cash Collateral Issues

Although the question of hotel rents has been resolved, no cases yet have addressed the manner in which a creditor may perfect a lien in Casino cash. By its very nature, a Casino generates substantial amounts of cash on a daily basis. The amount of cash constantly fluctuates, and unlike ordinary bank accounts, cash is located throughout the casino. Substantial cash may be held in the Casino "cage", but an even greater amount may reside within gaming devices and floor banks and on tables. Free hotel rooms, casino "comps", markers, chips, tokens and customer deposits also figure in the mix.

IV. BANKRUPTCY OPERATING ISSUES UNIQUE TO GAMING CASES

A. Agreements re Electronic Gaming Devices

In Nevada, gaming devices are common in locations other than casinos. For instance, video poker machines, and to a lesser extent slot machines, are frequently located in bars, restaurants, convenience stores, and grocery stores. [17] Gaming machines in locations other than casinos frequently are owned by third parties and placed under contract. These contracts fall into two types: space lease and participation. Under a space lease, a licensed slot operator actually leases space from the owner (or lessee) of a bar, for ***301** instance, for a flat sum per week or month. The slot operator retains 100% of the gaming revenue. Under a participation, the slot operator and the debtor share in the revenues. In a participation, the owner or lessee must be licensed, while in the space lease situation, only the slot operator is licensed.

Both space leases and participation agreements generally are treated as executory contracts, subject to assumption, rejection or assignment in accordance with Section 365 of the Code. Gaming law, however, may profoundly affect the timing of an assignment and limit the persons or entities to whom an assignment may be made. For instance, in a participation agreement, a debtor owner or lessee has the ability to change slot operators very quickly. Any slot route operator may provide machines. In a space lease, however, the slot route operator has the license and consequently to bring in a new slot operator would require a new license to be issued for the location. This can take several months unless Gaming Authorities are willing to handle an application on an expedited "emergency basis." Nevada law provides for an emergency approval if the debtor's business is to be managed by a receiver, trustee or assignee.

B. Security Interests in Casino Revenues and Gaming Devices

1. Casino Cash

While Section 552 may resolve certain issues regarding perfection of a security interest in hotel rents, there is no settled law respecting perfection of liens in other Casino cash.

Section 552, as amended, is consistent with earlier decisions holding that an assignment of rents is perfected upon recordation of a deed of trust without further action. *See e.g.* In re Scottsdale Medical Pavilion, 159 B.R. 295, 302, 24 Bankr. Ct. Dec. (CRR) 1218, Bankr. L. Rep. (CCH) ¶ 75504 (Bankr. 9th Cir. 1993), aff'd, 52 F.3d 244, Bankr. L. Rep. (CCH) ¶ 76466 (9th Cir. 1995). Excepting rents, however, courts have held that a security interest in cash may be perfected only by possession. *See, e.g.*, In re Ventura-Louise Properties, 490 F.2d 1141 (9th Cir. 1974); Matter of Charles D. Stapp of Nevada, Inc., 641 F.2d

737, 8 Bankr. Ct. Dec. (CRR) 397 (9th Cir. 1981). This is, of course, consistent with Section 9-304 of the Uniform Commercial Code, which provides a security interest in cash is perfected by possession. A security interest in proceeds, however, may be created by filing under Section 9-305.

Taking possession of cash pursuant to a writ of execution or garnishment is not affected by licensing, though it may have an effect if cash is depleted below minimum levels. If it is the intention to control the cash of the Casino with operations continuing, the appointment of a receiver is required. However, gaming law provides that an individual may not exercise control over a licensed company without first obtaining the prior approval of Gaming ***302** Authorities. A receiver must obtain a license and undergo the same screening process required of the Casino's key personnel.

No decision respecting perfection of a security interest in Casino cash has ever been published. [18] These matters are seldom, if ever, litigated. The reason is that there is level of comfort in uncertainty, and in almost all cases, the Casino and hotel is worth more in an operating mode than with the Casino closed. Creditors who arguably have security interests in Casino cash generally object to use of cash collateral. Rather than risking having the bankruptcy court make an all-or-nothing ruling which may result in the closing of the Casino and hotel, creditors and debtors-in-possession usually stipulate to use of cash collateral and adequate protection.

2. Gaming Equipment

Distribution, sales and use of gaming devices is closely regulated. In Nevada, one is required to have a distributors license in order to sell, use or distribute a gaming devices either for use or play both inside and outside Nevada. Violation of this provision is a gross misdemeanor. Simple possession of one of these devices, improperly distributed, can be a misdemeanor. Obviously, these restrictions would greatly complicate efforts to liquidate assets or enforce security agreements.

Nevada law, however, provides that in cases of bankruptcy or foreclosure of a lien by a bank or other person holding a security interest for which gaming devices are security in whole or in part for the lien, Gaming Authorities may authorize the disposition of the gaming devices without requiring a distributors license. Otherwise, the enforcement of a security interest in gaming equipment, or even a sale in the ordinary course, may result in a third party or creditor owning (and perhaps criminally possessing) a warehouse full of slots without any ability to sell them or move them out-of-state. [19]

3. Riverboats

Riverboat gaming operations also implicate federal law governing the perfection of a security interest in a vessel. Section 31321 of the Ship Mortgage Act [20] requires that a conveyance, mortgage or related instrument, including any part of a documented vessel or a vessel for which the application for documentation is filed, be filed with the Secretary of Transportation ***303** in order to be valid against any persons except the grantor or a person having actual notice of the security instrument. The statute further provides that each conveyance, mortgage or related instrument that is filed in substantial compliance with § 31321 is valid against any person from the time it is filed with the Secretary. A preferred ship mortgage attaches to the vessel and all the equipment and appurtenances on board owned by the vessel's owner. [21]

In the event that the vessel is not a documented vessel as defined at 46 U.S.C. § 12101, *et seq*., it is necessary to look to the applicable state law where the vessel is titled to determine the perfection of the security interest in the vessel and the equipment and appurtenances on board. Under state law, perfection is governed by the Uniform Commercial Code. [22]

Several cases have found that Mississippi dockside Casinos do not constitute "vessels" for purposes of Federal admiralty and maritime matters. [23] In the case of Mississippi Casinos, ordinary barges are converted into floating dockside Casinos. The Casinos are not designed, intended, nor capable of being used as a means of water transportation. The Casinos are not equipped

with standard marine equipment but, instead, are permanently moored and positioned in non-navigable waterways. Because the Casinos were not "vessels," the courts have found that the documentation filed by a lender, purportedly to perfect a ship mortgage under Federal law, was invalid and, therefore, the lender did not possess a valid first ranking security interest enforceable in the bankruptcy case. [24] Conversely, if the Casino is required to sail in order to conduct gaming operations, [25] then it undoubtedly would be a "vessel" under Federal law, and security interests therein would be governed by the Ship Mortgage Act. [26]

V. FEDERALISM CONCERNS

A. Tensions During Pendency of the Case

The automatic stay provided by Section 362 expressly excludes the ability ***304** of a governmental unit to enforce its "police or regulatory powers, other than obtaining or enforcing a money judgment." Conversely, Perez v. Campbell, 402 U.S. 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971) and 11 U.S.C. § 525(a) prohibit discrimination against a debtor in possession. Section 525 provides, in pertinent part:

> (a) ... a governmental unit may not deny, revoke, suspend, or refuse to renew *a license, permit, charter, franchise, or other similar grant to*, condition such a grant to, discriminate with respect to such a grant against ... a person that is or has been a debtor under this title or a bankrupt or a debtor under the bankruptcy act ... *solely because* such bankrupt or debtor has been a debtor under this title or a bankrupt or debtor under the bankruptcy act ...

11 U.S.C. 525(a) [emphasis added].

The Judiciary Committee, in its report to the House of Representatives, stated that § 525 prohibits actions by governmental organizations that can seriously affect the debtor's livelihood or fresh start, and that Section 525's enumeration of the various forms of discrimination is not an exhaustive list. *In re Rath Packing Co*., 35 B.R. at 618, *quoting* H.R. Rep. No. 525, 95th Cong., 1st Sess. 367 (1977), U.S.C.C.A.N. pp. 5787, 6323. Certainly, gaming licensure will seriously affect a Casino debtor's livelihood and opportunity for a fresh start.

There appears to be only one reported case addressing the interplay between State gaming law and Section 525. In In re Elsinore Shore Associates, 66 B.R. 723, 15 Bankr. Ct. Dec. (CRR) 420, 15 Collier Bankr. Cas. 2d (MB) 1128, Bankr. L. Rep. (CCH) ¶ 71553 (Bankr. D.N.J. 1986), the bankruptcy court permanently enjoined the New Jersey Gaming Commission from attempting to enforce a statute that allowed for the renewal of a gaming license to be conditioned upon payment of all outstanding state fees and taxes. The bankruptcy court rejected the commission's argument that Section 525 was not designed to confer a benefit upon debtors and that by enforcing the statute (which would require payment of pre-petition taxes and fees), the commission was treating the debtor in the same manner as all other gaming licensees. The court emphasized that the New Jersey statute created a clear conflict between the state regulatory scheme and the priorities contained in the Bankruptcy Code. The court did note, however, that Section 525 would not prohibit a governmental unit from requiring a debtor to prove future financial responsibility. [27]

***305** B. Tensions in the Plan Process

A plan of reorganization that contemplates cancellation of existing stock and reissuance of new stock may result in a change of control that will require the prior approval of Gaming Authorities. Sales of gaming equipment requires prior approval. Assumption and assignment of a agreement relating to gaming devices may require approval of Gaming Authorities. The granting of any registrations, amendment of orders of registration, findings of suitability, approvals or licenses to be sought in connection with a plan of reorganization are discretionary with Gaming Authorities. The burden of demonstrating the suitability or desirability of certain business transactions is at all times upon the applicant. Any licensing or approval process requires the

submission of detailed financial, business and personal information, as well as the completion of a thorough investigation. The time and manner in which each application is investigated and considered is entirely within the discretion of Gaming Authorities. Additionally, Gaming Authorities have absolute authority to limit, restrict or condition any application or request for withdrawal filed in any manner deemed reasonable by Gaming Authorities. These matters all may affect the plan and confirmation process, taking certain critical decisions and the timing of the effective date of a confirmed plan out of the hands of a Casino debtor or bankruptcy court and placing them in the hands of Gaming Authorities.

Tensions may exist, as well, among the various branches of State government and the bankruptcy actors, especially in emerging jurisdictions. In Jordan v. La. Gaming Control Board, 712 So. 2d 959 (La. App. 1st Cir. 1988), aff'd in part, rev'd in part, 712 So. 2d 74 (La. 1998), the Louisiana courts were asked to referee a dispute between certain legislators, on the one hand, and the Gaming Control Board and the Governor (supported by the Casino debtor and its creditors), on the other hand, over who in the State government had the authority to approve and execute the amended New Orleans Casino operating contract which had been negotiated as part of the confirmed plan in In re: Harrah's Jazz Company, Case No. 95-14545 (Bankr. E.D. La. 1995).

C. Sovereign Immunity

1. Seminole Tribe

In the landmark case of ***306** Seminole Tribe of Florida v. Florida, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252, 34 Collier Bankr. Cas. 2d (MB) 1199, 42 Env't. Rep. Cas. (BNA) 1289, 67 Empl. Prac. Dec. (CCH) ¶ 43952 (1996), the Supreme Court invalidated a Congressional waiver of sovereign immunity under the Indian Commerce Clause. Although *Seminole* did not address bankruptcy law, commentators immediately questioned the decision's affect on the Bankruptcy Code. Indeed, a number of courts, including three U.S. Circuit Courts of Appeal, already have relied upon *Seminole* in holding that Section 106 of the Code is unconstitutional. *See, e.g.*, In re Elias, 218 B.R. 80, 32 Bankr. Ct. Dec. (CRR) 2, 39 Collier Bankr. Cas. 2d (MB) 782 (Bankr. 9th Cir. 1998), decision aff'd, 216 F.3d 1082 (9th Cir. 2000); In re Sacred Heart Hosp. of Norristown, 133 F.3d 237, 245, 31 Bankr. Ct. Dec. (CRR) 1246, 32 Collier Bankr. Cas. 2d (MB) 238, Bankr. L. Rep. (CCH) ¶ 77604 (3d Cir. 1998), as amended, (Feb. 19, 1998); Matter of Estate of Fernandez, 123 F.3d 241, 31 Bankr. Ct. Dec. (CRR) 601, 38 Collier Bankr. Cas. 2d (MB) 1249, Bankr. L. Rep. (CCH) ¶ 77514 (5th Cir. 1997), amended on denial of reh'g, 130 F.3d 1138 (5th Cir. 1997); In re Creative Goldsmiths of Washington, D.C., Inc., 119 F.3d 1140, 1145, 31 Bankr. Ct. Dec. (CRR) 218, 38 Collier Bankr. Cas. 2d (MB) 574, Bankr. L. Rep. (CCH) ¶ 77457 (4th Cir. 1997).

Section 106 is a Congressional waiver of state sovereign immunity with respect to virtually every substantive provision of the Bankruptcy Code (60 sections in all). Section 106 grants bankruptcy courts the power to enter money judgments against states and to enforce *any* order, process or judgment against *any* governmental unit under applicable non-bankruptcy law. In light of *Seminole*, the power of Gaming Authorities and the jurisdiction of the bankruptcy courts appear to be on a collision course. There has already been a near miss.

In In re National Cattle Congress, Inc., 179 B.R. 588, 33 Collier Bankr. Cas. 2d (MB) 401, Bankr. L. Rep. (CCH) ¶ 76455 (Bankr. N.D. Iowa 1995), a debtor-in-possession who operated a pari-mutual dog racing facility moved the bankruptcy court to declare that the Iowa Racing & Gaming Commission's attempt to revoke their gaming license was a violation of the automatic stay. The commission argued that revocation of the gaming license was an exercise of their regulatory power, and thus exempt from the automatic stay under Section 362(b)(4). The bankruptcy court concluded that the commission's resolution to revoke the license was an exempt exercise of its regulatory powers, but that revocation of the license itself was an impermissible attempt to exercise control over property of the estate. *Id.* at 597-98. The District Court affirmed the decision. In In re National Cattle Congress, Inc., 91 F.3d 1113 (8th Cir. 1996), the Eighth Circuit Court of Appeals noted the recent *Seminole* decision:

> While this case was pending on appeal, the Supreme Court decided [[*Seminole*]. *Seminole* holds that the Indian Commerce Clause, U.S. Const. art. I, § 8, ***307** cl. 3, does not grant Congress the power to abrogate a State's immunity under the Eleventh Amendment. Seminole expressly overrules Pennsylvania v. Union Gas Co., 491 U.S. 1, 109 S. Ct. 2273, 105 L. Ed. 2d 1, 29 Env't. Rep. Cas. (BNA) 1657, 19 Envtl. L. Rep.

> 20974 (1989) (overruled by, Seminole Tribe of Florida v. Florida, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252, 34 Collier Bankr. Cas. 2d (MB) 1199, 42 Env't. Rep. Cas. (BNA) 1289, 67 Empl. Prac. Dec. (CCH) ¶ 43952 (1996)), which held that the Interstate Commerce Clause, U.S. Const. art. I, § 8, cl. 3, granted Congress the power to abrogate Eleventh Amendment immunity. The Commission suggests that an order enforcing the automatic stay against the Commission violates the State of Iowa's Eleventh Amendment immunity as construed in *Seminole*. ... Accordingly, without reaching the merits of the bankruptcy and district court orders under review, and without expressing a view as to the Eleventh Amendment issue, we remand this case to the district court with instructions to remand to the bankruptcy court for further consideration in light of *Seminole*.

Id. at 1114.

Although the case was remanded, no other decisions in *In re National Cattle Congress, Inc*. on this issue were ever published. No further appeals followed. Inevitably, however, bankruptcy courts will be called on to resolve the conflicts between the automatic stay and the regulatory power of Gaming Authorities. Although not raised in *In re National Cattle Congress, Inc*., gaming law and Section 525 of the Bankruptcy Code also present obvious federalism concerns.

The tension between state gaming law and bankruptcy law is sometimes apparent when a claimant argues that a state court judgment is entitled to res judicata effect in a subsequent bankruptcy. For instance, in In re Leroux, 216 B.R. 459 (Bankr. D. Mass. 1997), two casinos had obtained pre-petition default judgments in New Jersey based upon gambling debts. In his Chapter 11 case, the debtor had objected to the claims, arguing that the gambling debts were void as against the public policy of the State of Massachusetts. The court rejected the argument, noting that 28 U.S.C. 1738 provides that judicial proceedings in other states are entitled to "the same full faith and credit in every court within the United States and its Territories and Possessions ..." After determining that New Jersey law applied to the gambling debts, and that the default judgments were appropriately obtained, the court overruled the objections, notwithstanding Massachusetts public policy. One can only speculate as to the result, however, where a gambling debt has not been reduced to judgment or where there are issues respecting the choice of law and a claims proceeding results. [28]

*308 2. *Ex Parte Young* and Other Exceptions to *Seminole* [29]

An exception to State sovereign immunity against suits in Federal court is set forth in Ex parte Young, 209 U.S. 123, 28 S. Ct. 441, 52 L. Ed. 714 (1908), and its progency. *Young* permits Federal court suits against individual state officers, in their capacities as such, for prospective injunctive or declaratory relief. Thus, in certain instances, State Gaming Authorities may be sued in bankruptcy court to further the purposes of reorganization under the Bankruptcy Code.

Additionally, States may waive their sovereign immunity defense, either expressly or through conduct. An explicit waiver can occur if the State participates in a Federal program that conditions its receipt of Federal funds upon a waiver of sovereign immunity. [30] Indeed, Congress easily can overrule the effect of *Seminole* on bankruptcy cases simply by conditioning the States' receipt of sought-after Federal funds on their waiver of sovereign immunity in bankruptcy cases, [31] much as the Feds now coerce States to adopt certain laws to receive highway funds. Submission by the State of a proof of claim in a bankruptcy case also will effect a waiver of sovereign immunity, not only on the merits of the claim, but also for related dischargeability, automatic stay, plan confirmation and other issues. [32]

Finally, certain bankruptcy matters do not implicate a State's sovereign immunity because they are not "suits" against the State within the meaning of the Eleventh Amendment. A discharge order clears all dischargeable debts, including those owed to a State, because the order is based on the bankruptcy court's jurisdiction over the debtor and his estate, and not over the State. [33]

Similarly, a bankruptcy court proceeding for determination of the scope of the automatic stay and whether the stay precluded a state administrative ***309** proceeding against the debtors and their officers, although it affected the State's rights, was not an Eleventh Amendment "suit" against the State. [34]

3. Indian Tribes Are Sovereigns, Too

The *National Cattle Congress* [35] case, once again, raised a sovereign immunity issue, only this time it dealt with the Sac and Fox Tribe of the Mississippi in Iowa, and not the State of Iowa. The debtor's chapter 11 plan proposed to extinguish a real estate mortgage lien held by the Tribe in exchange for a restrictive covenant prohibiting gambling on the property. The bankruptcy court upheld the Tribe's assertion of sovereign immunity. Thus, it appears that the same issues raised above vis-a-vis States are applicable to attempts to drag an Indian tribe into a bankruptcy case against its will.

VI. CLAIMS PROCEEDINGS AND AVOIDANCE ACTIONS

As discussed above, gaming law may have a profound impact upon the administration of Casino's bankruptcy estate. Bankruptcy courts are far more likely, however, to encounter gaming issues in the course of claims proceedings and avoidance actions. If there is one obvious trend involving gaming and bankruptcy law, it is that the continued prevalence of litigation to determine the dischargeability of debts and to recover transfers relating to gambling. [36] The cases generally fall into three categories: (1) Casino v. Gambler; (2) Cash advancing credit card company v. Gambler; and (3) Chapter 7 Trustee v. Casino.

A. Casino v. Gambler

No clear winner has emerged in the seemingly endless battles between Casinos and their patrons regarding the dischargeability of gambling debts. The results in these cases appear to depend more upon how the courts view the parties and gambling, rather than upon any particular legal principal. The quintessential casino-friendly non-dischargeability case is presented by In re Poskanzer, 143 B.R. 991 (Bankr. D.N.J. 1992). This case involved a debtor who in the 1970's and 80's had "amassed a personal fortune" developing hundreds of properties throughout the northeastern part of the United States. The debtor was "experienced businessman", and in fact had been "celebrated ***310** as an icon in the real estate business in New Jersey". Moreover, the debtor had an "established history of satisfying his gambling debts". Less than one month prior to his Chapter 7 filing, the debtor had obtained hundreds of thousands of dollars in credit from casinos in Las Vegas and Atlantic City based upon a bank account with assets "grossly inadequate to meet his newly incurred casino debts." Given these facts, it was a foregone conclusion that the gambling debts would be deemed non-dischargeable.

A more interesting case is presented by In re Anderson, 181 B.R. 943, 33 Collier Bankr. Cas. 2d (MB) 967, Bankr. L. Rep. (CCH) ¶ 76539, 28 U.C.C. Rep. Serv. 2d 606 (Bankr. D. Minn. 1995). In that case, a casino had accepted dozens of bad checks (59 to be precise) totaling more than $11,000.00 over roughly a two-week period. In response to the debtor's argument that he had hoped to make good his losses, the court stated: "Rather than responding prudently, however, he continued to play, to pass checks, and to play again, on the increasingly-fantastical hope that his luck would turn and that he could beat the outstanding checks to his bank with a deposit of winnings." The court deemed the entire principal debt non-dischargeable, as well as interest, attorneys' fees and even civil penalties. Interestingly, in its twelve-page decision, the court devoted only one brief paragraph to its discussion of the casino's reliance upon the debtor's implied representations regarding the validity of his checks, stating: "The Plaintiff also has proved up the forth element, reliance, though it did so more by invoking the universal understanding of transactions by check in our consumer-based economy than it did by producing direct evidence." Conspicuously absent was any discussion regarding the reasonableness of the casino in accepting nearly 60 checks in two weeks from a patron less than two months past his eighteenth birthday.

Other cases emphasize that the these types of cases often turn on the court's perception of the debtor. In In re Vianese, 195 B.R. 572 (Bankr. N.D.N.Y. 1995), the bankruptcy court awarded attorneys' fees to a debtor couple after it dismissed a complaint by a casino to have a $16,500.00 gambling debt determined non-dischargeable. The court noted that the debtors were an assistant county superintendent of business and a sales manager for a local real estate company and stated that the check returned to the casino for non-sufficient funds "should be viewed as 'an excess similar to other excesses associated with living beyond one's means.'"

In In re Hall, 228 B.R. 483 (Bankr. M.D. Ga. 1998), the bankruptcy court rejected a casino's argument that the debtor's gambling debts were non-dischargeable because they were for "luxury goods and services" Although the court earlier noted that the debtor had essentially engaged in a marker-kiting scheme, using money obtained from one casino upon the execution of a marker to pay debts to other casinos, the court held that the gambling was not a "luxury". The debtor had lost hundreds of thousands of dollars over ***311** the past 15 years and his recent gambling activities reflected "a spirit of desperation, not pleasure." The court also rejected the casino' argument that the debt had been procured through actual fraud. Although the debtor had signed the subject marker less than ten days before filing bankruptcy and had as his sole source of income a business he described as a "sinking ship," the court found that the debtor "honestly, though unreasonably, believed that he would one day get lucky and be able to satisfy his debts." In stark contrast to *In re Anderson*, the court further concluded that the casino had taken insufficient steps to examine the debtor's credit worthiness (requesting a six-month average balance on the debtor's bank account) and thus failed to demonstrate that it reasonably relied upon the debtor's representations respecting his credit worthiness. [37]

B. Cash-Advancing Credit Card Company v. Gambler

Markers are the not the only means by which gamblers incur debt. Cash advances from credit card companies are far more common, and like casinos, credit card companies frequently seek to have such debts determined to be non-dischargeable. The lengthiest opinion on this subject in at least the past two years (49 pages) comes from the Middle District of Louisiana. In re Melancon, 223 B.R. 300 (Bankr. M.D. La. 1998) involved a couple who had obtained cash advances of nearly $8,000.00 and borrowed $5,000.00 purportedly to purchase an automobile (they instead gave the loan proceeds to their son and daughter-in-law to purchase a new car). When applying for the $5,000.00, the debtors not only misrepresented the purpose of the loan, but also failed to mention a second mortgage on their home and more than $25,000.00 in credit card debt, most of which was for cash advances to support one debtor's gambling habit. In deeming the debt non-dischargeable, the court confronted a common defense in such cases: the subjective hope a debtor's luck would turn. The court's comments are memorable:

Debtors in the credit card/gambling cases have, about unanimously, offered the following: "I believed I was going to pay the money back because I believed, albeit unreasonably (debtor's lawyer intelligent enough to throw the bait, hoping the judge involved will bite at the intelligent-sounding objective/subjective discussion—how does it go? "We find the debtor, however, unreasonably, believed she was going to win at gambling. Therefore, because of the subjective intention we are after, ... the debtor intended to pay back.") ***312** ... Of course, only the most self-destructive person would go a-gambling hoping or believing they were going to lose. Hello? Don't all people (except this distressed few) who gamble believe they are going to win, or, at least break even? Or, put another way, will any bankruptcy judge ever hear the following testimony: "I knew there was no way I was going to win, and I do not believe myself to be overly self-destructive; I simply enjoyed going to the casino (video poker establishment, racetrack, gambling boat, etc.) because they, during certain hours, give you free drinks and food, and I like the flashing bright lights—besides, I feel important when the valet parks my car." Answer, No. We will never see it. So where do the courts, who stop asking themselves what to do when the debtor testifies that he believed he was going to win, go wrong?

It appears to us that they go wrong by failing to consider the following line of inquiry. Q. Had you ever won before (over what you borrowed or came with)? A. Yes. Q. What did you do with your money? A. (1) put it back up to try to double it; (2) took it home and saved it until next time; (3) counted it, set it aside, and gambled only a small portion of it while applying the remainder of my winnings to the creditor from whom I borrowed the money. If the answer is (1), the follow-up inquiry is "Did you win more, keep what you had won, lose what you had won, or lose more than you had won?" A. (1) I won more (then we are back to the aforementioned questions); A. (2) I kept what I had won (again, back to the aforementioned questions); A. (3) I lost what I had won (which generates the aforementioned questions regarding the use to which he was to put the amount that

constituted the break-even money); A. (4) I lost more than I had won (which generates the follow-up—where did you get the money that you had to bet with after your losses exceeded your winnings?). All of this is a long way of suggesting that before a court believes a debtor who claims to have had a plan to win and use the winnings to pay back the amount borrowed, shouldn't there be evidence—if the debtor ever had won (and what debtor hasn't)—that winnings had been used before? In other words, don't we know that we do not have to believe what witnesses say they believed and hoped just because they say so?

The outcome in *In re Melancon* is largely a result of the court's position that a credit card company has no duty to investigate the credit worthiness of a customer in order to reasonably rely upon an implied representation that the debtor will repay the debt. Other courts, however, have held in favor of the gambler for precisely this reason. In In re Reynolds, 221 B.R. 828 (Bankr. N.D. Ala. 1998), for example, the court held that the debtor's reckless disregard respecting their ability to repay cash advances used for gambling established the requisite intent for the debt to be determined non-dischargeable as having been procured by false pretenses. The credit card company's complete lack of investigation, however, rendered any reliance on its part unreasonable. Judgment was entered for the debtors.

Other courts continue to accept the "subjective intent to repay" test so criticized in *In re Melancon*. Their reasoning, however, may be no less compelling (and involve far less moralizing). In In re Scocozzo, 220 B.R. 850 (Bankr. M.D. Pa. 1998), the court held that the credit card company had failed to establish that a cash advance had been procured by false pretenses, ***313** false representation or actual fraud, simply by proving that the only source of repayment was gambling winnings. According to the court, "[The debtor's] gambling created a large and needless financial obligation. Rarely, however, are the bills of debtors limited to expenditures for necessities. The fact remains that gambling has been largely legitimized and currently represents no greater a lack of frugality than many other examples of contemporary lifestyle. If Congress wishes to shut the door on the dischargeability of debts of this nature, they are quite able to articulate the language to accomplish that objective." [38]

C. Chapter 7 Trustee v. Casino

One would imagine that question of whether a debt to a casino is avoidable as a fraudulent transfer would have been resolved years ago. Nonetheless, Chapter 7 trustees continue to pursue actions against casinos seeking to recover gambling losses, arguing that the debtor did not receive reasonably equivalent value for the debt incurred. For instance, in In re Armstrong, 231 B.R. 739 (Bankr. E.D. Ark. 1999), judgment vacated, 259 B.R. 338 (E.D. Ark. 2001), a Chapter 7 trustee sued Harrah's casino in Shreveport, Louisiana, seeking to recover $377,000.00 in gambling losses over the one-year period prior to the debtor's bankruptcy. The trustee argued (and the bankruptcy court found) that the debtor knew that the debts he incurred to Harrah's would "hinder, delay or defraud" numerous other creditors, including victims of a Ponzi scheme. The trustee did not prevail, however, ***314** on either his actual or constructive fraudulent conveyance claims. The actual fraudulent conveyance claim failed because the casino successfully demonstrated that it gave value for the transfer and had acted in good faith. The constructive fraudulent conveyance claim failed because the court concluded that by permitting a wager (regardless of the likelihood of a positive outcome), the casino had provided reasonably equivalent value. On appeal, however, the District Court found that the casino did not act in good faith when it extended credit to the debtor, and thus was not protected by the "good faith transferee for value" defense to the trustee's fraudulent transfer claim; the casino did not engage in a diligent inquiry regarding the debtor's assets, liabilities, and income before initially extending credit and subsequently increasing the debtor's credit limit, and the casino became aware of circumstances placing it on inquiry notice of the debtor's potential insolvency within the relatively short span of time after approving the debtor's credit application.

The Harrah's casino in Robinsonville, Mississippi, fared no better against the Armstrong trustee than did its cousin in the Bayou State, albeit losing on a different theory. In In re Armstrong, 231 B.R. 723 (Bankr. E. D. Ark. 1999), aff'd, 2001 WL 332920 (E. D. Ark., Mar. 30, 2001), the debtor signed 26 markers totalling $50,000, which his bank honored approximately thirty days later. The debtor was placed into involuntary bankruptcy within the 90-day preference period. The trustee sued Harrah's to recover the payments made on the markers as preferential. The bankruptcy court agreed, rejecting the Casino's new value and ordinary course of business defenses.

VII. CONCLUSION

Many unique issues are raised in Casino bankruptcy cases due to their highly regulated nature. Although Casino cases tend to be fact-specific, we hope that the above provides insight into some of the issues presented in Casino bankruptcies.

Footnotes

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1 Another article that explores many of the same issues is John M. Czarnetzky, *When the Dealer Goes Bust: Issues in Casino Bankruptcies*, 18 Miss. C.L. Rev. 459 (1998).

2 11 U.S.C. § 507(a)(6).

3 In re U.S. Metalsource Corp., 163 B.R. 260, 266, 25 Bankr. Ct. Dec. (CRR) 215, 28 Fed. R. Serv. 3d 854 (Bankr. W.D. Pa. 1993).

4 *See* In re Revco D.S., Inc., 91 B.R. 777 (Bankr. N.D. Ohio 1988).

5 There are, of course, other types of gaming properties besides the traditional Las Vegas style casino. Riverboat gaming has become popular throughout much of the Midwest and along the Gulf Coast and occasionally presents conflicts (or at least an interesting convergence) of state gaming and federal bankruptcy and admiralty law. Some of these issues are addressed below. Other types of gaming of include horse and greyhound racing, jai alai, and bingo. (As state-sponsored programs, lotteries are unlike other forms of gaming.) Each type of gaming will naturally present unique issues in bankruptcy. Many of the regulatory issues that are likely to be encountered in a bankruptcy involving a horse or dog racetrack, a jai alai facility or bingo hall, however, are likely to parallel those encountered in a traditional casino. Moreover, cases involving traditional casinos are more common than cases involving other forms of gaming. For these reasons, this article will focus primarily on the traditional casino.

6 Regulatory schemes obviously vary by locality. The State of Nevada, however, has the longest history of legalized gaming and has established the most comprehensive regulations respecting gaming activities. Because Nevada law frequently serves as a basis for gaming regulation in other states, general discussions of gaming law are based upon Nevada law. Emerging gaming jurisdictions often have a more ambiguous legislative policy towards gaming issues. Louisiana law will be cited to illustrate a non-Nevada approach.

7 Though gaming licensed Casinos may be owned and operate by individuals, limited liability companies, partnerships and trusts, for ease of this overview, the discussion is limited to corporations.

8 This common structure, dictated at least in part by gaming concerns, may have a significant impact upon both case administration and claims litigation. For instance, in In re Elsinore Corp., 228 B.R. 731, 33 Bankr. Ct. Dec. (CRR) 850, 41 Collier Bankr. Cas. 2d (MB) 321 (Bankr. 9th Cir. 1998), the appellate panel upheld a determination by the bankruptcy court that workers at the Atlantis Hotel & Casino in New Jersey were not entitled to priority treatment under Section 507(a)(3) for wages earned within 90 days of the cessation of business at the Atlantis. The wage claimants were employed at the parent/holding company level, and the parent corporation had not ceased doing business as a holding company.

9 See La. R.S. § 27:236(C).

10 See also La. R.S. § 27:236(D).

11 See La. R.S. §§ 27:236 and 277.

12 See La. R.S. § 27:271.

13 See La. R.S. §§ 27:233-236.

14 La. R.S. § 27:236(E).

15 There are certain exceptions to the requirement that shareholders obtain findings of suitability. For instance, under Nevada law an "institutional investor," which acquires more than ten percent (10%), but not more than fifteen percent (15%) of the registered company's voting securities may apply to Gaming Authorities for a waiver of a finding of suitability if such institutional investor holds the voting securities for investment purposes only. See also La. Admin. Code § 42:1X.2143. Activities which are not deemed to be inconsistent with holding voting securities for investment purposes only include: (1) voting on all matters voted on by stockholders; (2) making financial and other inquiries of management of the type normally made by securities analysts for informational purposes and not to cause a change in its management, policies or operations; and (3) such other activities as Gaming Authorities may determine to be consistent with such investment intent.

16 See also La. Admin. Code §§ 42:1X.2145 and 2147.

17 Gaming devices, regardless of type (i.e. video poker, video blackjack, or traditional slot machines) are generally referred to as "slots". Businesses that provide gaming machines to numerous businesses are known as "slot route operators". See also La. R.S. § 27:301 *et seq*. re: video draw poker devices.

18 However, In re S & J Holding Corp., 42 B.R. 249, 39 U.C.C. Rep. Serv. 668 (Bankr. S.D. Fla. 1984), held that money from video arcade machines was not proceeds, was not subject to a filing-perfected security interest in proceeds and, therefore, was not subject to a prepetition security interest in the machines and their proceeds.

19 See also La. R.S. § 27:275 *et seq*.

20 46 U.S.C. § 31321

21 Estate of Rhyner v. Farm Credit Bank of Spokane, 780 P.2d 1001, 1005, 1990 A.M.C. 1185 (Alaska 1989); U. S. v. F/V Golden Dawn, 222 F. Supp. 186 (E.D.N.Y. 1963) *quoted in*, First National Bank Trust Company of Escanaba v. Oil Screw Olive L. Moore, Barge Wiltranco I, 521 F.2d 1401 (6th Cir. 1975).

22 See La. R.S. § 10:9-101 *et seq*.

23 Pavone v. Mississippi Riverboat Amusement Corp., 52 F.3d 560, 1995 A.M.C. 2038, 32 Fed. R. Serv. 3d 271 (5th Cir. 1995); King v. Grand Casinos of Mississippi, Incorporated-Gulfport, 697 So. 2d 439 (Miss. 1997); *accord* Chase v. Louisiana Riverboat Gaming Partnership, 709 So. 2d 904 (La. Ct. App. 2d Cir. 1998), writ denied, 719 So. 2d 1057 (La. 1998).

24 In re Biloxi Casino Belle Inc., 176 B.R. 427, 435 (Bankr. S.D. Miss. 1995).

25 See La. R.S. § 27:65(B).

26 See Kathy Benetrix v. Louisiana Riverboat Gaming Partnership, d/b/a Isle of Capri Casino, 1995 WL 867854 (W.D. La. 1995).

27 There is also authority which supports the conclusion that Section 525 of the Bankruptcy Code prohibits a state from revoking a debtor's self-insured certificate, under a state's applicable workers' compensation act. *See* In re Rath Packing Co., 35 B.R. 615, 11 Bankr. Ct. Dec. (CRR) 595, 9 Collier Bankr. Cas. 2d (MB) 1295 (Bankr. N.D. Iowa 1983) (Iowa State Insurance Commissioner's revocation of debtor's self-insured status violated 11 U.S.C. § 525); *accord*, In re Hillcrest Foods, Inc., 10 B.R. 579, 7 Bankr. Ct. Dec. (CRR) 735, Bankr. L. Rep. (CCH) ¶ 67999 (Bankr. D. Me. 1981) (the suspension of debtor's status as self-insurer under Maine Workers' Compensation Act may be a violation of 11 U.S.C. § 525); *see also* In re Blue Diamond Coal Co., 145 B.R. 895 (Bankr. E.D. Tenn. 1992) (Tennessee Workers' Compensation Board motion to dismiss adversary complaint by debtors alleging improper revocation of debtor's certificate of self-insurance denied, because such action by Board may constitute a violation of 11 U.S.C. § 525).

28 For instance, in Carnival Leisure Industries, Ltd. v. Aubin, 53 F.3d 716 (5th Cir. 1995), the Court of Appeals held that an unpaid gambling debt arising in the Bahamas, previously held to be unenforceable as against Texas public policy, could not be used to support action for fraud against gambler who was extended credit by casino). Inevitably, similar facts will arise in the context of a claims proceeding.

29 For an excellent discussion of *Seminole Tribe*, *Young* and the other sovereign immunity issues, see 2 *Collier on Bankruptcy* ch. 106 (15th ed. rev. 2000).

30 In re Innes, 184 F.3d 1275, 1281, 34 Bankr. Ct. Dec. (CRR) 1143, 42 Collier Bankr. Cas. 2d (MB) 857, 137 Ed. Law Rep. 185, Bankr. L. Rep. (CCH) ¶ 77976 (10th Cir. 1999), cert. denied, 529 U.S. 1037, 120 S. Ct. 1530, 146 L. Ed. 2d 345 (2000).

31 The Supreme Court has said as much: College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 119 S. Ct. 2219, 2230-31, 144 L. Ed. 2d 605, 135 Ed. Law Rep. 362, 51 U.S.P.Q.2d (BNA) 1065 (1999).

32 In re Rose, 187 F.3d 926, 930, 34 Bankr. Ct. Dec. (CRR) 1046, 42 Collier Bankr. Cas. 2d (MB) 899, 137 Ed. Law Rep. 885, Bankr. L. Rep. (CCH) ¶ 77977 (8th Cir. 1999) (and cases cited therein); *accord* In re MCA Financial Corp., 237 B.R. 338, 342, 42 Collier Bankr. Cas. 2d (MB) 1193 (Bankr. E.D. Mich. 1999) (motion for relief from stay).

33 In re Collins, 173 F.3d 924, 930, 34 Bankr. Ct. Dec. (CRR) 211, Bankr. L. Rep. (CCH) ¶ 77917 (4th Cir. 1999), cert. denied, 528 U.S. 1079, 120 S. Ct. 785, 145 L. Ed. 2d 663 (2000); *accord* In re Phelps, 237 B.R. 527, 533-34 (Bankr. D.R.I. 1999).

34 In re International Heritage, Inc., 239 B.R. 306, 310-11, 35 Bankr. Ct. Dec. (CRR) 59, 42 Collier Bankr. Cas. 2d (MB) 1986, Blue Sky L. Rep. (CCH) ¶ 74193 (Bankr. E.D.N.C. 1999).

35 In re National Cattle Congress, 247 B.R. 259, 35 Bankr. Ct. Dec. (CRR) 251, 43 Collier Bankr. Cas. 2d (MB) 1685 (Bankr. N.D. Iowa 2000).

36 Because most bankruptcy cases involve debtors with "no-asset" estates, the battleground revolves around non-dischargeability. Whether a gaming debt is an allowable claim is, of course, an issue of applicable state law.

37 There are, of course, numerous other examples of casinos succeeding in claims litigation against gambling customers. *See, e.g.*, Matter of Wegener, 186 B.R. 692, 27 U.C.C. Rep. Serv. 2d 923 (Bankr. D. Neb. 1995) (bankruptcy court rejected argument that keno operator's employee's debt for unpaid keno tickets was unenforceable based upon purported public policy prohibiting employee of gaming company to participate in employer's game). Gambling debts may also be relevant in a confirmation setting. *See* In re Famisaran, 224 B.R. 886 (Bankr. N.D. Ill. 1998) (denying confirmation of Chapter 13 plan based, in part, on debtor's expenditures at local casino).

38 *In re Melancon* is one of the very few cases in which a court has sided with a credit card company. The overwhelming majority of cases in the last few years have held in favor of the debtor. *See* In re Cron, 241 B.R. 1 (Bankr. S.D. Iowa 1999) (Chapter 7 debtors who had obtained cash advances for gambling 60 days prior to bankruptcy successfully rebutted presumption of non-dischargeability where she and her co-debtor husband were both employed and not hopelessly insolvent, had earmarked winnings for repayment of debt, and had repaid previous cash advances; debtors' bankruptcy had been necessitated by unforeseen change of circumstances resulting from loss of job); In re McLeroy, 237 B.R. 901 (Bankr. N.D. Miss. 1999) ($9,000.00 Cash advance was dischargeable where debtor testified that she intended to repay issuer, had history of making payments, paid $1,250.00 towards debt, and had not consulted with bankruptcy attorney until several months later.); In re Stearns, 241 B.R. 611, 35 Bankr. Ct. Dec. (CRR) 311 (Bankr. D. Minn. 1999) (Credit card company failed to demonstrate actual reliance upon implied representation of debtor regarding ability re repay debt and failed to show that debtor's belief that she could repay cash advance from gambling "big win" was not genuine); In re Kong, 239 B.R. 815, 35 Bankr. Ct. Dec. (CRR) 1, Bankr. L. Rep. (CCH) ¶ 78017 (Bankr. 9th Cir. 1999) (Finding that debtor lacked fraudulent intent was not clearly erroneous, even though debtor made no attempt to repay cash advance for gambling and consulted with bankruptcy attorney 2 or 3 days after loss; debtor had prior history of success at gambling and had previously paid back cash advances.); and Rembert v. Citibank South Dakota, N.A., 219 B.R. 763 (E.D. Mich. 1996), aff'd, 141 F.3d 277, 32 Bankr. Ct. Dec. (CRR) 531, Bankr. L. Rep. (CCH) ¶ 77666, 1998 FED App. 106P (6th Cir. 1998) (Reversing judgment holding cash advance for gambling non-dischargeable where evidence was undisputed that the debtor subjectively believed that she would win sufficient funds to repay debt.).

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Bankruptcy Trends in the Gaming Field Update

RUDY J. CERONE*

The following is an update, in "pocket part" format, to the article *Bankruptcy Trends in the Gaming Field*, 10 J. BANKR. L. & PRAC. 293 (May/June 2001).

VI. CLAIMS PROCEEDINGS AND AVOIDANCE ACTIONS

A. Casino v. Gambler

Page 311, add at the end of the carryover paragraph:

See also, In re Baumblit, 15 Fed. Appx. 30, 2001 WL 880872 (2nd Cir., Aug. 6, 2001) (gambling debt was not within the exception to dischargeability on the grounds that the debtor obtained credit through "false pretenses, a false representation, or actual fraud"); *In re Liu*, 2002 WL 31954445 (Bankr. N.D. Ga., Dec. 12, 2002) (UST's objection to the debtor's discharge based on the amount of money lost gambling pre-petition).

In a case of man bites dog, gamblers have stricken back against casinos who refer matters to the Bad Check Collections Unit ("BCU") of the District Attorney's office of Clark County, Nevada. The courts in two cases have granted debtors relief from the casinos' attempts to use the DA's office to collect their unpaid gambling debts. In *Baumblit, supra*, the Second Circuit affirmed the bankruptcy court's finding that Caesar's Palace's post-petition referral of the debtor's markers to the BCU violated the automatic stay and that the referral was not the commencement of a criminal action or proceeding that would be excepted from the automatic stay pursuant to § 362(b)(1). *Id.* at *35 and **4. Moreover, the court found that the casino's actions constituted a deliberate violation of the automatic stay entitling the debtor to actual damages pursuant to § 362(h). *Id.* In *In re Simonini*, 282 B.R. 604 (D. W.D.N.C. 2002), the court found that Nevada's attempted prosecution of the debtor for unpaid markers was really a debt collection action, and not a criminal prosecution, stating that the BCU's prosecution was a "debt collection in sheep's clothing." *Id.* at 614. The court granted the debtor a permanent injunction against Nevada's prosecution and extradition from North Carolina to Nevada.

Other suits and potential actions by gamblers against casinos either are in the works or are on the horizon. See *Addicted Gambler, Bankrupt Sues Casino For His Losses*, Wall Street Journal, Oct.

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22, 2002, http://online.wsj.com/article/0,,SB1035228816558331071.djm,00.html; *Organization: Casinos Could Be Sued*, Las Vegas Review-Journal, June 6, 2002, at http://www.lvrj.com/lvrj_home/2002/Jun-06-Thu-2002/news/18909265.html (casinos could be the next "big tobacco".)

B. Cash-Advancing Credit Card Company v. Gambler

Page 313, insert a new final paragraph:

Online gamblers also lost a significant attempt to avoid paying their debts by blaming credit card companies. A class action lawsuit to that effect was filed in 2000 against Visa, MasterCard and the banks that issued their cards. In *In re MasterCard Int'l, Inc. Internet Gambling Litigation*, Case No. 01-CV-30389 (5th Cir. Nov. 20, 2002), the court held that the gamblers "got exactly what they bargained for – gambling 'chips' with which they could place wagers." A unanimous 5th Circuit panel dismissed the suit because the gamblers failed to show the predicate acts necessary to sustain a civil RICO action.

Page 313, add at the end of footnote 38:

; *Matter of Mercer*, 246 F.3d 391 (5th Cir. 2001) (each use of pre-approved credit card by chapter 7 debtor was in nature of implied representation by debtor of her intent to repay any credit extended; credit card issuer "actually relied," as a matter of law, on debtor's implied, card-use representation regarding her intention to repay credit card debt; and case would be remanded for determination on knowing falsity, intent to deceive and justifiable reliance issues); *In re Alnajjar*, 276 B.R. 844 (Bankr. N.D. Ohio 2002) (debtor's unsuccessful gambling at casino would not be excepted from discharge as debt for money or credit obtained by debtor's "false pretenses, false representation or actual fraud".).

C. Chapter 7 Trustee v. Casino

Page 313, insert after the "Armstrong" citation:

, *aff'd*, 285 F.3d 1092 (8th Cir. 2002).

Page 314, insert in the "Armstrong" citation in lieu of the Westlaw cite:

260 B.R. 454 (E.D. Ark. 2001), *aff'd*, 291 F.3d 517 (8th Cir. 2002).

Page 314, add the following final paragraph:

In a non-bankruptcy case, which easily could occur in a bankruptcy context, a state court receiver, appointed to recover assets on behalf of duped investors in a fraudulent company, brought an action against casinos under California's version of the Uniform Fraudulent Transfer Act

("UFTA"). *Fisher v. Las Vegas Hilton Corp.*, 47 Fed. Appx. 824, 2002 WL 31085332 (9th Cir., Sep. 18, 2002). In that case, the Ninth Circuit held that allegations that the head of a company transferred $26 million to casinos and then gambled that money in the casinos' slot machines were sufficient to allege "transfer" under UFTA; that fact issues regarding whether the casinos knew or should have known that proceeds were being gambled by the head of the company were illegal precluded judgment on the pleadings on the issue of whether the casino had an affirmative defense to the receiver's action under the UFTA; that the receiver's allegations that transfers from the head of the company to casinos through gambling were constructively fraudulent and voidable under the UFTA had to fail absent an allegation that the head of the company did not receive reasonably equivalent value for his transfers to the casino; and that the receiver adequately pled a claim for relief under California statute providing that a receiver appointed oversee a defendant's assets may avoid transfers of unlawfully obtained property.

Page 314, add the following new section and renumber the Conclusion to VIII:

VII. MISCELLANEOUS MATTERS

Can earnings received by a debtor from gambling activities be used to fund the debtor's chapter 13 plan? Not surprisingly, one court has said no. *In re Cushman*, 263 B.R. 293 (Bankr. W.D. Mo. 2001). Section 1325(a)(6) of the Bankruptcy Code requires that a debtor "will be able to make all payments under the plan . . . ." Gambling winnings apparently are too uncertain, as a matter of law, to meet that requirement:

> Setting all moral and policy arguments aside for the moment (which weigh *strongly* against allowing a debtor to attempt to fund a Chapter 13 Plan with gambling winnings), the Court believes that gambling, regardless of the ability of the gambler, is inherently too uncertain a source of income to fund a Chapter 13 Plan.

Id. at 295. The court also noted that, despite his success at gambling, the debtor still was unable to pay his debts pre-petition and found it necessary to file for bankruptcy in the first place. *Id.*

While gambling winnings are not a stable enough source of revenue to fund a chapter 13 plan, they are property of the debtor's bankruptcy estate. In *In re Kedrowski*, 284 B.R. 439 (Bankr. W.D. Wis. 2002), the court considered the provisions of the Indian Gaming Regulatory Act, which permits tribes to distribute a portion of the tribal gaming revenues to members on a per capita basis, 25 U.S.C. § 2710(b), when considering a chapter 7 trustee's claim in a member's bankruptcy that the distributions due to the member were property of the bankruptcy estate. The court found that the debtor's right to receive distributions from the tribe's gaming operations is a property right within the meaning of § 541(a) of the Bankruptcy Code. *Id.* at 459, *citing Johnson v. Cottonport Bank*, 259 B.R. 125, 131 (W.D. La. 2000).

Finally, much has been made in the public debate about whether the spread of legalized gambling

has resulted in an increased number of bankruptcies. Undoubtedly, the growth of legalized gambling and the increase of bankruptcy filing are two concurrent trends of the recent past. However, is there a cause and effect relationship between the two? The Treasury Department has concluded that there exists only a "weak relationship between frequent high-risk gambling and the probability of declaring bankruptcy." U.S. DEP'T OF THE TREASURY, *A Study of the Interaction of Gambling and Bankruptcy*, Executive Summary at i (July 1999). It, thus, appears that the recent rise in consumer bankruptcies cannot be laid at the feet of the gambling industry.

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