



JUL 7 2006

Chairman Johnny Hernandez
Santa Ysabel Band of Diegueno Indians
P.O. Box 130
Santa Ysabel, CA 92070

RE: PROMISSORY NOTE

Dear Chairman Hernandez:

The purpose of this letter is to respond to your request of February 28, 2005, that the National Indian Gaming Commission ("NIGC") review the Promissory Note between the Santa Ysabel Band of Diegueno Indians ("Band" or "Borrower") and Yavapai-Apache Nation ("Nation" or "Lender") ("Note"). The purposes of our review are to determine whether the Note is a management contract or a collateral agreement to a management contract and therefore subject to our review and approval under the Indian Gaming Regulatory Act ("IGRA") and whether the Note violates the "sole proprietary interest" clause in IGRA.

Authority

The authority of NIGC to review and approve gaming related contracts is limited by IGRA to management contracts and collateral agreements to management contracts. 25 U.S.C. § 2711. The former authority of the Secretary of the Interior to approve such agreements under 25 U.S.C. § 81 was transferred to NIGC pursuant to IGRA. 25 U.S.C. § 2711(h).

1. Management Contracts

A "management contract" is "any contract, subcontract, or collateral agreement between an Indian tribe and a contractor or between a contractor and a subcontractor if such contract or agreement provides for the management of all or part of a gaming operation." 25 C.F.R. § 502.15.

A "collateral agreement" is "any contract, whether or not in writing, that is related either directly or indirectly, to a management contract, or to any rights, duties or obligations created between a tribe (or any of its members, entities, organizations) and a management contractor or subcontractor (or any person or entity related to a management contractor or subcontractor)." 25 C.F.R. § 502.5.

Management encompasses activities such as planning, organizing, directing, coordinating, and controlling. *See NIGC Bulletin No. 94-5.*

In NIGC's view, the performance of any one of these activities with respect to all or part of a gaming operation constitutes management for the purpose of determining whether an agreement for the performance of such activities is a management contract requiring NIGC approval.

After careful review, we have determined that the Note is not a management contract and therefore does not require the approval of the Chairman.

2. Proprietary Interest

We are concerned, however, that the Note violates the sole proprietary interest provision in the Band's Gaming Ordinance ("Ordinance"), which is required by IGRA, and thus impermissible under IGRA. Among IGRA's requirements for approval of tribal gaming ordinances is that "the Indian tribe will have the sole proprietary interest and responsibility for the conduct of any gaming activity." 25 U.S.C. § 2710(b)(2)(A). Under this section, if any entity other than a tribe possesses a proprietary interest in the gaming activity, gaming may not take place. NIGC regulations require that all tribal gaming ordinances include such a provision. 25 C.F.R. § 522.4(b)(1).

The Ordinance sets forth the requirement that the Band is the sole owner of the gaming operation. "The Santa Ysabel Tribe of the Santa Ysabel Indian Reservation shall have the sole proprietary interest in and responsibility for the conduct of any gaming facilities and/or enterprise(s) authorized by this ordinance." *See Ordinance at Section IV.* NIGC can enforce provisions of a tribal ordinance. 25 U.S.C. § 2713(a).

IGRA does not define "proprietary interest" but case law and secondary legal authorities suggest that it is to be taken in a straightforward, ordinary sense, i.e. an ownership interest. Although there are no cases directly on point, courts have defined proprietary interest in a number of contexts. In a criminal tax case, an appellate court discussed what the phrase proprietary interest meant, after criticizing the trial court for not defining it for jurors, saying:

It is assumed that the jury gave the phrase its common, ordinary meaning, such as 'one who has an interest in, control of, or present use of certain property.' Certainly, the phrase is not so technical, nor ambiguous, as to require a specific definition.

Evans v. United States, 349 F.2d 653 (5th Cir. 1965).

In another tax case, the issue was whether the plaintiff had a sufficient proprietary interest in a wagering establishment to be liable for taxes assessed against persons engaged in the business of accepting wagers. The court observed:

It is not necessary that a partnership exist. It is only necessary that a plaintiff have some proprietary interest. . . One would have a proprietary interest if he were sharing in or deriving profit from the club as opposed to being a salaried employee merely performing clerical and ministerial duties.

Dondlinger v. United States, 1970 U.S. Dist. LEXIS 12693 (D. Neb. 1970) (emphasis added).

Secondary sources also shed light on the definition of "proprietary interest." In a chapter on joint ventures in *American Jurisprudence*, the difference between having a proprietary interest and being compensated for services is discussed in the context of determining when a joint venture exists:

Where a contract provides for the payment of a share of the profits of an enterprise, in consideration of services rendered in connection with it, the question is whether it is merely as a measure of compensation for such services or whether the agreement extends beyond that and provides for a proprietary interest in the subject matter out of which the profits arise and for an ownership in the profits themselves. If the payment constitutes merely compensation, the parties bear to each other, generally speaking, the relationship of principal and agent, or in some instances that of employer and employee [footnote omitted]. On the other hand, a proprietary interest or control may be evidence of a joint venture. [footnote omitted]

46 Am. Jur. 2d *Contracts* § 57 (emphasis added).

Consequently, if a joint venture is found to exist, it would be further evidence that a tribe does not hold the sole proprietary interest in the gaming operation.

Determination

We are concerned that the terms in the Note may violate the sole proprietary interest mandate of IGRA. In sum, the Note contemplates that the Nation will loan [] to the Band which the Band will repay from [] loan for the development, construction and completion of a gaming facility and retail expansion ("Permanent Financing"). The Note also provides that the Nation may guarantee the loan for the Permanent Financing. For this loan guaranty, the Band will pay the Nation []

64

[] We are concerned that this interest rate, coupled with the term, provides the Nation an ownership interest in the Band's gaming operation.

A. Agreement Provisions

1. Promissory Note

The Promissory Note provides that the Nation shall loan [] or so much as may from time to time be disbursed, to the Band. See p. 1. The Band shall pay the Note Principal Balance with interest, either with proceeds from Permanent Financing or begin paying monthly payments in [] See p. 5, Section 7(a). The Note Principal Balance is the total principal sum but may be reduced by all repayments of principal on the Loan. See p. 3, Section 1. Interest Rate on the Note Principal Balance is [] See p. 4, Section 3(a). Permanent Financing is defined as an amount not to exceed [] to be obtained by the Band and if necessary, guaranteed by the Nation to finance costs and expenses related to development, construction and completion of the Facilities. See p. 3, Section 1. Facilities are defined as any facility where gaming activity regulated by IGRA is conducted. See p. 2, Section 1. The default rate is [] ("Default Rate"). See p. 4, Section 3(b). If Permanent Financing is not in place by [] the Band will pay the Note in an amount sufficient to amortize the Note Principal Balance over [] (the "Amortization Period"). See p. 5, Section 7(a). If Permanent Financing is obtained during the Amortization Period, the Note Principal Balance shall be due and payable in full from the proceeds of the Permanent Financing. *Id.* All outstanding principal of and interest on the Note shall be due and payable on the Maturity Date and accelerated by occurrence of a Default. See p. 5 Section 7(b).

64

Maturity date is the earlier of the date on which the Borrower obtains Permanent Financing or [] See p. 3, Section 1. As security for the Note, the Band grants the Nation an exclusive, first priority security interest and lien on the Collateral. See p. 6, Section 11. Collateral is all earnings, income, revenues and the rights to receive them. See p. 1. 64

2. Loan Guaranty

The Nation will guaranty the Band's Permanent Financing ("Loan Guaranty"). See p. 3, Section 1. The Band shall pay the Nation a Cash Flow Participation Interest ("CFPI") on the Loan Guaranty, [] 64

Net Revenues means gross revenues from the Facilities after prizes and payouts and other usual deductions to reach the "win" less operating expenses. See p. 3, Section 1.

[] See p. 5, Section 7(c). Commencement date is the first day on which the Facilities are open to the public for business. See p. 1, Section 1. Upon default, 64

B. Cash Flow Participation Interest

We are specifically concerned about the CFPI for the Loan Guaranty. The CFPI provides the Nation an increasingly and cumulatively significant portion of the Band's Net Revenues over the term. The CFPI potentially could provide the Nation an ownership interest in the Band's gaming operation, because the Nation, not the Band, would receive the primary benefit of the Band's gaming operation.

1. Risk

The Band's cost for obtaining this Loan Guaranty from the Nation is high. Typically, lenders who guaranty, or back, a loan in the event the borrower defaults may receive a little higher interest rate than conventional financing which may be the prime rate plus a few more percentage points. The rate reflects the risk the Lender takes in guaranteeing the financing of a new operation. This Loan Guaranty is extremely different from how conventional financing, even for Indian gaming, is structured. Here, the interest rate, or the CFPI, [

b4

An increased level of financial risk assumed by a guarantor could justify a higher interest rate than from conventional financing for the guaranty. Such factors bearing on risk could include the location of the operation, financial projections, market conditions and the Band's inability to obtain conventional financing; however, in this instance, the parties have not provided any other information regarding the level of risk involved in the development of this gaming operation.

The Nation will reap a great benefit from the gaming operation itself, above and beyond a typical guarantor. The Band will no longer be the primary beneficiary of its gaming operation's Net Revenues as a large benefit of it would potentially flow to the Nation.

2. Term

We are also concerned that [

b4

The Loan Guaranty, in essence, becomes a profit sharing arrangement which is an impermissible proprietary interest.

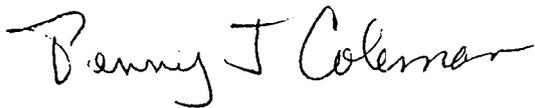
Conclusion

This Note raises concerns. The Nation will capture a high percentage of Net Revenues from the Band's gaming operation through the CFPI. This arrangement indicates that the Nation has an ownership interest in the Band's gaming operation. Such an ownership interest would violate the mandate in IGRA and the Ordinance that tribes possess the sole ownership interest in their gaming operation.

LETTER TO CHAIRMAN HERNANDEZ
PAGE 7

A copy of this letter and the Agreement will be forwarded to the Office of Indian Gaming Management of the U.S. Department of the Interior for its review. If you have any questions or concerns, please contact Wendy Helgemo, Staff Attorney, at (202) 632-7003.

Sincerely,

A handwritten signature in cursive script that reads "Penny J. Coleman".

Penny J. Coleman
Acting General Counsel

cc: George Skibine, Director, Office of Indian Gaming Management (w/enclosure)