JUN 16 2006

VIA FACSIMILE & REGULAR MAIL

Billy Evans Horse
Chairman
Kiowa Tribe of Oklahoma
P.O. Box 369
Carnegie, Oklahoma 73015
Fax: (580) 654-2188

Don Pongrace, Esq.
Todd Araujo, Esq.
Akin Gump Strauss Hauer & Feld LLP
1333 New Hampshire Avenue, N.W.
Washington, DC 20036-1564
Fax: (202) 887-4288

Frank Reddick
Akin Gump Strauss Hauer & Feld, L.L.C.
2029 Century Park East
Suite 2400
Los Angeles, CA 90067-3012
Fax: (310) 229-1001

Re: Senior Secured Credit Agreement between the Kiowa Casino Operations Authority and Luna Gaming Randlett, L.L.C.

Dear Sirs:

On May 11, 2005[1], Mr. Reddick, on behalf of the Kiowa Casino Operations Authority ("KCOA"), a government instrumentality of the Kiowa Indian Tribe of Oklahoma ("Tribe"), requested that the National Indian Gaming Commission ("NIGC") review the Senior Secured Credit Agreement, dated April 22, 2005, between the KCOA and Luna Gaming Randlett, L.L.C ("Luna Gaming") and its collateral agreements, listed below (hereinafter collectively referred to as ("Transaction Documents"). Specifically, KCOA seeks a determination that the Transaction Documents do not constitute a management contract, as defined in the Indian Gaming Regulatory Act ("IGRA"), 25 U.S.C. § 2701 *et seq.*

[1] On December 19, 2005, the Kiowa Tribe passed Tribal Resolution No. CY_2005-205, which requested that the NIGC stay, for a period of 90 days, any decisions related to the documents submitted by the Kiowa Tribe for review. Upon receipt of this resolution, NIGC staff suspended review of the documents. On April 12, 2006, the NIGC received Tribal Resolution No. CY-2006-515 which, among other things, authorized tribal action to obtain necessary approvals from the NIGC. Consequently, NIGC staff renewed review of the documents.

We conclude, as set forth more fully below, that the Transaction Documents constitute a management contract or collateral agreements to a management contract that require the Chairman's approval. Moreover, as is detailed herein, the Transaction Documents evidence Luna Gaming's proprietary interest in the gaming activity in violation of IGRA and NIGC regulations. Finally, several provisions of the Credit Agreement infringe on tribal government functions.

Agreements Submitted

Mr. Reddick on behalf of KCOA submitted the following agreements:

1) Senior Secured Credit Agreement, dated April 22, 2005, by and between KCOA and Luna and First Amendment to Senior Secured Credit Agreement, dated September 9, 2005;

2) Note, dated April 22, 2005, executed by KCOA in favor of Luna;

3) Inducement Agreement, dated April 26, 2005, between the Tribe and Luna;

4) Depository Agreement, dated April 22, 2005, between KCOA, Luna, and Wells Fargo Bank;

5) Restricted Account Agreement, dated April 22, 2005, by KCOA, Luna, and Wells Fargo Bank; and

6) Security Agreement dated April 22, 2005, between KCOA and Luna.

Authority

The authority of the NIGC to review and approve gaming related contracts is limited by the IGRA to management contracts and collateral agreements to management contracts.[2] 25 U.S.C. § 2711. The authority of the Secretary of the Interior to approve such agreements under 25 U.S.C. § 81 was transferred to the NIGC pursuant to the IGRA. 25 U.S.C. § 2711(h).

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,

[2] However, certain gaming-related agreements, such as consulting agreements or leases or sales of gaming equipment, should be submitted to the NIGC for review. *See NIGC Bulletin No. 93-3.*

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 the view of the NIGC, 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. *Id.*

Proprietary Interest

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 also require that all tribal gaming ordinances include such a provision. *See* 25 C.F.R. § 522.4(b)(1).

"Proprietary interest" is defined in Black's Law Dictionary, 7th Edition (1999), as "the interest held by a property owner together with all appurtenant rights . . . ." An owner is defined as "one who has the right to possess, use and convey something." *Id.* "Appurtenant" is defined as "belonging to; accessory or incident to. . . ." *Id.* Reading these definitions together, proprietary interest creates the right to possess, use and convey something.

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 the trial court had been criticized 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, *Dondlinger v. United States*, 1970 U.S. Dist. LEXIS 12693 (D. Neb. 1970), 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.

Id. (emphasis added).

The legislative history of IGRA is an additional aid for interpreting the statute's mandate that a tribe "have the sole proprietary interest and responsibility for the conduct of any gaming activity." 25 U.S.C. § 2710(b)(2)(A). The legislative history of the IGRA with respect to "proprietary interest" is scant, stating only that, "the tribe must be the sole owner of the gaming enterprise." S. Rep. 100-446, 1988 U.S.C.C.A.N. 3071-3106, 3078. "Enterprise" is defined as "a business venture or undertaking" in Black's Law Dictionary, 7th Edition (1999). Despite the brevity of this information, the drafters' concept of "proprietary interest" appears to be consistent with the ordinary definition of proprietary interest, while emphasizing the notion that entities other than tribes are not to share in the ownership of gaming enterprises.

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).

Finally, the preamble to NIGC regulations provides some examples of what contracts may be inconsistent with the sole proprietary interest requirement, but then concludes that "[i]t is not possible for the Commission to further define the term in any meaningful way. The Commission will, however, provide guidance in specific circumstances." 58 Fed. Reg. 5802, 5804 (Jan. 22, 1993).

Loan Particulars

Luna Gaming will loan the KCOA [ ] to finance the development and construction of an approximately 60,000 square foot Class II and Class III casino in Randlett, Oklahoma which will operate approximately [ ] slot machines and offer table games, food and beverage outlets and approximately 1,000 parking spaces. Inducement Agreement at Page 1;[3] Credit Agreement at §2.01; Definitions at page 48. The loan will carry an interest rate of [ ] Credit Agreement at § 1.04. The term of the loan is [ ] years from the date the project is completed. Credit Agreement at Definitions, page 44 ("Maturity Date"). Assuming no prepayment of the loan, the interest cost to the Tribe over the life of the loan will be [ ] This amounts to [ ] per month in principal and interest payments.

In addition, the KCOA shall pay monthly service fees [ ] to Luna Gaming as follows: [ ] Credit Agreement at § 2.01.

Determination

After careful examination, we have determined that the Transaction Documents, taken together, constitute a management contract. This determination is based on the presence of several key provisions in a number of the documents that bestow management control on Luna Gaming. In addition, we find that the Security Agreement (SA) bestows a proprietary interest upon Luna Gaming in violation of the IGRA and that several provisions of the Credit Agreement infringe on tribal government functions.

Management Control

The SA contains several indications of management control by Luna Gaming. First, the SA assigns and pledges to Luna a security interest in all existing and later acquired Collateral. SA at § 2. It further provides that Luna may "[o]perate and consume the Collateral...for the purpose of performing any of [KCOA'S] obligations with respect thereto." SA at § 7. In addition, it states that Luna Gaming "[m]ay exercise all other rights, powers and privileges of an owner of the Collateral." SA at § 9(p). Collateral includes, among other things, gaming revenue, gaming inventory, goods, materials, fixtures, present and future gaming accounts, all gaming agreements and contracts and all books and records.[4] SA, Definitions, page 2. Finally, an event of default exists if the Tribe defaults under the Credit Agreement or any other Loan Document. SA at § 8.[5]

[3] Luna Gaming's website states that the "Kiowa Casino" will have 1300 machines and 12 table games.

[5] While "Loan Document" is not defined in the Security Agreement, we assume it means any and all of the documents listed on page one of this letter that were entered into between KCOA and Luna relative to the loan from Luna to KCOA.

In the event of default on the loan, Luna would effectively assume control of literally the entire gaming operation. Of particular concern is Luna's control over all gaming contracts to which the KCOA had entered. This authority would include, for example, contracts for management of the casino, contracts with gaming machine vendors, employment contracts, marketing contracts, and a whole host of other agreements that KCOA had entered into to facilitate operation and management of the casino. Luna Gaming would exercise all rights and powers that KCOA had under these agreements and contracts. Luna Gaming would therefore have complete control over the casino with the right and power to, for example, manage gaming employees, order and place gaming equipment, and determine marketing strategy and oversee its implementation. Luna Gaming would also have complete control over gaming proceeds.

We are concerned that Luna Gaming will, in an effort to protect its financial investment and assure its loan is repaid, exert undue influence over the management of the operation. Luna Gaming could have a presence in the casino for a period of [redacted] years, and the Tribe will likely be very receptive to the company's suggestions as [redacted] 64

If there were any question as to whether Luna Gaming is capable of managing the gaming operation should KCOA default on the loan, it appears Luna Gaming is soundly experienced in and qualified to manage an Indian gaming operation. Luna Gaming has developed and managed several Indian and non-Indian gaming operations around the country, including Little River Casino Resort in Manistee, Michigan (managed by Luna from 1999-2004); Upper Lake Casino (Development and Management Agreement entered into in 1995); Cal Neva Resort Hotel and Casino (Luna awaiting Nevada State licensing to operate the casino); Red Dolly Casino in Colorada (Luna is 100% shareholder); and Motor City Casino in Detroit (Luna was co-owner until merger/buyout. Casino now top grossing casino in Detroit). http://www.lunaent.com/gaming.

Another provision in the Credit Agreement likewise is a management provision. Section 5.01(c)(A) states that the Tribe shall provide to Luna Gaming an annual marketing plan "in form and substance satisfactory" to Luna Gaming. Management control is established when Luna Gaming is given the last word on the Tribe's plan for promoting its gaming operations. Marketing, which include advertising and promotions, is an integral function of the management of a casino and has no place in loan agreements.

Luna Gaming will also have management control over the Tribe's Operating Account, which is funded from gaming revenue. CA at §5.23. Amounts shall be disbursed from the Operating Account only in accordance with the gaming operation's operating budget approved by Luna Gaming to pay Operating Expenses and only following receipt by Luna Gaming of a written Operating Expenses request. Id. The KCOA must make written requests to Luna Gaming every time it needs to use casino revenue to pay casino expenses. Likewise, the provision that requires the Tribe to make written requests to Luna for capital expenditures is an inappropriate function of a lender and indicates management control. CA at § 5.22. This degree of power over the revenue from the

gaming operation is not an appropriate function of a lender and is strong indicia of management control.

Finally, the term of the Transaction Documents raises concern regarding management. Each of the Transaction Documents (with the exception of the Restricted Account Agreement) dates from April 22, 2005-over one year ago. The "Maturity Date" of the loan upon which the entire deal is based is [redacted] years from the Completion Date. Credit Agreement at Definitions page 44. The Completion Date is the date on which certain conditions are met, most importantly construction and development of the casino. Credit Agreement at Definitions page 37; § 4.03. Construction has begun, but is in the early stages. This means that Luna may exert that control which is set forth in the Transaction Documents for [redacted] years from the date the casino development is completed. Such a lengthy term is an indication of a management contract, *see NIGC Bulletin No. 94-5*, and in fact [redacted]

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Based on the above analysis, we find that, although the Transaction Documents explicitly deny that they are management agreements, Credit Agreement § 3.18, a management relationship between the parties exists with respect to the gaming operation.

The definition of "collateral" in the SA presents a separate issue. As defined, collateral includes fixtures. SA, definitions, page 2. IGRA prohibits any transfer or conveyance of any interest in land or other real property. *See* 25 U.S.C. § 2711(g). This prohibition also applies to fixtures on land. The following provisions are problematic for the same reason: 1) Senior Secured Credit Agreement, § 8.14; 2) Inducement Agreement, Exhibit A, § II.

Proprietary Interest

The same provisions of the Security Agreement that give rise to management control by Luna, referenced above, also bestow a proprietary interest in the gaming operation on Luna Gaming, in violation of the IGRA, its implementing regulations and the Tribe's gaming ordinance. *See* 25 U.S.C. § 2710 (b)(2)(A); 25 C.F.R. § 522.4(b)(1); Kiowa Gaming Ordinance Article 6.[6] Luna Gaming maintains a level of control that is consistent with one possessing an ownership interest. See 25 U.S.C. § 2710(b)(2)(A). The default provisions of the Credit Agreement which provide for Luna Gaming to operate the casino violate the proprietary interest mandate of IGRA because they usurp the Tribe's ability to own and operate its gaming operations.

[6] Section 2 assigns and pledges to Luna a security interest in all existing and later acquired Collateral; Section 7 provides Luna may "[o]perate and consume the Collateral...for the purpose of performing any of [KCOA'S] obligations with respect thereto."; Section 9(p) states that Luna Gaming "[m]ay exercise all other rights, powers and privileges of an owner of the Collateral"; Collateral includes, among other things, gaming revenue, gaming inventory, goods, materials, fixtures,[6] present and future gaming accounts, all gaming agreements and contracts and all books and records.[6] SA, Definitions, page 2; and an event of default exists if the Tribe defaults under the Credit Agreement or any other Loan Document. SA at § 8.[6]).

Tribal Government Functions

In addition to the management control provisions set forth above, several provisions encroach on tribal government functions. First, the Credit Agreement provides that Luna Gaming shall approve the annual operating budget of the gaming operation. CA §§ 5.01 (c)(A); 5.23. Any "increases in Operating Expenses in excess of the annual operating budget approved by [Luna Gaming]...must be approved in writing by [Luna Gaming] prior to distribution of such excess amounts from the Operating Account." Credit Agreement at § 5.23. The approval of an operating budget and any changes thereto is a distinctly tribal government function. When the NIGC reviews management contract submissions, we often find this authority granted to the manager. We respond by advising the parties that the manager may recommend an operating budget but that the approval authority rests with the tribal government.

The Credit Agreement likewise gives Luna Gaming approval authority over capital expenditure plans and budgets. CA § 5.01(c)(C). The approval of capital expenditure plans and budgets is a tribal government function. Again, when the NIGC reviews management contract submissions, we often find this authority granted to the manager. We respond by advising that parties that the manager may recommend capital expenditure plans and budgets, but that the approval authority rests with the tribal government.

Financial Arrangement

We have not here addressed the financial arrangement between the parties. The financial arrangement is complicated by the fact that [ ]. Furthermore, we cannot complete our analysis of the financial arrangement without further information. As we continue to work with the parties, we will examine the entire financial arrangement, and in that regard request that Luna Gaming provide us with its financial projections, including cash flow statements and a breakdown of projected interest and fee payments from the Tribe. We also request the Tribe provide financial projections updated with depreciation, sales and marketing agreements and any gaming machine agreements. For both parties, it would be helpful if the notes to the financial projections more fully describe the terms of the loans and the number of class II vs. class III machines.

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Conclusion

As the Transaction Documents constitute a management contract, they require the approval of the NIGC's Chairman. Please be advised that an unapproved gaming management contract is void. Management of a gaming operation under an unapproved agreement could result in closure of the operation. *See* 25 C.F.R. § 573.6(a)(7); *NIGC*

Bulletin No. 94-5. Recently, the Tenth Circuit Court of Appeals reiterated that "[l]acking the formality of NIGC approval, an agreement to manage does not become a contract: it is void." *First American*, 412 F.3d at 1176 (citing *United States ex rel Bernard v. Casino Magic Corp.*, 293 F.3d 419, 421 (8th Cir. 2001)).

Furthermore, because the Credit Agreement also violates the sole proprietary interest provision of the IGRA, no gaming may take place under the Transaction Documents unless and until revisions are made to those provisions that grant Luna Gaming a proprietary interest.

If you have any questions, please contact Maria Getoff, Staff Attorney, at 202-632-7003.

Sincerely,

Penny J. Coleman
Acting General Counsel