

Fond du Lac Band of Lake Superior Chippewa Reservation Business Committee

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February 26, 2018



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Sequoyah Simermeyer, Associate Commissioner
National Indian Gaming Commission
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Dist. III Representative
Roger M. Smith, Sr.

Executive Director,
Tribal Programs
Miyah M. Danielson

Re: Comments of the Fond du Lac Band of Lake Superior Chippewa in response to the NIGC's invitation for Tribal consultation on IGRA's sole proprietary interest requirement

Dear Chairman Chaudhuri, Vice-Chair Isom-Clause, and Associate Commissioner Simermeyer:

I write on behalf of the Fond du Lac Band of Lake Superior Chippewa in response to your letter dated December 22, 2017, inviting consultation on several matters affecting Indian gaming. We appreciate the invitation to consult, and we write to offer our recommendations regarding the third issue listed in that letter – the Indian Gaming Regulatory Act's requirement that tribes have the “sole proprietary interest in and responsibility for the conduct of [Indian] gaming.” 25 U.S.C. §§2710(b)(2)(A); §2710(d)(1)(A).

We have also reviewed the Discussion Draft of a proposed regulation to be added to 25 CFR part 573 to provide standards for the agency to use in administering the sole proprietary interest requirement. This Discussion Draft was circulated by the Commission during its recent tribal consultations. We offer comments on that discussion draft below and in the enclosure to this letter.

As you state in your December 22 letter, the NIGC has previously addressed the sole proprietary interest requirement through bulletins, legal opinions, and enforcement actions. And the federal courts have addressed this requirement as well. The Commission now asks whether it should promulgate regulations to administer the sole proprietary interest requirement, and if so, how best to do this.

The Fond du Lac Band has considerable experience regarding IGRA's sole proprietary interest requirement, based on years that the Band spent in litigation on this matter. This history is discussed in the NIGC's NOV 11-02 (July 12, 2011) which applied to the Fond du Lac Band, as well as in several court decisions related to that NOV. Fond du Lac's experience illustrates the importance of the Act's requirement that tribes “have the sole proprietary interest

and responsibility for the conduct of [Indian] gaming.” 25 U.S.C. §§2710(b)(2)(A); §2710(d)(1)(A).

Through its issuance of opinions and enforcement actions on the sole proprietary interest requirement, including the enforcement action that applied to the Fond du Lac Band, the NIGC has developed a useful body of common law on this matter. We believe this agency law properly serves the congressional intent in IGRA that the revenues generated by Indian gaming inure to the benefit of Indian tribes, not outside parties, so that the tribes have resources to address the longstanding unmet needs of Indian people and reservation communities. Thus, the various standards that the Commission has developed to date with regard to the sole proprietary requirement should be maintained and indeed strengthened. We also believe that the promulgation of regulations to codify these standards would provide very useful guidance to tribes and to parties doing business with tribes, and would reduce uncertainty in this area and thereby help eliminate disputes.

1. IGRA’s “sole proprietary interest” requirement and the NIGC’s development of law interpreting and applying that requirement.

Congress in IGRA required tribes to “have the sole proprietary interest and responsibility for the conduct of [Indian] gaming,” 25 U.S.C. §§2710(b)(2)(A); §2710(d)(1)(A).

The sole proprietary interest requirement is a core element of IGRA that implements the key purpose of the Act: to ensure that the benefits of gaming flow to the tribes, and not to third parties, so that tribes can use the gaming revenues to meet the health, education, housing, and needs of their members.

This key purpose is evident in the text of IGRA, its legislative history and the court decisions interpreting the Act.

At the time of IGRA’s enactment, an increasing number of tribes had successfully established bingo operations which, collectively, had generated “more than \$100 million in annual revenues to tribes.” S. Rep. No. 100-446, at 2 (1988). Congress found that these gaming revenues “enabled tribes . . . to provide a wider range of government services to tribal citizens and reservation residents than would otherwise have been possible.” *Id.* at 2. For gaming tribes, as the Court of Appeals for the Eighth Circuit noted, “the income often means the difference between an adequate governmental program and a skeletal program that is totally dependent on Federal funding.” *City of Duluth v. Fond du Lac Band of Lake Superior Chippewa*, 785 F.3d 1207, 1211 (8th Cir. 2015) (quoting S. Rep. No. 100-466, at 3 (1988)).

But Congress was concerned that non-Indian parties would siphon off revenues from tribal gaming operations. For that reason, Congress mandated that tribes have the “sole proprietary interest” in Indian gaming. 25 U.S.C. §2710(b)(2)(A), (d)(1)(A)(ii). Congress imposed this requirement to “ensure that the Indian tribe is the primary beneficiary of the gaming operation,” *id.* §2702(2), consistent with the “principal goal of Federal Indian policy [which is] to promote tribal economic development, tribal self-sufficiency, and strong tribal government.” *Id.* §2701(4). As one federal court stated, “Congress enacted the IGRA to promote and regulate

gaming on tribal lands for the benefit of the tribes....” *City of Duluth v. Fond du Lac Band of Lake Superior Chippewa*, 830 F. Supp. 2d. 712, 718 (D. Minn. 2011) *aff’d in relevant part and rev’d in part*, 702 F.3d 1147 (8th Cir. 2013) (emphasis added).¹

Congress did not define the phrase “sole proprietary interest,” and instead authorized the NIGC to determine when and how that statutory requirement was to be satisfied in light of the newly emerging Indian gaming industry and the unforeseen situations that might impair effective regulatory oversight of that industry. Congress also authorized the NIGC to implement IGRA both by promulgating rules and through enforcement actions. 25 U.S.C. §§2705, 2706, 2713. When the NIGC promulgated its initial regulations under IGRA, it concluded that the meaning of the “sole proprietary interest” requirement was best left to determination in the context of specific circumstances. 58 Fed. Reg. 5804 (Jan. 22, 1993).²

That approach allowed the Commission to acquire experience as Indian gaming developed, and afforded the Commission the flexibility to address unanticipated circumstances as they occurred. The Commission correctly recognized that it could not anticipate, in advance, the various ways in which third parties might seek to structure arrangements with tribes, where those arrangements, as the Commission found, too often sought to bypass IGRA’s requirements to the detriment of tribal interests and contrary to congressional intent.

As the then-Chairman of the NIGC, Philip N. Hogen, reported to the Senate Indian Affairs Committee by letter dated February 1, 2005, the Commission had “became more and more concerned about contracts [with Indian tribes] that included egregious terms benefitting contractors rather than tribes.”³ The NIGC found that non-Indian parties were undermining IGRA’s “sole proprietary interest” requirement by structuring their agreements with tribes through the use of various consulting and development contracts that were designed to both avoid IGRA’s requirements for approval of management contracts, and to mask violations of the “sole proprietary interest” mandate. In his 2005 letter to the Senate Indian Affairs Committee, then-NIGC Chairman Hogen explained the agency had a responsibility to review these types of

¹ See also *Rincon Band of Luiseno Indians v. Schwarzenegger*, 602 F.3d 1019, 1035 (9th Cir. 2010) (“IGRA’s stated purposes include ensuring that tribes are the primary beneficiaries of gaming and ensuring that gaming is protected as a means of generating tribal revenue.”) (emphasis in original); *Wells Fargo Bank v. Lake of the Torches Econ. Dev. Corp.*, 658 F.3d 684, 694 (7th Cir. 2011) (“Congress enacted [IGRA] to provide a comprehensive regulatory framework for gaming operations by Indian tribes that would promote tribal economic self-sufficiency and strong tribal governments.”)

² The federal courts have upheld the Commission’s authority to implement the sole proprietary interest standard through case by case adjudication. See *City of Duluth v. Fond du Lac Band of Lake Superior Chippewa*, 702 F.3d 1147, 1152-54 (8th Cir. 2013) (NIGC had authority to define statutory terms through adjudicative decisions as well as formal rulemaking).

³ A copy of Chairman Hogen’s February 1, 2005 letter to the Senate Committee on Indian Affairs is enclosed.

alternative contract arrangements to ensure that they did not violate the expressed congressional intent that tribes have the “sole proprietary interest” in gaming on Indian land:

[T]he Commission [began] to realize that some contractors were apparently receiving an ownership interest in tribal casinos because they were certainly not providing services worth the enormous sums of money they were receiving.

Id. at 5.

In his letter to the Senate Committee, the Chairman cited several examples where agreements between tribes and non-Indian partners were structured for tribes to provide large “rent” payments to the non-Indian interests for use of a casino building and equipment, years after the tribe had paid for the property in full—in other words, to require the tribes to “rent” back property and facilities they already owned. These “rent” payments sometimes constituted more than 30 percent of the tribe’s net gaming revenues. The NIGC Chairman explained the illegality of such arrangements:

In one agreement, for example, the tribe had a 10-year obligation to pay its contractor 35% of its net gaming revenues each month as so-called “rent” for gaming equipment and the casino building, all of which the tribe had already paid for in full within the first 6 months of the 10-year term.

These agreements, and others like them, violate IGRA’s sole proprietary interest requirement because the developer’s compensation is paid from the casino’s profits, and it is paid in such a way and in such quantity as to bear little or no relationship to the value of the services provided or to the risk assumed. Rather, profits are distributed to the developer as to one with a fractional ownership interest—a proprietary interest—in an enterprise and its profits. The Commission’s review has enabled tribes to avoid such illegal and unconscionable agreements and has thus assured that they are the primary beneficiaries of their casinos.

Id. at 5-6 (emphasis added).

The NIGC Chairman added: “the review of contracts, both for management contract and sole proprietary interest violations, has, without exaggeration, saved Indian tribes tens of millions of dollars. In so doing, review has helped ensure that tribes are the primary beneficiaries of their casinos, as IGRA intends. 25 U.S.C. §2702(2).” *Id.* at 4.

Both before and since Chairman Hogen’s 2005 report to the Senate, the Commission, through its general counsel, issued more than 50 opinions on the sole proprietary interest requirement. The Commission also took several enforcement actions, finding that various contractual arrangements between gaming tribes and non-Indian parties violated IGRA’s “sole proprietary interest” standard. This has resulted in the development of an extensive body of common law under which the Commission has defined the basic elements for testing whether, in a contract between the tribe and a third party, the tribe maintained the sole proprietary interest

and responsibility for its gaming operations. In general, the Commission has concluded that where a non-Indian party takes little risk, makes little capital investment and receives compensation in the form of a percentage of gaming revenues that is disproportionate to any services provided, the non-Indian party has an impermissible ownership interest in a tribe's gaming activity. See NIGC's NOV 11-02 at 11-14 (July 12, 2011) (summarizing agency law on "sole proprietary interest" issue).

2. The Fond du Lac Band's experience with the sole proprietary interest requirement.

As described in the NIGC's NOV 11-02 and a series of related federal court decisions,⁴ the Fond du Lac Band has experienced, first-hand, the problems that arise where a tribe does not have the sole proprietary interest in or responsibility for a gaming enterprise.

In the early days of IGRA, the Band entered into an agreement with the City of Duluth under which the Band established a casino on a parcel of tribal trust and reservation land held by the Band within the City. The agreement was made at a time when the Commission was only just first constituted, and before it had developed any regulations or issued any opinions on any matters.

The agreement, made in 1994, sought to restructure a pre-IGRA agreement that had created a joint venture between the Band and the City and which was no longer allowed by IGRA. The 1994 agreement provided that, for an initial term (from 1994 until 2011), the Band would pay the City 19 percent of the Casino's gross revenues from gaming machines, with payments for a second term (from 2011 to 2036) to be negotiated at the end of the first term. These payments were denominated as "rent" to be paid by the Band for "subleasing" the gaming facility from a joint Band-City Commission, even though the Band was the owner of the facility it was "subleasing." NOV 11-02 at 7, 15-16. Under the agreement, the City further held the right to review and veto any changes to the Band's gaming ordinance as well as the right to review and object to the Band's decisions on gaming licenses. NOV 11-02 at 2, 8, 17.

As the Band-City agreement neared the end of its initial term, the Band saw that the NIGC's law interpreting the sole proprietary interest had developed and that under the Commission's more developed standards, the Band's agreement with the City was contrary to the law. The Band stopped making payments to the City, and raised its concerns with the City and the NIGC. See NOV 11-02 at 5-6. The City however responded by filing suit against the Band seeking to compel the Band to continue to make payments under the agreement. The Band counter-claimed and challenged the legality of the agreement.

⁴ *City of Duluth v. Fond du Lac Band of Lake Superior Chippewa*, 708 F. Supp. 2d 890 (D. Minn. 2010) (*Duluth I*); *City of Duluth v. Fond du Lac Band of Lake Superior Chippewa*, 830 F. Supp. 2d 712 (D. Minn. 2011) (*Duluth II*), *aff'd in part and rev'd in part*, 702 F.3d 1147 (8th Cir. 2013) (*Duluth III*); *City of Duluth v. Fond du Lac Band of Lake Superior Chippewa*, 977 F. Supp. 2d 944 (D. Minn. 2013) (*Duluth IV*), *rev'd and remanded*, 785 F.3d 1207 (8th Cir. 2015) (*Duluth V*), *on remand*, 2015 WL 4545302 (D. Minn. July 28, 2015) (*Duluth VI*). See also *City of Duluth v. National Indian Gaming Commission*, 89 F.Supp.3d 56 (D.D.C. 2015).

The NIGC, in a comprehensive opinion issued in July 2011, examined both the terms of the City-Band agreement as well as its implementation, concluded that it did not comply with the sole proprietary interest requirement and directed the Band to cease operating under that agreement. NOV 11-02 (July 12, 2011). “Based on a thorough review of the parties’ submissions and the 1994 Agreements,” the Commission “conclude[d] that the 1994 Agreements, as written and as implemented, violate IGRA’s mandate that the Band retain the sole proprietary interest in and responsibility for its gaming activity,” *id.* at 7, and issued a Notice of Violation against the Band. The Commission found that the 1994 Agreements were illegal because (i) the level of compensation being paid by the Band to the City bore no relation to any investment made or services provided by the City to the Band, and (ii) the City had control over the Band’s gaming operations through a right to review and power to approve (or veto) Band regulations of the Band’s gaming operations.

In particular, the Commission found that the 19 percent of gross revenues paid to the City—which totaled approximately \$75 million from 1994 to 2009—was equivalent to between 26.6 percent and 33.5 percent of the net profits. NOV 11-02 at 16-17. The Commission found that the City, in return, had made no capital investment in the Casino since 1994, nor had any on-going financial or other risk. *Id.* at 17. As the Commission said, “The Band is paying rent on a property it already owns and, according to the Summary Appraisal Report supplied by the Band, for a far higher rental rate than market rental rates.” *Id.* at 7.

Further, the Commission concluded that the City did not provide any services to the Casino beyond the municipal services provided to any other citizen or business located in the City, and found that the \$75 million already paid to the City bore no “rational relationship” to any services provided by the City. NOV at 9, 17. The NIGC, applying its precedent, also found that the intangible value of the City’s support in 1986 for the Secretary’s trust acquisition of the Casino site was not the type of quantifiable economic benefit that would justify a revenue sharing arrangement. *Id.* at 10. (“support of a trust acquisition is not of tangible economic benefit justifying a share of gaming revenue”).

The City retained the services of an economist, who undertook an analysis of tribal-state gaming compacts which the City submitted to the NIGC and relied upon to argue that the 1994 City-Band contract was similar to existing tribal-state compacts. The NIGC considered this argument, but found such a comparison to be misplaced because IGRA establishes a comprehensive legal framework for tribal-state gaming compacts which does not apply to agreements between tribes and cities. *Id.* at 10; *see also* 25 U.S.C. §2710(d).

The NIGC also considered the level of control that the City exercised over the Casino under the agreement. The NIGC found that under the agreement the Band cannot “modify its gaming ordinance or regulations, as they apply to the Fond Du Luth casino, unless the City of Duluth consents to the modification or the modification is required by Federal law or a tribal-state compact.” NOV 11-02 at 8. The NIGC also found that “the Accord provides the City with the right to review and object to the Band’s licensing decisions.” *Id.* The NIGC concluded that “the City’s power to directly control the regulation of the Band’s gaming activity infringes on the Band’s authority as confirmed by Congress. Accordingly, the Band does not retain the sole proprietary interest in, and responsibility for, the gaming activity.” *Id.*

Based on all these facts, the NIGC directed the Band to “cease performance under the 1994 Agreements of those provisions identified in this NOV as violating IGRA.” *Id.* at 18.

The NIGC’s decision was then the subject of litigation. In the City’s suit against the Band to enforce the agreement, the Band argued, and the federal courts agreed, that the NIGC’s decision, set out in the NOV, established that the agreement was no longer lawful and that the Band should be relieved of further obligations under that agreement.⁵ The NIGC’s decision was also addressed in a second suit by the City against the NIGC in which the City challenged the Commission’s authority to have issued the NOV and the Commission’s interpretation of the sole proprietary interest requirement.⁶ In their rulings in these cases, the federal courts recognized the NIGC’s authority to determine whether tribal agreements with third parties – however denominated – complied with the IGRA’s sole proprietary interest requirement, upheld the NIGC’s 2011 determination that the Band’s agreement with the City violated that requirement, and relieved the Fond du Lac Band of all further obligations under the agreement.⁷

The NIGC ruling that declared the 1994 City-Band contract contrary to the sole proprietary interest requirement ended the dramatic diversion of Band revenues to the City that had gone on for years. Millions of dollars in funds from the Band’s gaming operation that would have been paid to the City are now devoted instead to funding critical tribal government programs and services – elder care, head start programs, medical, dental, nursing and behavioral health services, education, roads maintenance, funding of a tribal judicial system and police force, maintenance of an environmental resources program, and more – as intended by IGRA.

3. Recommendations.

The Commission’s opinions provide an extensive body of common law which defines and informs the meaning of the sole proprietary interest requirement, and which has been given effect by the courts.⁸ While this body of administrative common law helps to define the sole

⁵ *Duluth II*, 830 F. Supp. 2d. 712 (D. Minn. 2011), *aff’d in relevant part*, *Duluth III*, 702 F.3d 1147 (8th Cir. 2013). *See also Duluth V*, 785 F.3d 1207 (8th Cir. 2015), and *on remand*, *Duluth VI*, 2015 WL 4545302 (D. Minn. July 28, 2015).

⁶ *City of Duluth v. National Indian Gaming Commission*, 89 F.Supp.3d 56 (D.D.C. 2015). (finding that the NIGC acted in exercise of its enforcement authority when issuing the NOV, and applying *Chevron* deference, upheld the agency’s interpretation of the “sole proprietary interest” standard and its application to the agreements).

⁷ *Duluth II*, 830 F. Supp. 2d. 712 (D. Minn. 2011), *aff’d in relevant part*, *Duluth III*, 702 F.3d 1147 (8th Cir. 2013). *See also Duluth V*, 785 F.3d 1207 (8th Cir. 2015), and *on remand*, *Duluth VI*, 2015 WL 4545302 (D. Minn. July 28, 2015).

⁸ *See, e.g.*, cases discussed at notes 5 and 6 *supra*. *See also Bettor Racing, Inc. v. Nat'l Indian Gaming Comm'n*, 812 F.3d 648, 652 (8th Cir. 2016) (upholding NIGC’s NOV against a third party which operated a pari-mutuel betting business at the tribe's casino without an NIGC approved management contract, and which used a scheme under which the tribe paid the

proprietary interest requirement, there would be benefits to tribes and to the regulated community generally if the Commission were to promulgate regulations to codify the common law rules. Such regulations would provide a single readily available source of administrative guidance that would reduce potential disputes about the scope or meaning of the applicable standards governing the sole proprietary interest requirement.

If the Commission decides to develop regulations, the Commission should ensure that the protections afforded to tribes by the sole proprietary interest requirement are not weakened from current agency standards and, if anything, should be strengthened.

The sole proprietary interest requirement is still an important protection that the Commission must remain vigilant in enforcing. While many tribes have developed the expertise necessary to effectively finance and manage their gaming enterprises, there are still likely to be tribes that are not yet in such a position, or which may be vulnerable to over-reaching by third parties that seek to take advantage of tribes. This problem is illustrated by the Commission's recent settlement agreement with the Cheyenne and Arapaho Tribes of Oklahoma, SA-17-01 (April 11, 2017). There, an unscrupulous employee used his position to deprive the tribe of the opportunity to purchase the land that the tribe was leasing for its gaming operation, and instead arranged to have title to that land transferred to a private entity which then charged the tribe an exorbitant rent (including 1% of the gross gaming revenues) – in violation of the sole proprietary interest requirement of IGRA – depriving the tribe of more than \$1 million in tribal income over an 18-month period.

Based on the Band's experience in this area, Commission regulations on the sole proprietary interest requirement should contain the following essential elements:

- The rule should provide that any arrangement between a tribe and a third party will be evaluated based on the Commission's consideration of all of the facts and circumstances pertaining to the arrangement and the true economic impact of the arrangement.
- The rule should require evaluation of the terms of the arrangement with the third party without regard to the form of the agreement, *i.e.*, lease, services agreement, purchase agreement, management contract, etc., and without regard to the specific form that the payment to the third party takes, *i.e.*, profit-sharing, fee-for-services, rent, bonus, etc.
- The rule should require that the size of the payment be assessed as a percentage of net revenues (not gross revenues) absent some compelling justification for using gross revenues.

company "bonuses" that effectively gave the company a high percentage (65% to 78%) of the net revenues.)

- The rule should require that there be a rational and substantial relationship between the size of the aggregate payment to the third party and the fair market value of benefits provided by the third party to the tribe.
- The rule should require that the payment to the third party be justified by tangible economic benefits provided to the tribe, not intangible benefits such as the third party's "support" for a trust acquisition or similar accommodation.
- The rule should examine the term of the arrangement, with a presumption that the term is excessive if it extends beyond the 5-7 years applicable to management agreements, absent other factors that would justify a longer term (such as a substantial loan that requires a long-term repayment plan).
- The rule should require that the third party does not fully or partially exercise operational control over the gaming enterprise or possess other indicia of ownership.
- The rule should require that the third party does not exercise any authority (including a right to veto) over any governmental act of the tribe, including the tribe's right to amend the tribal gaming ordinance or to issue, deny, modify or revoke a tribal gaming license.
- The rule should require that the third party does not have access to the books and records of the gaming operation in a fashion that is commonly associated with ownership.

We had an opportunity to review the Commission's Discussion Draft of a possible regulation regarding the sole proprietary interest requirement, and we enclose with these comments some suggested revisions in light of the above recommendations. We also suggested that these regulations be placed in Part 560 instead of Part 573 which sets out the procedures for enforcement. While the sole proprietary interest requirement could trigger an enforcement action under Part 573, the draft regulations on sole proprietary interest set out substantive standards rather than procedures. Given this, we thought that the Commission might instead use one of the reserved, but unused parts, such as Part 560, for regulations on the sole proprietary interest.

We are also aware of concerns expressed by some tribal representatives that any Commission regulations on the sole proprietary interest requirement not undermine innovative measures for financing tribal gaming operations, especially where a tribe may face challenges in establishing or operating a gaming enterprise. But we also believe, based on the Commission's experience in addressing this requirement, that the Commission can and would continue to engage in the very fact-specific analysis that it has done to date, to ensure that any innovative arrangement still complies with the requirement that payments made by the tribe to a third party are in consideration for a tangible economic benefits to the tribe, and commensurate with the fair market value of any services, investment, or other tangible thing of value provided by the third party to the tribe.

We appreciate the opportunity to provide these comments and look forward to working with the Commission should the Commission decide to develop regulations on this matter.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'K. Dupuis', with a stylized flourish at the end.

Kevin Dupuis, Sr., Chairman

Enclosures

**Sole Proprietary Interest –NIGC’s discussion draft regulation
with Fond du Lac Band’s Suggested Revisions**

Use in Subpart F, Part 560:

a) Among the requirements of the Indian Gaming Regulatory Act is the requirement that the Tribe have the sole proprietary interest in and responsibility for the conduct of Indian gaming. In determining whether the sole proprietary interest requirement has been violated, the Chair may examine all facts and circumstances concerning the arrangement between the Tribe and a third party without regard to the form of the arrangement – (*i.e.*, lease, services agreement, purchase agreement, management contract, loan, etc.) – and without regard to the specific form of the payments to the third party (*i.e.*, profit-sharing, fee-for-services, rent, bonus, transfer of assets, etc.)

b) In evaluating whether the sole proprietary interest mandate has been violated, the Chair will consider the totality of circumstances concerning the arrangement between a Tribe and a third party, and will take the following factors into consideration, any one of which may lead to a conclusion that the sole proprietary interest standard has been violated:

1. the amount of revenue paid to or retained by the third party and, in those cases where a third party receives a percentage share of the tribe’s revenue, the share should be evaluated as a percentage of net revenue, absent some compelling justification for using gross revenue;
2. the value of any other property or asset transferred to or acquired by the third party;
3. whether the third party received or was entitled to a share of the gaming revenue for no return, service, or asset provided to the gaming operation, or for a return, service or asset that was not of commensurate value;
4. whether the third party provided to the Tribe any tangible economic benefit for the payments it received (whether such tangible benefits are in the form of services, financial investment, or property or other asset), and whether the fair market value of the benefit provided by the third party to the Tribe bears a rational and substantial relationship to amount of the payments or other value received by the third party;
5. whether the amount of revenue given to or retained by a management contractor (whether such contractor was approved or unapproved) exceeds the statutory cap set forth in IGRA for management contractors;
6. whether the third party holds or exercises a right of control, in whole or part, over the gaming operation or can exercise or modify any governmental authority of the tribe, such as, but not limited to:

- a. a right or power to exclude the Tribe from the premises of the gaming operation or part thereof, or otherwise limit access of the Tribe to the gaming operation;
 - b. a right or power to operate the gaming enterprise, or any part thereof as the proprietor;
 - c. a right or power to seek a judicial appointment of a receiver over the gaming operation;
 - d. a right or power to make decisions as a co-owner, partner, or joint venturer with the Tribe;
 - e. a right or power as a holder of stock or option or any other interest that reflects an ownership interest in a gaming operation.; and
 - f. a right or power to approve or veto any governmental act of the Tribe, including, for example, the Tribe's right to amend the tribal gaming ordinance, regulations, or other tribal laws, or to issue, deny, modify or revoke a tribal gaming license
7. the term of or duration of the contractual relationship between the Tribe and the third party, with a presumption that the term is excessive if it extends beyond the 5 to 7 year term limit that is applicable to a management contract, and whether the Tribe has a commercially reasonable opportunity to terminate the agreement prior to the expiration of its term;
8. in the case of a loan from the third party to a Tribe, whether the loan adheres to or deviates from the customary lending practices for similar kinds of financing;
9. whether there is any grant or assignment of Tribal proprietary rights to the third party, including, but not limited to:
- a. the third party's right to access to records or financial information regarding the gaming operation or part thereof;
 - b. the third party's right to place gambling devices that are controlled by a third party in the gaming operation or part thereof; and
 - c. the grant of a security interest in the gaming operation to a third party.
- c) The Chair has discretion to take other factors not listed in subparagraph (b) into consideration for purposes of determining whether the sole proprietary interest mandate has been violated.
- d) Any enforcement action for violation of the sole proprietary interest requirement must specify the factors relied on by the Chair and the reasons for relying on them.

e) This regulation does not otherwise affect gaming operations that are expressly authorized in the Indian Gaming Regulatory Act, such as those permitted under 25 U.S.C. 2710(b)(4)(B), which allows a Tribe to license third parties to conduct class II gaming on the Tribe's reservation under certain conditions specific in that subsection.



February 1, 2005

The Honorable John McCain, Chairman
The Honorable Byron Dorgan, Vice-Chairman
The Honorable Daniel Inouye, Member
Committee on Indian Affairs
United States Senate
836 Hart Office Building
Washington, DC 20510

Re: Contract review and IGRA's sole proprietary interest requirement

Dear Senators:

This is in response to the December 15, 2004, letter of Senators Campbell and Inouye, then the Chairman and Vice-Chairman, respectively, of the Committee on Indian Affairs. The letter expresses concerns about the National Indian Gaming Commission's review of gaming-related contracts for violations of the sole proprietary interest requirement of the Indian Gaming Regulatory Act ("IGRA"). Senator McCain has previously expressed interest in this issue in the context of the Mohegan Sun Management contract. We appreciate the concerns of the Committee. Consequently, we thought it might be helpful if we provided our thoughts on the issue.

Reduced to its essentials, the December 15 letter is concerned that the Commission's contract review has discouraged otherwise-willing contractors from working with Indian tribes, and thus has deprived the tribes of opportunities to develop or expand casinos. The letter is further concerned that the Commission brought about that state of affairs by the *ad hoc* application of a new standard for violations of IGRA's sole proprietary interest requirement, without notice or guidance to the tribes or their contractors in a manner that is not subject to review, thus depriving all concerned of their statutory and constitutional protections under the Administrative Procedure Act.

We wish to assure you, Senators, that this is not the case. We believe that we have helped the tribes and that we have saved them tens of millions of dollars by providing guidance on this issue. In a nutshell:

- The Commission's review of gaming-related contracts is intended to assure that the Indian tribes are the primary beneficiaries of their gaming operations, as IGRA requires. Our review has identified for tribes casino development contracts that were not only illegal but also unconscionable. Proposed under the guise of mutually-beneficial ventures, some were so one-sided that the tribes would realize nearly nothing from the gaming operation.

- The Commission's review of contracts, which are voluntarily submitted by the parties, attempts to identify potential IGRA violations before they occur, and thus avoid both the necessity of enforcement actions against tribes and the myriad problems that can arise when parties suddenly discover that their operating agreement was executed in violation of applicable law. When our review identifies IGRA violations in contracts already in effect, tribes are often able to renegotiate them without our having to bring enforcement actions and interrupting casino operations.
- The Commission's review is not a new exercise, nor does it apply new standards, previously undisclosed. Since 1993, Indian tribes and their contractors have, at the Commission's encouragement, submitted some 440 contracts for review, specifically for a determination that they are not subject to, or that they comply with, IGRA's requirements for management contracts. The review for sole proprietary interest violations became part of this review about 6 years ago as the Commission became more and more concerned about contracts that included egregious terms benefiting contractors rather than tribes. Before that, the issue had lain dormant since January 1993, when the Commission, in adopting regulations on tribal ordinances, provided a formal statement on sole proprietary interest in the Federal Register and indicated that it would provide further guidance in individual cases.
- The Commission's review does not infringe on the rights of Indian tribes or their contractors. The Commission is charged with IGRA's enforcement, and I may bring enforcement actions for all IGRA violations, including the requirement that a tribe, in all of its contractual undertakings, maintain the sole proprietary interest in, and responsibility for, all gaming activity. This is so whether or not the parties have submitted their contracts for review. For every alleged IGRA violation, the parties are entitled to administrative review before the full Commission under the Administrative Procedures Act and to subsequent judicial review if they are still aggrieved.

A more detailed legal and factual discussion follows.

Legal background

To begin with, IGRA requires, as one of the necessary conditions for a tribe to open and operate a casino, a gaming ordinance approved by me, as the Commission Chairman. 25 U.S.C. §§ 2710(b)(B); 2710(d)(1)(A). For approval of a gaming ordinance, IGRA requires, among other things, 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). The Commission therefore adopted regulations providing that tribal gaming ordinances include a provision to that effect. 25 C.F.R. § 522.4(b)(1).

As such, should a tribe and a contractor execute an agreement that gives to the contractor some proprietary interest in the gaming operation, the agreement violates both the tribal gaming ordinance and IGRA, which empowers me to correct those, and all other, violations

through enforcement actions. Therefore, any agreement that violates IGRA's sole proprietary interest requirement places the tribe at risk of fines and closure of its casino.

That said, a complete discussion of the Commission's review of gaming-related contracts -- agreements for the development and construction of casinos, loan agreements, gaming equipment leases, etc. -- also requires a brief discussion of management contracts. As summarized above, the Commission's review of contracts for sole proprietary interest violations has long been part of a voluntary compliance program, namely the voluntary submission of management contracts by tribes and their contractors for a determination by the Commission that the contracts do not offend IGRA's stringent requirements. The Commission encourages this review in order to both advance IGRA's purposes and ensure compliance. Specifically, the Commission's review ensures that Indian tribes are the primary beneficiaries of their casinos and that enforcement actions for IGRA violations are avoided.

As you are aware, tribes and their contractors submit to me, as Chairman, all contracts for the management of Indian casinos, together with any collateral agreements, *i.e.* any agreement related to a management contract, or to the rights, duties, and obligations that a management contract creates. 25 U.S.C. § 2711(a); 25 C.F.R. § 553.2; 25 C.F.R. § 502.5.

IGRA has many strict requirements for the approval of management contracts, and a list of them is unnecessary here. Suffice it to say that a management contract that I have not approved is void, and management of a casino under a void agreement has a number of undesirable consequences. The tribe is subject to fines and the closure of its casino in an enforcement action; the contractor has to vacate the casino; the tribe has to run the casino by itself; and the contractor is subject to legal action to disgorge to the tribe the proceeds of the contract.

The history of the Commission's voluntary contract review

Given IGRA's restrictions on management contracts, and the consequences for managing without an approved contract, the Commission had, by 1993, received a number of requests for guidance on whether specific agreements were, under IGRA, management contracts that require approval and background investigations. Accordingly, on July 1, 1993, the Commission issued Bulletin 93-3, "Submission of Gaming-Related Contracts and Agreements for Review," which invited tribes and their contractors to submit what the December 15 letter calls "non-management contracts" -- again, gaming equipment contracts, development agreements, loan agreements, etc. -- to the Commission for review in order to determine if they were management contracts.

On October 14, 1994, the Commission issued Bulletin 94-5, "Approved Management Contracts v. Consulting Agreements (Unapproved Management Contracts are Void)," which provided additional guidance on the issue. Noting that what distinguishes a management contract from other gaming contracts "depend[s] on the specific facts of each case," the Commission restated its willingness to provide voluntary review. Tribes and their contractors did not hesitate to accept the Commission's offer. Since July 1993, the Commission has received some 440 requests to review contracts.

The Commission's review for violations of IGRA's sole proprietary interest requirement is simply a part of the voluntary review of gaming-related agreements that it has conducted for more than 11 years. The Commission reviews such agreements both to see if they are management contracts and to see if they violate the sole proprietary interest requirement.

The sole proprietary interest review has its origins in January 1993, when the Commission adopted regulations concerning, among other things, the submission, review, and approval of tribal gaming ordinances. In response to a specific inquiry by a commenter, the Commission provided guidance on the meaning of the sole proprietary interest requirement. The Commission found:

1. An agreement whereby consideration is paid or payable to the gaming operation for the right to place gambling devices that are controlled by the vendor in such gaming operation is inconsistent with the requirement that a tribe have the sole proprietary interest.
2. Regarding collateral loans, a tribe may not grant a security interest in a gaming operation if such an interest would give a party other than the tribe the right to control gaming in the event of a default by the tribe.
3. Because IGRA specifies that a tribe (not its members) must have the sole proprietary interest, stock ownership in a tribal gaming operation by individual tribal members would also be inconsistent with IGRA.

58 F.R. 5804 (Jan. 22, 1993).

Having said this, the Commission felt further general guidance to be inappropriate, but concluded with a public offer to "provide guidance in specific circumstances" upon request. *Ibid.*

**Results of the Commission's contract review:
Tribes are the primary beneficiaries of their casinos**

Far from shutting down opportunities for tribes to build or expand casinos, the review of contracts, both for management contract and sole proprietary interest violations, has, without exaggeration, saved Indian tribes tens of millions of dollars. In so doing, review has helped ensure that tribes are the primary beneficiaries of their casinos, as IGRA intends. 25 U.S.C. § 2702(2).

The Commission has, for example, discovered agreements under which contractors have tried not only to take financial advantage of tribes but also to subvert IGRA's requirements for management contracts and for regulatory oversight. Contractors have presented tribes with so-called "consulting agreements" by which they offered to "assist" tribes in building and running a casino. Representative of such agreements is compensation of 35% of a tribe's net gaming revenue for a period of 5 to 7 years, well in excess of IGRA's 30% cap on compensation from net revenue in management agreements. 25 U.S.C. § 2711(c)(1). The contrac-

tors also insisted on preferential payments, *i.e.* payments from the tribe before all obligations other than operating expenses, and thus create the possibility that the tribe is left with very little or is left in debt to the contractor.

Contractors have attempted to safeguard their financial interests by arrogating to themselves significant management responsibilities, while at the same time claiming that the "consulting agreement" is not a management contract and not subject to my approval. Those management responsibilities have included such things as appointing the casino's general manager, who has direct supervisory authority over all casino departments and employees; developing the casino's internal controls; developing the casino's budget; deciding which games to offer; and directing casino marketing and advertising.

As the Commission's review and analysis developed, it prevented this kind of contract from ever taking effect, or allowed tribes to renegotiate such contracts if they had already been signed. As a result, the tribes have remained in control of, and have remained the primary beneficiaries of, their casinos. When notified that such agreements appeared to be management contracts that did not meet IGRA's limitations on payment from net revenues, or other of its stringent requirements, tribes were able to negotiate more favorable financial arrangements and realized savings of millions. In addition, contractors were prevented from managing Indian casinos without first undergoing the necessary background checks and suitability determinations. 25 U.S.C. § 2711(e). The Commission's review has thus advanced another of IGRA's essential purposes. It has ensured that casinos, and those who manage them, are free from corrupting influences. 25 U.S.C. § 2702(2).

As contractors realized that they were no longer able to circumvent management contract review by calling a contract a "consulting agreement" or a "development agreement," they began eliminating provisions that allowed them to control the day-to-day operations of casinos. In other words, they began to look for other ways to extract large sums of money from tribes without taking on responsibilities that would raise red flags in a review for management contracts.

This change in approach led the Commission to realize that some contractors were apparently receiving an ownership interest in tribal casinos because they were certainly not providing services worth the enormous sums of money they were receiving. By reviewing contracts for sole proprietary interest violations as well as management contract violations, the Commission has saved tribes many more millions of dollars.

In one agreement, for example, the tribe had a 10-year obligation to pay its contractor 35% of its net gaming revenues each month as so-called "rent" for gaming equipment and the casino building, all of which the tribe had already paid for in full within the first 6 months of the 10-year term.

In an even more egregious example, the tribe had a 5-year obligation to pay rent equal to all of the developer's costs, plus interest, plus an additional "rent" of 75% of net revenue. Following that, the tribe had a 10-year obligation to pay 16% of gross revenue, an amount

roughly equal to 50% of net revenue, and all of these payments were to be made long after the developer ceased providing services of any kind.

These agreements, and others like them, violate IGRA's sole proprietary interest requirement because the developer's compensation is paid from the casino's profits, and it is paid in such a way and in such quantity as to bear little or no relationship to the value of the services provided or to the risk assumed. Rather, profits are distributed to the developer as to one with a fractional ownership interest -- a proprietary interest -- in an enterprise and its profits. The Commission's review has enabled tribes to avoid such illegal and unconscionable agreements and has thus assured that they are the primary beneficiaries of their casinos.

**Results of the Commission's contract review continued:
Enforcement actions are unnecessary**

The Commission's review of gaming-related contracts, again, whether for management contract or sole proprietary interest violations, is sound regulatory practice with a number of other straightforward, beneficial effects. By identifying IGRA violations before they occur, enforcement actions are not required, nor are the fines of up to \$25,000 per day or the closure of casinos. 25 U.S.C. § 2713(a)-(b). By identifying violations in contracts soon after execution, we are often able to negotiate resolutions without the need for enforcement actions. Whenever violations may be discovered, by proceeding in this way, the parties are able to avoid the uncertainty and loss of business occasioned by formal action taken against tribes for contracts executed in violation of applicable law.

Due process

Finally, the Commission's review does not infringe upon the rights of tribes or their contractors. My authority is explicit in IGRA. Without limitation, I am empowered to bring enforcement actions against all IGRA violations. 25 U.S.C. § 2713.

Again, however, one of the purposes of contract review is to eliminate IGRA violations and thus to avoid enforcement actions whenever possible. Doing so by means of an advisory opinion in response to a voluntary request for review violates no one's rights.

I want to stress again that our review is informal and voluntary. The parties are not obliged to seek review, nor are they obliged to heed our advisory opinion if they do. Indeed, in the rare instances when the Commission has reached out and asked to review contracts, the request is, of necessity, still voluntary. We have no jurisdiction over the contractors to compel their compliance, and we have brought no enforcement actions against the tribes pursuant to which we might compel them to submit contracts. The tribes and their contractors are free to decline our request, just as they are free not to seek an advisory opinion in the first place. As such, our review is an informal, prophylactic exercise that seeks negotiated solutions rather than formal enforcement. In other words, our review simply does not implicate the parties' statutory or constitutional rights.

The Commission is at great pains, however, to protect those rights when voluntary, cooperative action ceases and I bring a formal enforcement action. The parties are then entitled to complete review before the full Commission under the Administrative Procedures Act, and they are entitled to subsequent judicial review in District Court if they are still aggrieved. 25 U.S.C. §§ 2713(a)(2), (3); 2713(b)(2); 2713(c).

Given, then, the advisory nature of the Commission's contract reviews, and given the full panoply of administrative and judicial review available to aggrieved parties, the statutory and due process rights of the tribes and of their contractors are not infringed in any way.

In conclusion, I hope that our explanation provides you with a more complete understanding of our reasons for addressing the sole proprietary interest issue in the manner that we have. I would be most pleased to meet with you personally to discuss this matter further, or any other matter of concern to the Committee. I thank you for your time, interest, and concern.

Sincerely,

/s/ Philip N. Hogen

Philip N. Hogen
Chairman