GETTING IN THE GAME: ENFORCING AND FORECLOSING ON SECURITY INTERESTS IN THE GAMING INDUSTRY

By Leanne Dodds and Diane Markert

For decades, the gaming industry has long been viewed as immune from economic downturn and has enjoyed vibrant eras of soaring revenues. Even during the recessions of 1990-1991 and 2001, casinos performed moderately well. Private and public investors alike freely extended credit and loans to gaming borrowers during the days of easy credit in 2006 and 2007 in exchange for a patchwork of secured interests in the equity and gaming assets of borrowers. This was often done without regard to the practical effects of how lenders would execute and foreclose on those secured interests. After all, the gaming industry was thought to be recession-proof and a safe gamble. If you build it, they will come. And so they did.

With ambitious expansion plans in hand, casinos heavily borrowed to finance their new developments and acquisitions, and lenders freely gave. Now, however, with the latest recession in full swing and gaming revenues swooning, the time-honored casino industry is under strain like never before. Casinos are defaulting on their debt obligations and covenants, expansion projects in the pipeline are being tabled or walked away from altogether and, as a result, senior secured creditors who once were sitting on the sidelines are now getting in the game as the new face of equity owners to recoup monies loaned during the easy-credit days.

In March's edition of *Casino Enterprise Management*, we discussed bankruptcy laws as they generally apply to the casino industry and gaming regulations. In this month's article, we take a more in-depth look at the foreclosure process and the practical considerations faced by lenders as they shift from casino creditor to owner.

Lenders who move to foreclose on security interests or undertake other strategies to manage defaulting loans of licensed gaming borrowers face a unique challenge. State gaming authorities need to know at any given time who owns, controls and operates gaming licensees; therefore, foreclosure of any equity security issued by a licensee cannot be automatic. Most states allow a secured party to foreclose on a gaming licensee's real property; gaming devices; the proceeds from the operation of casino games; and the personal property gaming collateral, including stocks, bonds and other securities issued by a gaming licensee or holding company.

However, in many jurisdictions, including Nevada, a lender generally cannot assume control of a gaming business or foreclose on a security interest in the equity of a gaming licensee or in gaming devices without first obtaining some form of prior state gaming authority approval or undergoing a suitability review, unless certain limited exemptions apply. Exemptions that may apply to a security interest foreclosure scenario include whether the gaming licensee is a publicly traded company, what percentage of stock or other equity interest is involved, whether the lender is an established commercial lender, and whether administrative waivers are obtainable. In Nevada, no approval is needed to enforce a security interest in the stock of a publicly traded gaming licensee corporation, unless the secured party would be acquiring control of the corporation or acquiring more than 10 percent of any class of voting security of the corporation.

If one of the limited exemptions does not apply, a casino lender who seeks to enforce its security interest in the equity of a gaming licensee generally must first obtain the state gaming authorities' approval to enforce the security interest. Any attempt to enforce the security interest without first obtaining such approvals is generally void. Part of the process of obtaining gaming authority approval may require that the casino lender or individual persons within the casino lender's organization obtain gaming licenses or satisfy state gaming suitability requirements. Moreover, as a prerequisite for seeking gaming authority approval to enforce the security interest, the casino lender must have previously complied with applicable state gaming laws when the loan was initially made to the gaming licensee, including obtaining required approvals of the pledge of the gaming licensee's equity security that was offered as collateral for that loan.

In Nevada, for example, a security interest in a gaming licensee's equity security may be enforced only after the Nevada Gaming Commission, following the recommendation of the Nevada State Gaming Control Board, approves the enforcement. Approval requires the secured party's satisfactory completion of an application process and its satisfaction of any licensing, registration, or suitability requirements, or the waiver by the Nevada Gaming Commission of those requirements.

As part of the application process to obtain approval to enforce the security interest in the equity securities of a gaming licensee, the secured party is responsible for submitting to the Nevada State Gaming Control Board the documents and information that the board requires or requests in order to conduct its investigation to determine whether to recommend enforcement of the security interest. Among other items, the secured party will submit to the Nevada State Gaming Control Board a schedule and description of the equity security to which the security interest attaches; copies of documents, such as the security agreement, showing the establishment of the secured obligation on the part of the gaming licensee borrower; and documentation evidencing

the gaming licensee borrower's default, including any notice of default sent to the gaming licensee borrower.

As part of its investigation, the board will consider the impact that enforcing the security interest may have on the continued operation of gaming at the borrower's casino establishment as well as whether the grant of the security interest in the equity securities was made in an attempt to evade any Nevada gaming law or regulations. For example, the pledge of any equity security in a Nevada gaming licensee given as collateral for a loan to that gaming licensee is void unless the pledge had previously been approved by the Nevada Gaming Commission.

Both the Nevada State Gaming Control Board and the Nevada Gaming Commission will also consider whether any individual persons associated with the secured party must be licensed, registered or found suitable under Nevada gaming laws in order for the security interest in the gaming licensee's equity security to be enforced. If that is the case, and if persons who should be licensed, registered or found suitable currently are not licensed, registered or found unsuitable, as applicable, the Nevada Gaming Commission will not approve the enforcement of the security interests—even if the secured party has otherwise satisfied all requirements imposed by the Nevada State Gaming Control Board as part of the security interest enforcement approval process.

However, if the secured party has submitted a written request to the commission asking for either a waiver or delay of the licensing, registration or suitability process, and if the board has recommended the waiver or delay, then the commission may grant either a temporary or permanent waiver of licensing, registration or finding of suitability, or may grant delayed licensing, registration or finding of suitability. The commission's grant of a waiver or delay is not guaranteed; casino lenders should therefore be aware of licensing, registration and suitability finding requirements.

Foreclosing a lien that was secured by a gaming licensee's gaming devices may also require authorization or approval of the state gaming authorities. Generally, a party may not distribute gaming devices to another party without having first obtained the applicable license from the state gaming authorities. Certain exceptions to this requirement may exist, however. In Nevada, the State Gaming Control Board may authorize a foreclosing casino lender to dispose of the gaming devices that had served as collateral for the loan to the gaming licensee without first obtaining a distributor's license.

With the current recession reducing revenues in the casino industry, lenders who had previously taken security interests in gaming licensees' collateral in exchange for easy-credit loans now find they must enforce those security interests in order to recoup the monies loaned and to minimize their losses. State regulation of gaming means, however, that enforcing a security interest in a gaming licensee's collateral may be neither automatic nor quick, with the casino lender needing to be aware of the state gaming authority approvals that the lender may need to obtain, including the possibility that the casino lender may need to satisfy state licensing or suitability requirements. State regulation of enforcement of security interests in gaming licensee equity securities is especially subject to gaming authority scrutiny; with a gaming license being a privilege subject to state control and approval, the gaming authorities must know, at any given time, who is in control of and operating a gaming entity.

To help ensure timely enforcement of a lender's security interest in a gaming licensee's pledged equity security, lenders must carefully comply with state gaming laws and regulations. In each case of foreclosure involving an equity interest in a gaming licensee, lenders must jump through the regulatory analysis to determine what approvals are required and whether exemptions apply. Such analysis should include each state in which the gaming licensee borrower is licensed.

This article focuses on enforcement of security interests from a gaming law perspective only and does not discuss enforcement under the Uniform Commercial Code. In addition to gaming-law considerations and approvals, casino lenders must still satisfy all provisions for enforcement of a security interest as addressed under the applicable state's Uniform Commercial Code.

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