September 23, 2008

Via U.S. Post and Facsimile

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RE: Development Agreement and Financial Services Agreement between the Ponca Tribe of Oklahoma and Sunway-Postoak Gaming Corporation

Dear Chairman Jones and Messrs. Bellmard, Culbertson and Postoak:

On March 10, 2008, National Indian Gaming Commission (NIGC) Field Investigators forwarded the Development Agreement (DA) and Financial Services Agreement (FSA) between the Ponca Nation of Oklahoma (Nation) and Sunway-Postoak Gaming Corporation (Sunway) for the NIGC Office of General Counsel's review. Under the DA and the FSA, Sunway promises to create a turn-key facility, secure funding, and assist with training prior to opening.

After reviewing the agreements, the Office of General Counsel concludes that together they constitute a management agreement under the Indian Gaming Regulatory Act (IGRA). 25 U.S.C. § 2701 *et seq*. Further, the agreements together may violate IGRA's sole proprietary interest mandate. 25 U.S.C. § 2710(b)(2)(A); 25 C.F.R. § 522.4(b)(1); Gaming Ordinance of the Ponca Tribe of Oklahoma § 501. As such, the

NIGC requests that the parties consider revising the agreements or send them to the NIGC Contracts Division for management contract review under 25 U.S.C. § 2711.

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. 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, 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.*

The Supreme Court has held that management employees are "those who formulate and effectuate management policies by expressing and making operative the decision of their employer." *N.L.R.B. v. Bell Aerospace Co.*, 416 U.S. 267, 288 (1974). Whether particular employees are "managerial" is not controlled by the specific job title or the position held by the employee. *Waldo v. M.S.P.B.*, 19 F.3d 1395 (Fed.Cir. 1994). Rather, the question must be answered in terms of the employee's actual job responsibilities, authority and relationship to management. *Id.* at 1399. In essence, an employee can qualify as management if the employee actually has authority to take discretionary actions - thus being a *de jure* manager - or recommends discretionary actions that are implemented by others possessing actual authority to control employer policy, thus being a *de facto* manager. *Id.* at 1399 (*citing N.L.R.B. v. Yeshiva*, 444 U.S. 672, 683 (1980)).

De facto management is also found where a developer provides individuals to supervise, train and instruct employees during the operation of a casino. *See First American Kickapoo Operations, L.L.C. v. Multimedia Games, Inc.*, 412 F.3d 1166, 1173

(10th Cir. 2005). This activity evidences an ongoing relationship. Instructing employees once a gaming operation begins its business is a traditionally management function. *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 provision, 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)(l).

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" states that, "the tribe must be the sole owner of the gaming enterprise." S. Rep. 100-446, 1988 U.S.C.C.A.N. 3071- 3078.

Finally, in regulatory preamble language, the NIGC provided a non-exhaustive list of arrangements that would violate the sole proprietary interest clause. According to this published guidance, sole proprietary interest violations would exist under:

- an agreement whereby a vendor pays the tribe for the right to place gambling devices that are controlled by the vendor on the gaming floor;

- a security agreement whereby a tribe grants a security interest in the gaming operation, if such an interest would give a party other than the tribe the right to control gaming in the event of default by the tribe; and
- stock ownership in a tribal gaming operation, even by tribal members.

58 Fed. Reg. 5802, 5804 (Jan. 22, 1993). Again, this list was not meant to be exhaustive, but does provide three types of scenarios that are not allowed under IGRA's sole proprietary interest clause.

Determination

The security provision of the FSA creates a trusteeship that constitutes management of part of the gaming operation. FSA § 2.7. The security provision states that in the event of default of payment or breach of the agreements by the Tribe, then Sunway will be allowed to impose a trusteeship on the project. FSA § 2.7. This action would allow Sunway to act as trustee for the pledged security, i.e. the net operating income that is promised to Sunway as part of its payment. FSA § 2.6. The net operating income is defined as monies received minus prizes paid, and thus constitutes adjusted gross revenue of the gaming operation without the deduction of operating expenses. FSA § 2.5. Further, this definition does not require operating expenses to be paid prior to Sunway receiving its share.

The result is that in the event of default, Sunway would act as trustee over the gaming revenue and would handle the payment of operating expenses, deciding to pay them or not at its discretion. Thus, Sunway would act as a manager of gaming revenue without an approved contract in violation of IGRA.

Additionally, we are concerned that Sunway's fees for its services may violate IGRA's sole proprietary interest mandate because they do not appear to be reasonably related to the service provided. IGRA requires tribes to possess the sole proprietary interest in their gaming operation. 25 U.S.C. § 2710(b)(2)(A). Development fees that are tied to the operation's profits and fail to reasonably relate to the service provided, or the risk undertaken, can look more like a stake in the business rather than mere payment for services rendered. As the industry standard runs between 2-5% of development costs for a developer, a higher fee would require justification through special risks or duties. Absent such duties or risks, a higher than standard fee would connote a proprietary interest that violates IGRA.

According to the agreements, Sunway will receive [ ] costs for its services. FSA § 2.3. Sunway will also receive [ ] over the life of the agreements. DA § 1(c). The agreements will last for [ ] FSA § 8.1. Anything above [ ] which constitutes [ ] of developments costs, will require justification. An estimate of Sunway's profit for these agreements appears as follows:[1]

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[1] These figures are estimates of profit, absent growth, that are based upon the financials received from the Tribe's Blue Star facility. The Blue Star facility has approximately [ ] machines and an estimated Win Per

[redacted] b4

Thus, absent growth, Sunway can expect to receive approximately [redacted] over the life of the agreement. This is almost [redacted] higher than the industry standard.

Sunway does claim additional duties in the DA that may help explain its fee. Sunway promises to manage the hotel over the life of the agreement, hire and train new casino employees prior to opening, install and train employees on accounting systems prior to opening, and establish audit procedures prior to opening. DA Exhibit F and FSA Exhibit B. These duties, however, do not seem to account for a fee that is [redacted] higher than the industry standard.

Conclusion

The trusteeship provision within the FSA creates a management contract. Management contracts are void without the Chairman's approval. 25 C.F.R. § 533.7. Further, the fees in the agreements may violate the sole proprietary interest mandate of IGRA. The NIGC asks that the parties please revise these agreements or submit them to the Contracts Division for management contract review.

If you have any questions, please contact Staff Attorney Rebecca Chapman at (202) 632-7003.

Sincerely,

Penny Coleman

Penny Coleman
General Counsel (Acting)

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Unit of [redacted] per day on each machine. The figures above represent an estimated [redacted] per day Win Per Unit on the [redacted] machines that will be part of the Tribe's new facility.