January 19, 2006

Mr. Donald Arnold
Tribal Chairman
Scotts Valley Band of Pomo Indians
9700 Soda Bay Road
Kelsyville, CA 95451

Dear Chairman Arnold:

The purpose of this letter is to respond to your request that the National Indian Gaming Commission (NIGC) review certain transaction documents executed by the Scotts Valley Band of Pomo Indians (Tribe) and Richmond Gaming (Developer). The documents included an Amended and Restated Turn-Key Facility Agreement, a Pre-Construction Promissory Note, and a Cash Management Agreement (Agreements).

The purpose of our review is to determine whether the Agreements, individually or collectively, constitute a management contract or collateral agreements to a management contract and therefore subject to our review and approval under the Indian Gaming Regulatory Act (IGRA).

As part of your submission you also included a discussion of why you felt the Agreements did not constitute management agreements and why the Agreements did not grant the developer a proprietary interest. We conclude that the Agreements do not constitute a management agreement subject to the approval of the Chairman. However, as we verbally indicated to you, we remain concerned that the Agreement violates the sole proprietary interest provisions of IGRA.

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

The NIGC has defined the term "management contract" to mean "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. The NIGC has

defined "collateral agreement" to mean "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.

After reviewing the Agreements, we conclude that the Agreements do not establish a management relationship.

Proprietary Interest

[redacted] is a seemingly high percentage for simply developing the gaming operation. b4
We are concerned that the agreement may, in some instances, give the developer an impermissible proprietary interest in the gaming operation.

Applicable Law

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. The NIGC, in its regulations, also requires that all tribal gaming ordinances include such a provision. 25 CFR § 522.4(b)(1). Accordingly, the Scotts Valley Band of Pomo Indians gaming ordinance, approved by the NIGC, specifically requires that "the Tribe shall have sole proprietary interest in and responsibility for the conduct of any gaming operation facilities and/or enterprise(s) authorized by this Ordinance . . .". Ordinance of the Scotts Valley Band of Pomo Indians No. 96-SUO-11, Section 2.

"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

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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. [emphasis added]

Id.

An additional aid to statutory interpretation includes the legislative history of the statute. 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, 2nd Edition, 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] [emphasis added]

46 Am. Jur. 2d *Contracts* § 57.

Finally, the preamble to the NIGC's 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).

Analysis

In your contract submission you included an analysis of the term "proprietary interest." We believe that your analysis is far too simplistic. Your opinion that a proprietary interest is only granted if the individual is given the right to "possess, use or convey the facility or gaming operation" ignores other aspects of the financial relationship between the parties. For example, the fact that an individual or entity is given an interest in the profits of an operation may be an indication of an equity interest rather than payment for services provided.

When an entity is compensated with a high percentage of an operations gross revenues we try to examine that percentage if expressed in terms of net revenue. For example, in certain situations, 16% of gross gaming revenue could translate into over fifty percent of net revenue. This would mean that over half of profits would be going to an entity other than a tribe. This raises our concerns that the Tribe may not be the primary beneficiary of the gaming operation.

By comparison, management contracts approved by the Chairman of the NIGC have a fee cap set at thirty percent (30%) of net revenues or forty percent (40%) of net revenues if the capital investment required and the gaming operation's income projections require the higher fee. *See* 25 U.S.C. §§ 2711(c)(1)-(2). The IGRA defines net revenues as: "gross revenues of an Indian gaming activity less amounts paid out as, or paid for, prizes and total operating expenses, excluding management fees." *See* 25 U.S.C. § 2703(9) (emphasis added).

The agreement between the Tribe and the Developer requires the Tribe to pay a percentage of its gross revenues over a period of [redacted] 64 The high percentage rate coupled with the long term length compels us to examine the agreement further to ascertain whether the risk involved justifies such a high level of compensation.

Our opinion is influenced by the fact that [redacted] According to the financial projections, the total Construction and Development Loan will be [redacted] which will be repaid over [redacted] The proposed compensation to the Developer is [redacted] and greatly exceeds the industry norms for development services. b4

We have considered the amount of pre-development expenditures[2] made by the developer in light of the fact that the Tribe has not acquired the land in trust, nor has it signed a compact with the State of California. While there are some risks, these risks do not bear a reasonable relation to the compensation the Developer would receive.[3]

Our concerns are further fueled by the potential changes that may occur for this project. The land is not in trust, and, at this time, the Department of Interior has not opined on whether the proposed casino location would qualify as Indian lands under IGRA. These factors have a direct relation to the risk involved as well as the compensation provided.

Our review of the documents raises other issues. The definition of "Net Revenues" and "Operating Expenses" (Master Definitions pp. 7-8) appear to contain exceptions to generally acceptable accounting principles. Under the IGRA and NIGC regulations, the gaming operation's financial statements must be prepared in accordance with generally accepted accounting principles.

In addition to the high level of compensation and the long term of the agreement we are also concerned about the degree of control the Developer exercises. For instance, the Amended and Restated Turn-Key Facility Agreement appears to [redacted] This type of control indicates a partnership agreement rather than an agreement for services. b4

The Developer's control of the financial records also appears to be too restrictive. The Tribe only has 30 days to question any expense paid by the Developer and then those expenses are deemed approved. (§ 2.5.5.1). As the sole owner of the gaming operation, the Tribe must have the access and authority to correct prior errors in the account records and the treatment of the operating expenses.

The agreement appears to limit the Tribe's ability to act as a sovereign regarding licensing. Section 8.31., pp. 28-29, limits the Tribe's ability to withdraw or refuse to renew tribal gaming licenses.

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Further, the Cash Management Account appears to grant the Developer complete access to the books and records without requiring the Developer to comply with all tribal laws. (§ 5.3.4, p. 13).

Finally, a copy of Tribal Resolution 22-04 was submitted with the agreements. The resolution authorizes the Tribal Chairman to execute the documents. The Resolution was signed by the Tribal Chairman on September 14, 2004. However, the certification sections are blank and the signature of the Tribal secretary is blank.

Determination

We conclude that the Agreements do not constitute a management agreement. However, at this time, based upon the uncertainty of the project scope, we are not able to provide a determination on whether or not the proprietary interest provisions of IGRA are violated. We believe, however, based on what we presently know, that a strong argument can be made that this agreement prevents the Tribe from being the primary beneficiary of the gaming operation and violates the requirement that the Tribe retain the sole proprietary interest in the gaming operation.

We anticipate that this letter will be the subject of Freedom of Information Act ("FOIA") requests. Since we believe that some of the information contained herein falls within FOIA Exemption 4(c), which applies to confidential and proprietary information, the release of which could cause substantial competitive harm, we ask that you provide us with your views regarding release within 10 days.

A copy of your letters and the contracts will be provided to the Office of Indian Gaming Management, Bureau of Indian Affairs, for its review. If you have any questions, please contact John Hay, Staff Attorney.

Sincerely,

Penny J. Coleman
Acting General Counsel

cc: Director, OIGM
Paul Filzer, Esq.
Pauline Girvin, Esq.