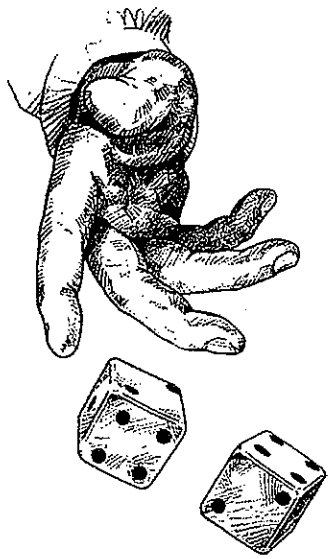
PLAYING CRAPS IN THE BANKRUPTCY SANDBOX:

PRACTICE GUIDEPOSTS AND ISSUES IN GAMING INDUSTRY RESTRUCTURINGS



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PLAYING CRAPS IN THE BANKRUPTCY SANDBOX

PART I

GUIDEPOSTS FOR REPRESENTATIONS IN GAMING BANKRUPTCIES

Presentation to the ABI Winter Leadership Conference
December 3, 2005

Prepared by Robert Jay Moore and Rudy Cerone[1]

INTRODUCTION

The Question:

How do gaming regulations fundamentally change the nature of the chapter 11 bankruptcy process for a casino operator?

The Answer:

Materially.

When a licensed gaming enterprise contemplates entering into or finds itself in a bankruptcy reorganization process, the state statutory and state and local regulatory overlays can complicate the planning and implementation process immensely. For instance, a gaming enterprise debtor might not be able to reorganize by simply converting its debt into the equity of a reorganized company – indeed, its creditors may be required, but may not even be eligible, to become licensed as equity owners of a gaming enterprise. The enterprise might not be able sell its assets to the economically highest bidder. Indeed, a gaming debtor might be forced to engage in multiple efforts to sell substantially all of its assets. Creditors hostile to a gaming debtor might face regulatory hurdles when seeking to appoint a trustee or when trying to confirm a plan that is opposed by the gaming debtor's management. Secured creditors might face battles over the value of their collateral because of the nature of a gaming license under state law (a gaming license cannot be hypothecated to become part of a secured creditor's collateral pool).

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[1] Mr. Moore is a Partner in the Global Financial Restructuring Group of Milbank, Tweed, Hadley & McCloy LLP. Mr. Cerone is a Member of McGlinchey Stafford PLLC practicing in its Commercial Litigation Section and specializing in business bankruptcy. These materials were prepared with the substantial assistance of David A. Zolkin of Milbank, Tweed, Hadley & McCloy LLP.

Several papers have been written over the past few years that provide an excellent general overview of the issues and concerns that exist in the chapter 11 bankruptcy cases of casinos. Among them, the 2001 Note entitled "Bankruptcy Trends in the Gaming Field" prepared by Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming.[2] and the 2004 article entitled "The House Doesn't Always Win" prepared by The Honorable Gregg W. Zive[3] These papers are excellent resource materials for any bankruptcy professional that becomes involved in a gaming chapter 11 case, and we include a copy of "Bankruptcy Trends in the Gaming Field" in the appendix to these materials.

This program, and the accompanying materials, will attempt to provide the practitioner with some practical guideposts for dealing with certain unique and significant issues that inevitably will arise during the course of a gaming chapter 11 bankruptcy case. Part II of these materials, entitled "Gaming Industry Restructuring Issues," prepared by Steven R. Strom, Managing Director, Financial Restructuring Group, CIBC World Markets is designed to provide a general overview of the issues that a financial advisor must consider in a gaming industry restructuring process. The crucial role that valuation issues play in a gaming bankruptcy is explored in Part III of these materials, entitled "Gaming Restructuring Valuation Issues - Trump Casinos: A Case Study," prepared by William Hardie III, Managing Director, Houliha Lokey Howard & Zukin.

THE REGULATORY OVERLAY

The ownership and operation of gaming facilities are subject to extensive state and local regulation. Gaming laws typically are implemented and enforced by state created commissions or boards ("Gaming Authorities"). Gaming Authorities are the gate-keepers for those who wish to enter into and remain active within the world of gaming ownership and operation. As a condition to obtaining and maintaining a gaming license, a casino must pay fees and taxes, observe stringent regulations on operations, submit and update comprehensive applications, and submit detailed financial, operating and other reports to Gaming Authorities. Gaming Authorities have broad powers to suspend or revoke gaming licenses. In addition, substantially all of a casino operation's material transactions (e.g., sales of substantial assets, issuance of securities) require prior notice to Gaming Authorities for their review, and in some instances, approval.

Any individual with a material relationship to or material involvement with a licensed gaming enterprise may be investigated by Gaming Authorities to ensure that he or she is found "suitable" to have such relationship. Consequently, officers, directors and other key persons (which include not only individuals – such as a general manager - but also related companies that may be designated by Gaming Authorities) must submit applications that contain detailed personal and financial information. Such persons are subject to thorough suitability (or licensing) investigation by Gaming Authorities.

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[2] Gerald M. Gordon, Rudy J. Cerone, and Scott Flemming, Note, Bankruptcy Trends in the Gaming Field, 10 J. BANKR. L. & PRAC. 293 (2001).

[3] Gregg W. Zive, Original Article, The House Doesn't Always Win, 8 GAMING L. REV. 278 (2004).

Gaming Authorities may deny any suitability or licensing application for any cause deemed reasonable.

Any person or entity that holds the equity securities of a licensed gaming enterprise similarly may be required, at its own expense, to file a suitability application and subject itself to a suitability investigation by Gaming Authorities. Although the law in most jurisdictions offers up certain exceptions to the requirement that a shareholder be subjected to a suitability investigation and determination, those exceptions fall away if the prospective shareholder's position in the company's equity is large enough or if the shareholder is able to exercise any control over what may be deemed to be management and operating decisions. For instance, under Nevada law, an institutional investor that holds less then 15% of the gaming enterprise's equity may obtain a waiver from suitability. Louisiana's version of the institutional investor exemption is unavailable to any institutional investor that holds 5% or more of the gaming enterprise's equity.

Holders of a gaming enterprise's debt securities also may be subjected to suitability investigations and approvals.

NOTWITHSTANDING APPLICABLE STATE LAW, IS A GAMING LICENSE PROPERTY OF THE BANKRUPTCY ESTATE?

Under the gaming laws of virtually every state, a gaming license is not considered to be property of the holder, but rather a revocable, non-assignable (absent Gaming Authority consent) privilege to conduct permitted gaming activities. However, when a bankruptcy petition is filed, an estate is created pursuant to section 541(a) of the Bankruptcy Code. The term "estate" is broadly defined in § 541(a) to include all of a debtor's legal or equitable interests in property, whether it is tangible or intangible. Property interests are interpreted in an expansive manner and it is federal, not state, law that determines the scope of estate property. United States v. Whiting Pools, Inc., 462 U.S. 198, 205 (1983); Butner v.. United States, 440 U.S. 48, 55 (1979).

Obviously, a gaming license is central to the ability of a gaming enterprise to operate its business. Absent the license, there would be no gaming enterprise, but merely a collection of assets that, absent the ability to conduct gaming, might not otherwise be integrated into a single business operation or capable, whether individually or in the aggregate, of generating the same level of revenues or profitability.[4] Consequently, notwithstanding the fact that states generally deem a gaming license to be nothing more

[4] There is still some value to a hotel, restaurants, etc. However, the collection is worth substantially less without the ability to operate as a casino, which may be both the marketing draw for the related operations and the principal source of profitability. Moreover, the impact that a gaming license has on such assets depends to some degree upon whether the state in which the license is issued is one in which only a limited number of gaming licenses are issued (e.g., Louisiana and Missouri) or one in which the issuance of the license is open (e.g., Nevada and New Jersey). In "open" states (not a technical term), the threshold for obtaining a gaming license generally is lower. One must still pass investigation, but, theoretically, there can be unlimited number of casinos in an "open" state.

than a privilege held by a gaming enterprise at the state's whim, it is difficult to say that the gaming debtor would not have some proprietary interest in the license that rises to the level of a property interest under section 541.

This view finds support in several cases in which bankruptcy courts, pursuant to section 362(a) of the Bankruptcy Code, have prohibited Gaming Authorities' from revoking gaming licenses during the course of a bankruptcy case on account of the debtor's failure to pay certain prepetition fees and taxes. See National Cattle Congress, Inc., 179 B.R. 588 (Bankr. N.D.Iowa 1995) remanded with directions, 91 F.3d 1113 (8th Cir. 1996) (the debtor has, at a minimum, a proprietary interest in its license to be administered by the Bankruptcy Court, and the Iowa Gaming Commission's revocation of the license in order to compel the post-petition payment of a pre-petition claim was deemed void ab initio); In re Elsinore Shores Associates, 66 B.R. 723 (Bankr.D.N.J. 1986) (section 362(b)(4), which, ordinarily, would except from the operation of the automatic stay actions of governmental units to enforce their police and regulatory powers, did not apply because the attempt to revoke the debtor's gaming license was not intended to protect the health, safety or welfare of the public, but rather to protect the state of New Jersey's pecuniary interests); In re NLV Corp., 1981 WL 157765 (Bankr. D. Nev. 1981)(section 105(a) of the Bankruptcy Code invoked to prohibit Nevada Gaming Authorities from shuttering the debtor's casino); see also Board of Trade of Chicago v. Johnson, 264 U.S. 1 (1924) (U.S. Supreme Court refused to limit the concept of property to the definition of property under nonbankruptcy law, holding that a seat on the Chicago Board of Trade, which was not considered property of the seat holder under Illinois law, constituted property of the debtor seat holders' bankruptcy estate). Notwithstanding this body of law, the issue of how the estate may value and dispose of its property interest in a gaming license is subject to significant constraint and requires further analysis.

PREEMPTION ISSUES

Although a gaming debtor may hold a property interest in a gaming license, that does not necessarily mean that the gaming debtor will be able to transfer the gaming license, sell its gaming operations or reorganize without first complying with state gaming laws and regulations. Indeed, unless applicable provisions of the Bankruptcy Code preempt state gaming laws under the Supremacy Clause of the U.S. Constitution, a chapter 11 gaming debtor must comply with all applicable gaming laws if it intends to successfully exit from bankruptcy.

"It is a familiar and well-established principle that the Supremacy Clause...invalidates state laws that 'interfere with, or are contrary to,' federal law." Hillsborough County. v. Automated Med. Labs., Inc., 471 U.S. 707, 712 (1985) (citations omitted). Where Congress is acting within its constitutional limits, it may preempt state laws simply by expressing its intent to do so within a statute. Id. at 713. Where Congress' intent to preempt is not express, federal courts may infer that intent under certain circumstances. Congress's intent to preempt all state law in a particular area may be inferred where federal regulation is sufficiently comprehensive to allow the reasonable inference that Congress left no room for state regulation. Id. Pre-emption of all laws in a

whole field will be inferred where the field is one in which the federal interest is so dominant that the federal system will be assumed to preclude state laws on the same subject. Id. Even where federal law has not completely displaced state regulation in a specific area, state law may be nullified to the extent that it actually conflicts with federal law. Id.

However, generally, the preemption of state law is disfavored, and one must show a "clear and manifest" intent on the part of Congress to preempt. BFP v. Resolution Trust Corp., 511 U.S. 531, 544 reh'g. denied, 114 S.Ct. 2771 (1994); Building & Trades Council v. Assoc. Builders, 507 U.S. 218, 224 (1993); Dept. of Revenue of Oregon v. ACF Industries, 510 U.S. 332, 345 (1994); English v. General Elec. Co., 496 U.S. 72, 87 (1990); Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 255 (1984). This restrained general approach to federal preemption is no less true in the bankruptcy context.

Although, as stated above, federal law determines the scope of estate property, the scope of a debtor's interest in property is still determined by state law. Butner, supra.

> Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law....Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a windfall merely by reason of the happenstance of bankruptcy.

Id. at 55 (citations and internal quotations omitted). Absent a countervailing federal interest, "the basic federal rule is that state law governs." Id. at 57; see also Integrated Solutions Inc. v. Service Support Specialties Inc., 124 F.3d 487, 492 (3d. Cir. 1997)(trustee precluded from assigning debtor's prejudgment tort claims in violation of New Jersey law); Nobelman v. American Sav. Bank, 508 U.S. 324, 329 (1993) ("In the absence of a controlling federal rule, we generally assume that Congress has left the determination of property rights in the assets of a bankrupt's estate to state law.") (citation and internal quotations omitted).

Following the Supreme Court's direction, the Third Circuit and other courts subsequently have concluded that "unless federal bankruptcy law has specifically preempted a state law restriction imposed on property of the estate, the trustee's rights in the property are limited to only those rights that the debtor possessed pre-petition." Integrated Solutions, 124 F.3d at 492.

1. Does Section 363 of the Bankruptcy Code Preempt Gaming Regulations Governing Sales or Other Dispositions?

Section 363(b)(1) of the Bankruptcy Code permits a trustee or debtor to use, sell

or lease property of the estate following notice and a hearing. Because section 363(b)(1) does not expressly authorize the trustee or debtor to sell property contrary to restrictions imposed by state and contract law, courts uniformly have been of the view that section 363(b)(1) is not in conflict with state law, and does not preempt applicable state law restrictions on the sale or transfer of property. Integrated Solutions, supra. Section 363(b)(1) is an enabling statute that gives the trustee or debtor in possession the authority to sell or dispose of property to the extent that the debtor would be entitled to do so under state law. Id; see also In re Schauer, 835 F.2d 1222, 1225 (8th Cir. 1987), at 1225; Universal Cooperatives, Inc. v. FCX, Inc. (In re FCX, Inc.), 853 F.2d 1149, 1155 (4th Cir.1988); In re Crossman, 259 B.R. 301, 307-08 (Bankr. N.D. Ill. 2001); In re Bishop College, 151 B.R. 394, 398-99 (Bankr.N.D.Tex.1993); In re Buildnet, Inc., 2004 WL 1534296 (Bankr.M.D.N.C.).

Consequently, a gaming debtor that seeks to sell or dispose of its gaming license or other assets pursuant to section 363(b)(1) must do so in total compliance with any applicable state gaming laws and regulations.

2. The Extent to Which a Plan of Reorganization Can Preempt Gaming Regulations Remains Subject to Debate.

Section 1123(a) specifies what must be included in a plan of reorganization under Chapter 11. Section 1123(a)(5) provides, in part, that "[n]otwithstanding any otherwise applicable nonbankruptcy law a plan shall...provide adequate means for the plan's implementation."

Prior to the Ninth Circuit's decision in In re Pacific Gas and Electric Company ("PG&E"), 350 F.3d 932 (9th Cir. 2003), decisions from several courts, including the Ninth Circuit, appeared to suggest that section 1123(a)(5) supported preemption of contrary state laws because, by the statute's plain language, a plan can be implemented "notwithstanding otherwise applicable nonbankruptcy law." See, e.g., Great W. Bank & Trust v. Entz-White Lumber & Supply, Inc. (In re Entz-White Lumber & Supply, Inc.), 850 F.2d 1338, 1340 (9th Cir. 1988); Public Service Co. of New Hampshire v. New Hampshire (In re Public Service Co. of New Hampshire), 108 B.R. 854, 891-92 (Bankr. D.N.H. 1989); In re FCX, supra; Wade v. Bradford, 39 F.3d 1126, 1130 (10th Cir. 1994); In re Kizzac Mgmt. Corp., 44 B.R. 496, 504 (Bankr. S.D.N.Y. 1984).

In PG&E, the debtor proposed a plan that contemplated the disaggregation of its power generation assets, electric transmission assets, gas transmission assets and electric and gas retail distribution business among four new corporations, each of which would be owned by the debtor's parent. The plan proposed that only one of the four new entities would remain subject to regulation by the California Public Utilities Commission ("CPUC"), while the remaining three would thereafter be subject to the exclusive regulatory jurisdiction of the Federal Energy Regulatory Commission ("FERC"). If the debtor were not disaggregated, it would remain subject in its entirety to regulation by the CPUC.

The debtor's disclosure statement made clear that the plan would have broad preemptive effect over many local and state laws pursuant to Bankruptcy Code section 1123(a)(5) and identified a nonexclusive list of many of the statutes, rules, order and decisions that would be preempted.

The bankruptcy court rejected the "across-the-board, take no prisoners preemption strategy" employed by the plan proponents, holding that there is no express preemption of non-bankruptcy law that permits wholesale unconditional preemption of numerous state laws...." PG&E, 273 B.R. 795, 820 (Bankr. N.D.Cal. 2002). Instead, it concluded that some nonbankruptcy laws may impliedly be preempted by the debtor's plan under section 1123(a)(5), but it reserved ruling on the preemption issues until a plan was proposed that did not so broadly preempt. On appeal, the district court eschewed the application of the federal courts' long standing presumption against preemption, elected to adopt a plain reading of section 1123(a)(5) and its preemptory language, and reversed the bankruptcy court.

The Ninth Circuit, reaffirming the long established presumption against preemption (discussed above), reversed the district court on grounds that another section of the Bankruptcy Code, section 1142(a), limited the preemptive effect of section 1123(a)(5). Section 1142(a) directly authorizes a debtor to implement its confirmed chapter 11 plan and provides as follows:

> Notwithstanding any otherwise applicable nonbankruptcy law, rule, or regulation relating to financial condition, the debtor and any entity organized for the purpose of carrying out the plan shall carry out the plan and shall comply with any orders of the court.

11 U.S.C. § 1142(a) (emphasis added).

In summary, section 1123(a)(5) provides that a plan must provide adequate means for its implementation. Section 1142(a) is the statute that actually empowers a debtor to implement its confirmed plan. The Ninth Circuit essentially concluded that because the preemptive effect of section 1142(a) is limited to nonbankruptcy laws, rules and regulations relating to financial condition, section 1123(a)(5)'s preemptive effect could not be greater.

The law on 1123(a)(5)'s preemptive effect today remains unsettled. In the Ninth Circuit and in any other courts outside of the Ninth Circuit that subscribe to its opinion in PG&E, a plan that proposes to preempt gaming laws will only be found to be proper if the gaming laws in question relate to the debtor's financial condition. A plan that proposes to preempt gaming laws relating to matters such as a sale to a third party, the replacement of old ownership with new ownership, or the replacement of old management with new management likely will lead to lengthy and costly court battles with Gaming Authorities and, perhaps, others opposed to the plan.

PRACTICE GUIDEPOSTS

The complications created by the regulatory overlay of state gaming laws can materially affect how the professionals involved in a gaming bankruptcy case must plan and guide their clients. The guideposts below are intended to assist the professional in formulating its advice to its gaming client and in approaching a gaming chapter 11 case. They assume that the parties either have agreed, or at least have not disputed, that the debtor must comply with applicable gaming laws and regulations.

Guidepost # 1: Understand Restructuring Alternatives

Restructuring alternatives for gaming debtors really are no different than those that exist for debtors in other industries. An estate can engage in a sale pursuant to section 363 or pursuant to a plan of reorganization ("Sale Alternative"). An estate can also engage in a restructuring that, among other possibilities, (i) deleverages the company by equitizing some or all of its debt ("Equity Swap Alternative"), (ii) brings in new investors or money to infuse the company with new capital that can be used to pay creditors and/or finance necessary capital expenditures and/or ongoing operating expenses ("New Ownership/Operation Alternative"), or (iii) combines in some fashion two or more of the foregoing alternatives (the "Hybrid Alternatives"). Assuming that preemption is not an issue (in other words, the debtors and parties in interest do not dispute that they will need to comply with gaming laws and regulations as part of any restructuring), what makes gaming restructurings different from and more complicated than other restructurings is (a) the impact that the regulatory overlay has on decision-making as to which alternative is best to pursue, (b) the cost and time delay associated with complying with gaming laws and regulations; and (c) the nuances that compliance necessitates in the drafting of any plan documents.

a. Decision-making.

(i) Sale Alternative.

Absent the unique circumstance of the solvent debtor that is able to pay its creditors in cash, in full, perhaps the easiest or most practical alternative available for the gaming debtor and its creditors is a Sale Alternative for cash, either pursuant to section 363 or through a plan.[5] The principal advantage of this alternative is that, if certain significant creditors (in number or amount) are unwilling or unable to undergo the licensing or suitability scrutiny that would be required of them under applicable gaming

[5] Not infrequently, certain key intellectual property rights associated with a casino operation may be held by non-debtor insiders or at equity levels such that their disposition is not solely within the control of the debtor and otherwise subject to its power to sell under Bankruptcy Code section 363 or through a plan. This fact must be born in mind in planning for maintaining operations during the interim post-sale or post-confirmation but pre-consummation prospective licensee review and approval period where the license is to be transferred away from an existing equity holder/sponsor/manager who holds such rights.

laws in the context of a plan that calls for an Equity Swap Alternative, a cash Sale Alternative process permits them to avoid such scrutiny altogether. In a cash sale, only the buyer and its insiders, ownership and affiliates will undergo such scrutiny. In many gaming cases, the cash Sale Alternative may be the only alternative that creditors are willing to support.[6]

On the other hand, pursuit of a Sale Alternative may not net creditors their best recovery. The market for the sale of gaming enterprise may be poor or the bids received may not meet expectations. Bidding by noninsiders might be chilled if insiders are permitted to bid on the debtor's business. Also, there are no assurances that the buyer selected will pass muster with Gaming Authorities. Finally, during the period between approval of the sale and the closing, the debtor and creditors need to make certain that old (i.e., licensed) management remains in place to bridge the gap between the date that the sale has been approved (or a plan that contemplates the sale is confirmed) and the date that the sale closes (the timing and gating precondition of which likely will hinge on approval of the sale and buyer by Gaming Authorities). As set forth above, officers, directors and certain other senior management members of a gaming enterprise must be either licensed or found suitable by Gaming Authorities to operate and control a gaming enterprise. Typically some or all of the officers, directors and senior management will continue with the debtor at least until the sale closes. However, if certain key individuals depart, for whatever reason, the debtor may have an immediate need to replace them and must do so with individuals who are already licensed or who can quickly become licensed.

(ii) Equity Swap Alternative.

Receiving and holding equity securities of a reorganized gaming debtor may net, over time, the highest and best return to creditors. In order to implement the Equity Swap Alternative, a significant percentage of the debtor's creditors (at least two-thirds in amount and a majority in number of those voting) must first be willing to vote to accept an Equity Swap Alternative plan. However, many creditors, particularly large institutional creditors that hold sizeable positions of the gaming debtor's debt, are not willing to expose themselves (and certain of those that they employ) to the expansive regulatory scrutiny and investigation that could be required under state gaming laws. Moreover, there is risk that certain creditors could be found by Gaming Authorities to be unsuitable as owners of a gaming enterprise in their state. Until a creditor is found to be suitable, it cannot receive as a distribution under the plan an equity interest in the reorganized debtor. Once a creditor is found unsuitable, it is not permitted to hold the equity interest it otherwise would be entitled to receive under the plan. Consequently, the Equity Swap Alternative plan must contain some mechanism for the liquidation of that

[6] A sale of the gaming debtor's assets in return for some portion of the equity of the buyer may or may not result in Gaming Authority scrutiny of creditors. If any creditor, because of the size of its claim against the debtor, would be entitled to receive under a plan a distribution of equity of the buyer that represents 5% or 10% or more (depending on the state) of the outstanding equity of the buyer, absent some otherwise applicable exemption that creditor could be subject to Gaming Authority scrutiny.

equity interest, which liquidation could result in the "unsuitable" creditor's receipt of some level of consideration compensating it for the equity that it otherwise would have be entitled to receive that will differ in form and may differ in value and timing of receipt from that which other creditors who are found suitable will receive.

The Equity Swap Alternative plan also would need to address licensing issues for the future officers, directors and senior management of the reorganized debtor. Unless the plan proposes to retain the old board, officers and management team, creditors will have to carefully consider and find replacements that already have been licensed or found suitable by Gaming Authorities in the applicable jurisdiction or that are easily and quickly capable of obtaining a license or being found suitable. This may prove to be a difficult task, particularly in states where there are a limited number of licensed gaming enterprises. However, generally, individuals that already have been found suitable or that already hold gaming licenses in another state are more likely to be found suitable, more quickly, than individuals who have never before been found suitable or been issued a license in the subject jurisdiction.

Finally, assuming that an Equity Swap Alternative plan is confirmed, who manages the gaming debtor during the period between the plan's confirmation date and the date that Gaming Authorities license or find suitable new ownership and management and the plan goes effective? Two options prevail. Either members of old management have been given economic incentive to remain with the debtor until the plan effective date takes place or the gaming debtor will need to obtain some sort of interim management by individuals and/or entities already found suitable or licensed by Gaming Authorities.

Due to the cumulative complexity of the foregoing factors, an Equity Swap Alternative plan is often disfavored by creditors.

(iii) New Ownership/Operation Alternative.

The New Ownership/Operation Alternative just as easily could be called the Equity Sale Alternative, because the debtor's parent is essentially selling its equity stake in the gaming debtor for cash or securities that will be used for the benefit of the estate and its creditors. The sale of the gaming debtor's equity may be particularly attractive to a buyer and the gaming debtor where there are net operating losses (a) of which the buyer believes it can take advantage through an equity purchase and (b) for which the buyer is willing to pay a premium over the amount it (and other prospective purchasers) would be willing to pay for the gaming debtor's assets. This alternative shares many of the same advantages, but also suffers many of the same licensing constraints, that exist in the Cash Sale Alternative. Additionally, however, because the equity of the gaming debtor is property of the gaming debtor's shareholder(s) (which also may be debtors in their own unconsolidated cases), and not property of the gaming debtor's estate, other hurdles may need to be addressed to ensure that value is conveyed to creditors. For instance, how best to effectuate the approach? Can or should the sale be conducted pursuant to section 363 or through a plan (which would require the parent or shareholders to commence

companion chapter 11 cases)? How does one ascertain and allocate the value received between the shareholders and gaming debtor, if at all? This method may best effected through a consensual plan in which the gaming debtor's parent or shareholders have consented to the downstreaming of value to the estate.

(iv) Hybrid Alternatives.

Structures of Hybrid Alternatives are driven principally by facts and circumstances surrounding the debtor (e.g., the composition of the creditor body and the extent of its willingness to undergo suitability, the health or robustness of the gaming industry, the state of competition -- whether the debtor is in an "open" license state or a "limited" license state -- the creditor body's relationship with management and ownership, the physical condition of the casino and hotel, and the presence of secured creditors and the extent of their collateral). The Hybrid Alternative structures are limited only by the creativity of a debtor, its creditors and their professionals.

Recently, Hollywood Casino Shreveport ("HCS"), a riverboat casino complex in Shreveport, Louisiana, and its secured bondholders were able to confirm a plan of reorganization that proposed one such Hybrid Alternative structure. In summary, under the HCS plan, HCS's old owner and operator, Penn National Gaming, Inc. ("Penn"), which indirectly owned 100% of HCS's outstanding equity, was replaced by a new majority owner and operator, Eldorado Resorts LLC ("Eldorado"). Eldorado was the successful bidder in a pre-bankruptcy bidding process run by HCS with the substantial input of an ad hoc committee consisting of two tranches of bondholders, one issue secured by a deed of trust on the hotel and an admiralty lien on the vessel and the other by the personal property and equipment. Eldorado, a licensed owner and operator of casinos in Nevada, purchased a 75% controlling stake in reorganized HCS and became its new management. The bondholders, which held $189 million in principal amount of HCS bonds and were undersecured, agreed to swap their existing debt for, among other things, (i) 100% ownership in Noteholder Newco, a newly created corporation that holds a 25% noncontrolling stake in reorganized HCS, (ii) $140 million principal amount of new secured notes issued by reorganized HCS, and (iii) $20 million of preferred distributions to be paid over eight years through Noteholder Newco. Under the plan, each trade creditor was permitted to elect to received a fixed percentage cash distribution on its allowed claims or pro rata treatment with the bondholders. In addition, HCS's senior executive officer and board member, who already was licensed by the Louisiana Gaming Authorities, agreed to become Noteholder Newco's sole officer and director, on an interim basis.

Because the bondholders collectively received far less than a controlling stake in the equity of reorganized HCS, under applicable Louisiana regulatory provisions only those bondholders who would be deemed post-closing to hold at least a 5% ownership interest in reorganized HCS were subject to undergoing a suitability investigation by the Louisiana Gaming Authorities. Even as to the three who exceeded this 5% limit, Louisiana law provided an exemption from the suitability investigation process if the

bondholders qualified as "Institutional Investors" and otherwise exercised no control over the licensee.[7]

The Plan was confirmed on July 6, 2005. Because Eldorado had entered into the investment agreement to acquire its 75% stake in HCS prepetition, it and its management team members were able to submit their various licensing applications to Louisiana Gaming Authorities early in the process. As a consequence, by the time HCS's plan was confirmed, Louisiana Gaming Authorities were virtually finished with their investigation of Eldorado and were able to approve its licensure shortly after plan confirmation.

b. Cost and Time Delay Necessitated by Compliance.

If the debtor, and its creditors, elect to engage in a sale of the debtor's assets, either pursuant to section 363 of the Bankruptcy Code or pursuant to a plan of reorganization, they must be mindful that, following the typical bidding and bankruptcy court approval process, the successful buyer will be required to submit itself to a suitability or licensing investigation by Gaming Authorities. Any such investigation likely will commence after the bankruptcy court has approved the sale to the buyer.[8] A final decision by Gaming Authorities regarding the suitability or licensability of the buyer could take several months. Moreover, if Gaming Authorities conclude that the buyer is not suitable, then the debtor and the estate must either start a new sale process from scratch or explore other restructuring alternatives. The cost and delay associated with the failure to close with the gaming debtor's selected buyer could be very damaging to the bankruptcy estate and to creditors' ability to recover on their claims.[9]

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[7] Certain plan document provisions that would have permitted the shareholders of Noteholder Newco to require the transfer of Eldorado's management and ownership of the casino to a new sponsor in the event that reorganized HCS defaulted on the new secured note obligations were deleted prior to confirmation to address concerns expressed by the Louisiana Gaming Authorities that they created a sufficient potential level of control to subject all converting bondholders to a suitability determination. It should be noted that even if the institutional investor exemption is otherwise applicable to a converting bondholder, the Louisiana Gaming Authorities retain the discretion to conduct, or require the bondholder to undergo, a suitability examination.

[8] In the Hybrid Alternatives example given above, Eldorado was able to undergo licensing investigation prior to plan confirmation because it had entered into its agreement to acquire its stake in reorganized HCS prior to the petition date. Eldorado thereafter worked closely with Louisiana Gaming Authorities, addressing their various questions and concerns throughout the course of the HCS bankruptcy case.

[9] The risk associated with Gaming Authority disapproval of a successful bidder can be somewhat ameliorated if the debtor has found, and the court has approved as part of the initial bankruptcy sale process, a willing, qualified back-up bidder. The presence of a back up bidder would permit the debtor to avoid a renewed sale process. However, obtaining a back-up bidder in the context of a gaming enterprise sale process may not be particularly easy, principally because bidders have little or no desire to put up a meaningful good faith deposit and then await completion of a Gaming Authority review process involving the successful bidder that could last for many months, during which the seller's performance and the buyer's objectives may have changed materially. Gaming Authorities are loathe to conduct simultaneously multiple or speculative investigative processes – the likelihood is that only in the event that the successful bankruptcy

Similarly, until Gaming Authorities find suitable a creditor that, pursuant to a plan, has agreed to swap its piece of debt for a piece of equity in the reorganized debtor, that creditor cannot receive a distribution of its equity. If Gaming Authorities conclude that the creditor is not suitable to own the stock, then the creditor is forbidden from ever receiving a distribution of such equity. And if Gaming Authorities cannot find suitable a significant creditor that, but for regulatory scrutiny, would have held a significant amount of the reorganized debtor's equity, the debtor's plan may not be able to go effective.

c. Impact of Regulatory Compliance on Plan Documents.

At least two provisions should be included in any plan documents in a gaming case. First, any sale agreement (or order approving a sale) or the plan should provide that the operative documents may be subject to Gaming Authority approval. By way of example, a confirmation order might contain the following language:

> Governmental Approvals. This Confirmation Order shall constitute all approvals and consents required, if any, by the laws, rules, or regulations of any state or any other governmental authority with respect to the implementation or consummation of the plan and any documents, instruments, or agreements, and any amendments or modifications thereto, and any other acts referred to in or contemplated by the plan, disclosure statement, and any documents, instruments, or agreements, and any amendments or modifications thereto, other than such approval of the Gaming Authorities as may be required under applicable state law.

Second, because, as discussed above, Gaming Authorities have the ability to prevent a person or entity from becoming an owner of a gaming enterprise if that person or entity is not found suitable, a plan that contemplates an Equity Swap Alternative must contain an acceptable mechanism that prevents a holder of an allowed claim that is in a plan class that is to receive equity in the reorganized debtor from receiving such equity. And such mechanism cannot violate section 1123(a)(4) of the Bankruptcy Code, which provides as follows:

> Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall...provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.

11 U.S.C. § 1123(a)(4).

Section 1123(a)(4) is designed to ensure that all members of a class of claims under a plan are subjected to the same treatment. In re Central Medical Center., Inc., 122 B.R. 568 (Bankr. E.D.Mo. 1990). The same treatment does not necessarily mean the

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court bidder is not found suitable by Gaming Authorities will a Gaming Authorities investigation process commence for a back-up bidder.

same consideration. Rather, it simply means that so long as all members of a class of claims are equally subjected to the same procedures, then, irrespective of the fact that some class members may wind up receiving more than others, section 1123(a)(4) is not violated. Id. In Central Medical Center, the plan of reorganization established a mandatory redemption schedule under which a given number of bonds (in the bondholder claims class) would be selected randomly by the indenture trustee to be redeemed each year between 1997 and 2011. This provision of the plan was challenged as unfairly discriminatory to the bondholder class members in violation of section 1123(a)(4). In support of their challenge, the objecting parties argued that (i) under the proposed lottery system, those bondholders chosen first would receive an interest rate different from those bondholders chosen to be paid later, and (ii) those bondholders that would be paid first would enjoy a greater present value on their claims than would those bondholders paid later. The court rejected these arguments, concluding that because the plan equally subjected all of the bondholders to the same set of procedures, the plan complied with section 1123(a)(4). Id. at 574-75; see also In re Dow Corning Corp., 255 B.R. 445, 501(E.D. Mich. 2000) (there is no requirement that settlement offers be proportional within a class; section 1123(a)(4) is satisfied when class members are "subject to the same process for claim satisfaction").

One example of how to treat those within a plan class that might not be found suitable by Gaming Authorities to own the equity of a gaming enterprise is to provide a mechanism for the sale or liquidation of the withheld equity by the reorganized debtor or a third party, with the net proceeds of such sale or liquidation going to the "unsuitable" claim holder. This mechanism was utilized in the HCS bankruptcy case for those bondholder claimants that either refused to submit to suitability or that were not found suitable. A copy of the actual provision as set forth in HCS's plan of reorganization is included in the appendix to these materials.

Guidepost # 2: Valuation Issues, or Why You Need the Best Financial Advisor Available

Valuation issues often are crucial to the outcome of chapter 11 gaming cases.[10] They can arise in various contexts throughout the case. Establishing equity, allowing claims, adequate protection, and plan confirmation are only a few examples of when valuation questions can be raised. In re Stanley, 185 B.R. 417, 423 (Bankr. D. Conn. 1995). The value of a debtor's collateral and the amount of a creditor's claim are among the most important issues between the debtor and the secured claimholder. Matter of T-H New Orleans Ltd. Partnership, 116 F.3d 790, 797 (5th Cir. 1997).

Concepts of valuation vary widely, but the Code takes no definitive position on the issue. The Code recognizes that the needs and circumstances of the case will dictate the philosophy of valuation. Section 506(a) provides that the value of the creditor's interest in the estate's property shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property. While others may

[10] See also "Gaming Restructuring Valuation Issues - Trump Casinos: A Case Study" at Part III of these materials.

come into play, the two valuation standards applied most often in chapter 11 cases are going concern value and liquidation value. In re Chateaugay Corp., 154 B.R. 29, 34 (Bankr. S.D. N.Y. 1993) (going concern); In re T.H.B. Corp., 85 B.R. 192, 195-96 (Bankr. D. Mass. 1988) (liquidation).

The Supreme Court in Associates Commercial Corp. v. Rash, 520 U.S. 953 (1997), a case involving the valuation of collateral for purposes of the cramdown provisions of chapter 13, weighed in on Section 506 valuations. Ending a conflict among the circuits, the Court held that the proper interpretation of Section 506(a) requires the proposed use or disposition of the collateral to be determinative. When a debtor intends to continue to hold and use the collateral, a liquidation value is inappropriate; rather, the proper valuation standard is the price a willing buyer in the debtor's trade, business or situation would pay to obtain like property from a willing seller. The Court left to the bankruptcy court, as the trier of fact, the task of identifying the best method of determining value.

Rash may be applicable generally in other settings. If the debtor proposes to retain and use the property, the considerations that led the Court to its conclusion in a chapter 13 cramdown setting would appear to be equally germane to chapter 11.

Neither the Bankruptcy Code nor the Bankruptcy Rules define or establish the time for determining valuation of collateral. The purpose of the valuation dictates its timing. Stanley, supra, 185 B.R. at 423. Depending on the circumstances, the relevant date of the valuation could be the petition date, the date of the valuation hearing, the date of the confirmation hearing, the effective date of the plan or at any other relevant point during the case. See, e.g., T-H New Orleans Ltd. Partnership, supra, 116 F.3d at 797-800; Stanley, supra, 185 B.R. at 423-25; In re Leedy, 230 B.R. 678 (Bankr. E.D. Va. 1999).

Enterprise value drives the casino reorganization process in that it determines the total amount of value that can be distributed to the various creditors. Enterprise value is determined by the results of a marketing process (i.e., sale of the company) or estimated by investment bankers typically utilizing three methodologies: discounted cash flow; precedent transactions; and comparable public companies. The discounted cash flow method often is the most controversial as casino properties have substantial operating leverage and parties often differ on the appropriate assumptions for a turnaround business plan.

Valuation issues also are complicated by management services agreements that, in essence, may provide a disguised form of dividend to the equity holder/sponsor, but also include provision of necessary services and access to trademarks and license agreements. Careful analysis of the agreement and services provided is required to determine if the contract is at market rates or inflated to provide a disguised dividend to equity holders.

Investment bankers also are used in a gaming case to value the various securities to be issued under a plan, to determine the risks of obtaining and pricing exit financing, and to assess the financial feasibility of the company under various plan scenarios.

Securities valuation is often the most controversial role. Management's credibility and the feasibility of its turnaround plan, as well as assessment of prospective local market conditions, are important but ultimately subjective aspects of determining the value of any securities.

Because most gaming companies are funded largely with secured debt, an appraisal of the collateral usually is obtained to determine the recovery allowed to secured lenders on account of the secured portion of their claims. The value of unsecured assets is available for distribution to unsecured creditors (including bondholder deficiency claims) on a pro rata basis.

Disputes often arise in allocating the enterprise value to value of secured assets and unsecured assets, particularly in cases where the state has limited gaming licensing and there can be significant value attributable to the gaming license itself. The gaming license usually is not part of a collateral package and determination of the "value" of the license thus is a critical element of analyzing the potential recovery by unsecured creditors. Complications arise in valuing the secured assets depending on whether the secured assets are to be valued as if a gaming licensee operates them when the license itself is not part of the collateral package. Similarly, the split in value between various pools of secured debt can be controversial. These issues are complicated by the fact that the ownership and transferability of the license in bankruptcy are subject to regulatory constraint.

Some of these valuation issues are illustrated in the following scenario. The bondholder committee ($200 million in claims secured by first mortgage) and trade committee ($10 million in claims) and the debtor agree that a bid from Colorado Pete's Casino is the highest enterprise value, providing $100 million in cash and $25 million of preferred stock to the reorganized debtor. Colorado Pete's will own all the common stock of the reorganized company and enter into a management services agreement for $5 million per year to provide its famous brand name and managerial and accounting services to the reorganized company. (Independent parties value the services at $2 million per year).

1. How does one allocate value between a) the old slot machines (which make money and are financed by an FF&E-secured loan), b) a hotel tower (part of a collateral package for the first mortgage and with rooms given away as marketing "comps" to loyal players) and c) a casino license (owned by the state) without which the slot machines cannot be operated?

2. What is the value of the preferred stock with the management services agreement?

3. If it takes Colorado Pete's 9 months to obtain regulatory approval, which parties should have exposure to the casino's operating profits and losses in the interim period?

Guidepost # 3: Understand Local Politics and Gaming Debtor's Relationship with Local Government and Officials.

Perhaps more than any other nationwide industry, casinos generate enormous political interest for a variety of reasons. Casinos generate substantial tax and other revenues for state and local governments and can help stimulate local economies through increased tourism, consumer spending and employment opportunities. Consequently, state and local officials typically are not anxious to see a casino operation shuttered on account of bankruptcy. Generally, if (i) the gaming debtor has been a good corporate citizen and has positively impacted its local economy and (ii) the gaming debtor's management and/or ownership have forged healthy relationships with local officials, it is more likely than not that those local officials will be supportive of the gaming debtor's reorganization efforts, or at least will not create unnecessary roadblocks to those efforts. On the other hand, if the gaming debtor's relationship with local authorities is poor because, for among other reasons, the casino or its management has violated gaming regulations, has not satisfactorily maintained the physical structure of the casino, or has had disputes with local authorities, the gaming debtor can and should expect that local officials will, among other actions, appear before the Gaming Authorities, file pleadings in the bankruptcy court, and use the local media to air their potentially negative views about the Company and to oppose the gaming debtor's plans to restructure if such plans do not coincide with the interests of the local government and its officials.

Guidepost # 4: Understand Gaming Authorities.

a. Gaming Authorities' Participation in Bankruptcy Cases.

Recognize that Gaming Authorities generally have little or no desire to participate in the bankruptcy arena. Outside of bankruptcy, Gaming Authorities have virtually unfettered power and control in regulating the business and financial affairs of a gaming enterprise. As described above, once a gaming enterprise files for bankruptcy, there is risk that the bankruptcy court will intrude upon Gaming Authorities' domain. The tension caused by this risk of intrusion means that Gaming Authorities tend to tread very carefully in the bankruptcy realm. It is not uncommon that Gaming Authorities will avoid making a single appearance in a bankruptcy case.

However, lack of participation should not be confused with lack of interest. The investigatory/administrative arm of Gaming Authorities frequently will take a keen interest in a gaming debtor and its bankruptcy case and, in addition to the traditional information that they receive, will insist upon receiving frequent updates and information regarding the bankruptcy case and any progress being made in restructuring negotiations among the parties in a case. Of course, Gaming Authorities will appear before the court if any party challenges Gaming Authorities' authority or interests.

Given the highly politicized nature of the gaming industry, representatives of Gaming Authorities are very cautious about the nature of their communications and with whom they communicate. Perhaps the best way to keep communication lines clear with

Gaming Authorities is to employ a gaming-regulatory attorney that is known and respected by Gaming Authorities.

b. Understand How Gaming Authorities Function.

Generally, Gaming Authorities are divided into two distinct arms. The first, and most visible to the public, is the board or commission of individuals appointed by the governor to render Gaming Authority decisions. The second is the investigatory/ administrative arm of the Gaming Authority, which handles the day-to-day functions of the Gaming Authorities. This second arm reviews the applications of prospective licensees and others, conducts investigations into the backgrounds of applicants, monitors financial and other reporting requirements of licensees, monitors and investigates possible violations in gaming regulations, and makes formal recommendations to the state appointed gaming board members or commissioners. Because the administrative arm of Gaming Authorities is the arm that conducts the diligence and makes the recommendations to the board or commission, it is at this level that potential licensees, and any other parties seeking Gaming Authority approvals, must focus their attention by arranging appropriate meetings and keeping open lines of communications. If the administrative arm does not recommend licensure, then a potential licensee's chances of obtaining a license or being found suitable by the board or commission is slim, at best.

Guidepost # 5: Find and Employ the Best Local Gaming Attorney Available.

A good gaming attorney will be able to fulfill multiple roles. First and foremost, he or she will be able to provide you with sound regulatory advice.

Second, as noted in the previous Guidepost, a gaming attorney's relationships with representatives of Gaming Authorities will enable you to obtain meaningful feedback regarding Gaming Authority views about the debtor, the bankruptcy case and any plan to sell or reorganize the debtor. A good gaming attorney also will help you to navigate through the myriad matters that Gaming Authorities will want addressed. A gaming attorney that is well respected by Gaming Authorities and that understands local gaming laws can substantially reduce the time and costs associated with the regulatory process.

Finally, any gaming attorney employed may be required to act as an expert witness in the area of gaming regulations and, in particular, suitability/licensability issues that are raised in connection with challenges to a plan's feasibility or a buyer's ability to be found suitable.