

Know the Rules Before Rolling the Dice

Legal Considerations for Gaming Industry Real Estate Transactions

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As legalized gaming continues to expand across the United States, attorneys advising clients on real estate transactions involving

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gaming companies must consider, negotiate, and structure transactions to address unique issues. This article explores the novel issues that arise in real estate transactions involving the gaming industry, with a particular focus on property acquisition, development, financing, and leasing transactions, and provides possible solutions including sample provisions.

Regulatory Landscape

Regulation of gaming is market-specific and varies from state to state, and even among counties and cities within the same state. As such, legal counsel must be familiar with the applicable regulatory scheme when advising on gaming-related real estate deals. Most states require gaming operators to be

licensed and regulate with whom they may do business. These states believe that the success of gaming in their states depends on public confidence and trust that gaming is honest, competitive, and free from criminal and corruptive elements. *See Nev. Rev. Stat. § 463.0129.* To achieve this result, states often require gaming companies to provide complete disclosures in licensure applications, undertake self-reporting, and comply with internal controls and due diligence.

These disclosures can be extensive and invasive. Some gaming applications are up to 60 pages long and require the provision of detailed information on, among other matters, material transactions; major purchases,

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sales, and leases; material financings; company distributors, purveyors, and suppliers; officers, directors, key employees, consultants, and lobbyists; lessees, licensees, and game providers; substantial owners; material litigation; legislative and regulatory developments; acts of wrongdoing by the company, executives, and employees; and actions requested by regulators, or regulatory or other violations. To determine whether an applicant is suitable to hold a gaming license, the applicable gaming authorities must review and investigate the information disclosed by the applicant, which can take several months. If an applicant has previously obtained a gaming license in a particular jurisdiction, the applicable gaming authorities may review only the new information since the last license was issued, and such an applicant may be able to obtain a gaming license in a few months. If an applicant has not previously obtained a gaming license in a particular jurisdiction, it may take more than a year to obtain the same.

Real Estate Transactions in the Gaming Industry

Common real estate transactions involving the gaming industry include acquisitions, developments, financings, and leases. Each type of transaction presents its own set of unique legal challenges.

Acquisition and Development

Often when a company desires to acquire or develop a gaming business, it expects to receive the gaming revenue generated by such business. Sharing in gaming revenue typically requires a gaming license or suitability approval, which, as discussed above, could take several months to obtain. Timing may not be an issue when a company is developing its own gaming property, but it may be an issue when a company seeks to acquire a gaming property because a seller may not want to wait for the prerequisite approvals to be obtained for the acquisition transaction to close. In addition, there is an element of risk. A developer may be hesitant to develop a gaming property

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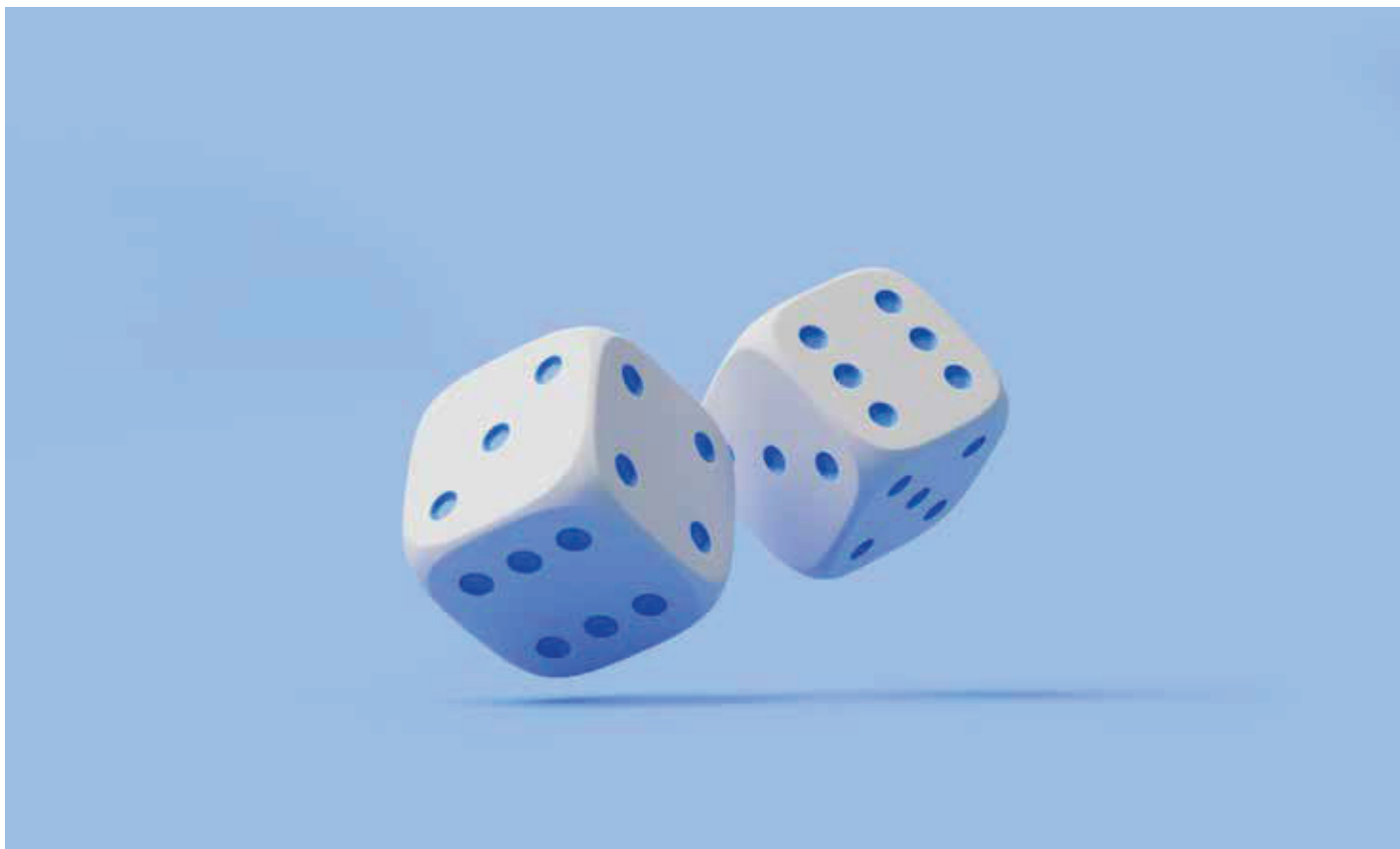
if it is not certain the developer can obtain the required gaming license. A seller may not want to enter into a purchase agreement and bind the property for possibly a year or more if it is not certain that the buyer can obtain the gaming license necessary to close the transaction. These considerations are amplified when the developer or buyer is entering the gaming industry for the first time.

Certain state laws, regulations, and practices also may affect provisions of a purchase agreement for a gaming property. For example, in some real estate transactions, an earnest money deposit may be paid directly to, and held by, a seller. There are some states in which gaming regulations prohibit this practice with respect to a gaming property, except in the instance where the purchase agreement has terminated and the seller

is entitled to the deposit as its remedy. Certain governmental authorities recommend that these purchase agreements also include provisions specifying how the chips, tokens, and progressive liabilities will be treated and that the parties will agree to a plan detailing how the gaming operations will be transitioned at closing. Often these purchase agreements will also include representations and warranties relating to the description and status of gaming licenses, covenants as to the maintenance of such licenses, the operation of the gaming business before the closing, and provisions addressing the possibility that the buyer fails to timely obtain the necessary gaming licenses to close the transaction. These provisions can be especially difficult to negotiate because the date for obtaining such gaming licenses is uncertain, and the gaming authorities retain broad discretion in granting or denying the necessary gaming licenses.

As discussed above, obtaining a gaming license or suitability approval requires the disclosure of extensive, private personal information. It can take several months to compile the application materials, and many more months after that for the required licensing or suitability review, all without any guaranty that such license or approval will be issued. Some buyers and developers are not willing to submit themselves to this process, and some sellers are not in a financial position or otherwise willing to wait for this process to be completed. Additionally, some developers prefer to have an alternative strategy available in the event they are ultimately unable to obtain a gaming license. Some buyers also may be seeking to acquire gaming properties through competitive bid processes, and although they may desire to obtain their gaming licenses, they may elect to structure the transactions to expedite closing and offer deal certainty to put themselves in the best position to win the bids.

To address these issues, there are some alternative structures that may be used in both the short term and the long term, and also in combination with each other. These alternative structures include a sale-leaseback,



third-party operator lease, and a gaming management agreement.

• **Sale-Leaseback.** In this type of transaction, the current owner-operator of a casino or other gaming property sells substantially all of its assets (excluding gaming assets) to a buyer, and then the seller-operator leases such assets back from the buyer and continues to operate the gaming property during the lease term. The benefit of this structure is that, in certain jurisdictions, this transaction can close quickly because no new gaming license or approval is required. Regulators almost always maintain discretion to call the parties forward for investigation or licensure, but this type of structure may be used in jurisdictions where advance approval to acquire the real estate assets is not required. The drawback of this structure is that the buyer-landlord typically cannot share directly in the gaming revenue generated at the gaming property, and assumes future licensing risk at the end of the lease term when the licensed tenant-operator vacates. This structure

is ideal in the short term for buyers who are willing to forego sharing directly in gaming revenue and have sellers who need immediate cash and are also in a position to continue operating at the licensed premises. It offers a faster closing with more deal certainty from a regulatory perspective because a new gaming license is not typically required.

These sale-leaseback transactions may be structured with a single seller and a single buyer; a single seller and multiple buyers; multiple sellers and a single buyer; or multiple sellers and buyers. For example, real estate investment trusts have been acquiring the real estate of several hotel casinos and leasing such real estate back to the original sellers or even new operators using this structure, though in the case of the latter, it is important to note that if the deal is structured such that the real estate is going to be leased to a new gaming operator (i.e., not the seller's gaming licensee), such gaming operator must obtain a new gaming license, which eliminates the timing benefit of this structure.

• **Third-Party Operator Lease.** In this type of transaction, a buyer or developer leases the gaming space to a third-party gaming operator, who obtains a gaming license and operates the casino or other gaming business under the provisions of the negotiated lease. These third-party operators typically have been licensed previously at multiple locations and are known quantities to the relevant regulators, allowing them to be licensed more quickly in new locations because they have been investigated previously. Another benefit of this structure is that it provides deal certainty by mitigating the licensing risk, but the drawback is that the buyer-developer-landlord still cannot directly share in gaming revenue. This structure is ideal in the short term for buyers who want to appeal to sellers by offering a faster closing with deal certainty and in the long term for buyers and developers who want to have a casino or sportsbook as an amenity but do not want to operate it.

• **Management Agreement.** In this type



of transaction, a buyer or developer enters into a management agreement with an experienced manager who will operate the casino or other gaming business on the owner's behalf pursuant to the provisions of a negotiated management agreement. The benefit of this structure is that both the owner and manager are able to share in the gaming revenue, but the drawback is that both parties have to obtain gaming approvals. This structure is ideal where the owner wants to use the manager's casino or sportsbook expertise and obtain a share of the gaming revenue but does not want to operate the gaming independently.

Over the life of a gaming property, all of these structures may be used. Consider an example of a casino that was acquired by a single buyer who obtained a gaming license and operated the casino for seven years. Thereafter, that owner-operator sells the casino to a buyer, but because that buyer wants more time to obtain a gaming license, they elect to enter into a sale-leaseback transaction in which the seller will continue to operate the casino under a negotiated lease for a one-year term. At the end of that term, the buyer is still not licensed, so the buyer brings in a third-party gaming operator to operate

the casino under a negotiated lease for a five-year term. At the end of that term, the buyer is finally licensed and takes over the operations of the casino. After a couple of years of operating, the buyer believes the casino is underperforming expectations, so the buyer retains a seasoned gaming management company to manage the casino under a negotiated management agreement.

Financing

Depending on the jurisdiction, (i) gaming authorities must approve any loan documents before they may be executed by a gaming licensee or holding company; (ii) such advance approval is not required, but a pledge of any equity interests in a gaming licensee or holding company will not be effective without the prior approval of the gaming authorities; or (iii) lenders to a gaming licensee or holding company are subject to being called forward by the gaming authorities for a finding of suitability. As such, lenders should be required to cooperate with gaming authorities in connection with the administration of their regulatory jurisdiction over the loan parties, including, at a minimum, providing basic information. Here is a sample provision:

The Loan Documents are subject to the Gaming Laws. Notwithstanding anything in the Loan Documents to the contrary, each Secured Party acknowledges that it is subject to being called forward by the Gaming Authorities for licensing, qualification, or finding of suitability or to file or provide other information. Each Secured Party agrees to cooperate with the Gaming Authorities in connection with the administration of their regulatory jurisdiction over the Loan Parties, including by providing such documents or other information as may be requested by the Gaming Authorities.

In the event of a default under such loan documents, the lender, depending on the jurisdiction, may be required to obtain regulatory approval or even obtain a gaming license to foreclose upon or exercise rights and remedies with respect to certain collateral, including (a) equity interests in a gaming licensee, (b) slot machines and other gaming-related systems and equipment, or (c) funds required to support minimum bankroll requirements. Loan documents also should set forth a

procedure whereby a lender who is not found suitable may be replaced or the borrower may prepay the portion of the loan held by such an unsuitable lender.

Often lenders will want counsel for the borrowers to provide gaming opinions as part of the opinion letters delivered at closing. Most of these opinion requests are not customary and are better covered by the borrowers (e.g., the borrowers have all licenses and permits that are necessary to operate their business), but it is customary to give opinions as to gaming approvals with respect to the loan documents with the appropriate qualifications. Here is a sample opinion:

No current consent, approval, or license from or filing with any [Insert Applicable State] Governmental Authority is required under Applicable [Insert Applicable State] Law to be obtained or made by any of the Companies in connection with the execution and delivery by each of the Companies of the Loan Documents to which it is a party, except (1) such filings, registrations, and recordings which are required to be made in order to perfect security interests purported to be granted by the Loan Documents and (2) those approvals and filings required to be obtained and made under the [Insert Applicable State] Gaming Laws as set forth in qualification paragraph (X) below.

Leasing

Gaming licenses are of critical importance to gaming companies. As discussed above, gaming licensees are regulated as to whom they may transact business with. Gaming regulators also review elements of the nongaming business because the public is likely to associate third-party tenants-operators with the gaming licensee. Gaming licensees ultimately can be held responsible for otherwise distinct operational activities of third-party tenants-operators, including compliance with laws, liquor license issues, live performer issues, and live entertainment tax compliance.

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As a result of the broad regulatory oversight, gaming licensees take an affirmative approach to self-policing third-party tenants and others operating in their hotel casinos and other gaming properties. One aspect of this approach is to conduct probity review background investigations of potential tenants and operators. The other aspect of this approach is to include a provision, in the applicable agreement with a third party who is occupying or operating within a gaming licensee's property, that permits the gaming licensee to terminate such agreement if such third party jeopardizes or limits its gaming license. Here is a sample provision:

Tenant acknowledges that Landlord and its affiliates are businesses that are or may be subject to and exist because of

privileged licenses issued by the Gaming Authorities. Notwithstanding anything to the contrary contained herein, in the event that Landlord deems it likely that Landlord's continued affiliation or contractual relationship with Tenant will preclude or materially delay, impede, jeopardize, or impair the ability of Landlord to obtain or retain any gaming licenses in any jurisdiction, or result in the imposition of materially burdensome terms and conditions on any such gaming licenses or subject Landlord to any disciplinary proceedings by any Gaming Authorities or constitute a violation of applicable laws, then Landlord may terminate this Lease immediately upon written notice to Tenant.

Given the proposed termination right, many tenants and operators attempt to negotiate this provision. Often they request cure rights and that the landlord agree to be reasonable in exercising its discretion. The landlord's ability to accept some of these comments will depend on applicable law, customary practice, and the direction given by the landlord's regulatory compliance committee.

Takeaways and Next Steps

Legal professionals advising their clients on real estate transactions involving the gaming industry must understand the intricate web of licensing requirements, regulatory oversight, and operational constraints that govern these transactions. Whether advising on acquisitions, developments, leases, or financings, attorneys must ensure that their clients are fully informed of the issues and structure the transaction to achieve the best results for their clients while complying with applicable laws. As the gaming industry continues to evolve, particularly with the expansion of online and sports betting, the legal landscape may grow more complex. Staying ahead of regulatory developments is essential for success in this high-stakes practice area. ■