SEVENTH CIRCUIT CASE HIGHLIGHTS THE RISK OF DELAY IN SECURING A NEVADA JUDGMENT IN MARKER CASES

By Vernon Nelson

On June 17, 2009, the United States Court of Appeals for the Seventh Circuit affirmed a ruling, on remand, of the United State Bankruptcy Court for the Western District of Wisconsin. The ruling allowed the claims filed by Wynn Las Vegas, LLC ("Wynn") and Desert Palace, Inc d/b/a Caesars Palace ("Caesars") in the bankruptcy matter *In re: Robert Bahram Jafari and Poopak Amanda Jafari,* Case Number 06-10155-11 (Bnkr. W.D.Wis.). See *Jafari v. Wynn, LLC (In Re: Jafari),* 569 F.3d 644 (7th Cir. 2009). Wynn's claim ($1,205,178.60) and Caesars' claim ($250,000.00) were based on markers executed by Robert Jafari in the fall of 2005.

Although the 7th Circuit affirmed the allowance of Wynn's and Caesars' claims, *Jafari* highlights a risk that may arise if a casino delays in obtaining a Nevada judgment in marker cases. If a debtor files for bankruptcy before a Nevada judgment is obtained, the bankruptcy court is not bound to allow the claim based on the full, faith, and credit clause of the Constitution. Instead, the bankruptcy court may have to decide whether to allow or disallow the casino's claim under 11 U.S.C. § 501. In making this decision, the bankruptcy court will have to decide which state's law will govern the adjudication of the claim. In order to make this decision, the court will have to determine whether to apply: (1) the forum state's choice-of-law principles; or (2) federal choice-of-law principles. This determination may affect whether the bankruptcy court applies the forum state's law, or Nevada law, in deciding whether to allow or disallow claims based on markers ("Marker Claims"). *Jafari* highlights the risk that a bankruptcy court may choose to apply the forum state's choice of law rules. If the forum state's choice-of-law rules are followed, the bankruptcy court may decide that the validity of marker claims should be decided based on the forum state's law instead of Nevada law. If the forum state's law does not allow for the enforcement of markers, the bankruptcy court will disallow the marker claims.

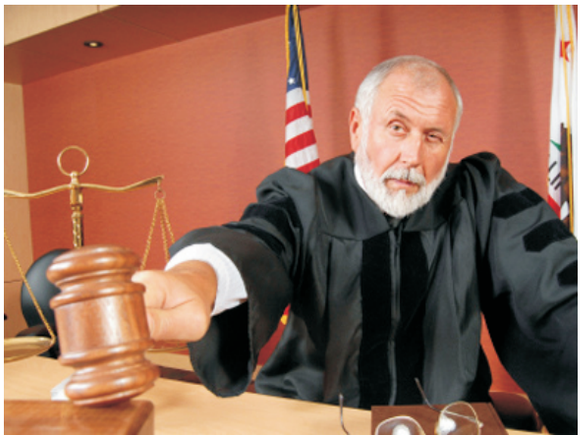
Robert Jafari was a former CEO of the Meadowbrook Manor chain of nursing homes. He had been a customer of Wynn for several years prior to the fall of 2005 and had always paid his markers. In the fall of 2005, he signed markers in excess of $1,000,000 at Wynn. He also signed markers totaling $250,000 at Caesars. In connection with the markers, Jafari signed credit applications at Wynn and Caesars. Both credit applications contained Nevada choice-of-law provisions. The markers executed by Jafari also contained Nevada choice-of-law provisions.

When Jafari did not repay the amounts due to Wynn and Caesars, both casinos deposited his markers. Both the Wynn and Caesars markers were returned by the drawee. The markers were stamped "refer to Maker." After the markers were returned, both Wynn and Caesars filed suit in Clark County, District Court. Jafari did not file an answer. Instead, he filed an individual Chapter 11 bankruptcy proceeding in the United States Bankruptcy Court for the Western District of Wisconsin; which stayed the District Court suit.

Both Wynn and Caesars filed proofs of claim in the bankruptcy proceeding. Jafari and the bankruptcy trustee (collectively "the Trustee") objected to the claims on the grounds that they were unenforceable under Wisconsin law. In ruling on the objections, the bankruptcy court began its opinion with a review of policy arguments regarding the alleged harmful nature of gambling and then opined that gaming debts were generally unenforceable. The court then recognized that NRS § 463.368 allowed for the enforcement of the markers executed by Jafari and that under the full faith and credit clause of the Constitution, a Nevada judgment based on the markers would have to be honored. The court

then discussed how "casinos now frequently obtain judgments in 'friendly states' and thereafter domesticate the judgments wherever the debtor might reside." Finally, the court went on to cite several cases where states have acknowledged the validity of such judgments. *See, In Re Jafari,* 378 B.R. 575 (Bankr. W.D. Wis. 2007).

However, the bankruptcy court correctly pointed out that neither Wynn nor Caesars had obtained a Nevada judgment and that the "full faith and credit clause [was] inapplicable to the outcome". Thus, the bankruptcy court found that it was necessary to determine whether the Marker Claims should be allowed or disallowed under 11 U.S.C. § 501. In determining this issue, the bankruptcy court opined that it was necessary to consider choice-of-laws principles to determine "which states law is the 'applicable law....” Therefore, the bankruptcy court



went on to consider whether to apply federal choice of law principles or Wisconsin choice of law principles. The bankruptcy court opined that Wisconsin choice-of-law principles applied. Having determined that Wisconsin choice-of-law principles apply, the bankruptcy court then determined that Wisconsin law should govern the validity of the Marker Claim. The bankruptcy court then held that the Wisconsin Anti-Gaming Statute invalidated the Marker Claims and upheld the Trustee's objection. *In Re Jafari*, 378 B.R. at 580.

Wynn and Caesars appealed the bankruptcy court's decision to the United States District Court for the Western District of Wisconsin. *See, In Re Jafari,* 385 B.R. 262 (W.D. Wis. 2008). The District Court reversed the bankruptcy court's decision. The District Court held that under either federal or Wisconsin choice-of-law rules, the court would determine that Nevada law governed the Marker Claims. The District Court remanded the case to the bankruptcy court so that the bankruptcy court could determine the validity of the Marker Claims under Nevada law. *In Re Jafari,* 385 B.R. at 268. On remand, the bankruptcy court determined that the Marker Claims were valid under Nevada law and that the claims were allowed. The Trustee appealed to the United States Court of Appeal for the Seventh Circuit.

The Court of Appeals affirmed the ruling of the District Court and the bankruptcy court's decision, on remand, to allow the Marker Claims. *Jafari v. Wynn, LLC (In Re: Jafari),* 569 F.3d 644 (7th Cir. 2009). In reaching its decision, the Court of Appeals considered whether federal choice-of-laws principles or the forum state's choice-of-law principles should be applied to determine which state's law should govern a claim filed under 11 U.S.C. § 501. *Jafari,* 569 F.3d at 647-649. The Court of Appeals first pointed out that when a federal court exercises diversity jurisdiction under 28 U.S.C. § 1332, it generally applies the choice-of-law rules of the state in which it sits. *Id.* at 648 (citing *Klaxon Co. v. Stentor Elec.Mfg. Co.,* 313 U.S. 487 (1941)). The court then pointed out, however, that bankruptcy court's jurisdiction does not arise from diversity jurisdiction, but from federal bankruptcy law. *Id.* Nevertheless, when determining the validity of most property rights, the bankruptcy court must apply state law. *Id.* (citing *Butner v. United States,* 440 U.S. 48, 54 (1979). The Court of Appeals recognized that “there is a tension as to whether bankruptcy courts follow federal common law choice-of-law principles or the forum state's choice of law principles. *Id.*

The Court of Appeals noted that the Supreme Court has stated in dicta that the question of which state's law applies “requires the exercise of an informed judgment in the balancing of all the interests of the states with most significant contacts in order to best accommodate the equities among the parties to the policies of those states.” *Id.* (citing *Vanston Bondholders Protective Comm. v. Green,* 329 U.S. 156, 161-162 (1946). Since this language in *Vanston* is only dicta, and since the Supreme Court has not subsequently addressed “whether federal choice-of-law rules or the choice-of-law rules of the forum state apply in bankruptcy,” the Courts of Appeal that have addressed this issue have been divided. *Id.* at 649. By way of example, the Court of Appeal cited *In re Lindsay,* 59 F.3d 942, 948 (9th Cir. 1995), where the United States Court of Appeal for the Ninth Circuit held, “in federal question cases with exclusive jurisdiction in federal court, such as bankruptcy, the court should apply federal, not forum state, choice-of-law rules.” *Jafari,* 569 F.3d at 649. However, the Court of Appeal also recognized that other Circuit

Courts of Appeal have concluded that a bankruptcy court should apply the choice-of-law rules of the forum state. *Id.* (citing *In re Gaston & Snow,* 243 F. 3d 599, 605-606 (2d Cir. 2001). The Court of Appeal further recognized that the Seventh Circuit had not yet decided the issue. *Id.* (citing *In re Morris,* 30 F.3d 1578,1582 (7th Cir. 1994).

Turning the case at bar, the Court of Appeal noted that the Trustee did not dispute that if federal choice-of-law principles were applied, Nevada law would apply and the Marker Claims would be allowed. *Id.* Thus, the Court of Appeal reasoned that if Wisconsin choice-of-law principles also resulted in the application of Nevada law to the Marker Claims, it would not have to resolve the issue of whether federal or Wisconsin choice-of-law principles should apply. *Id.*

The Court then conducted a review and analysis of Wisconsin contract choice-of-law rules. *Id.* at 649. The Court determined that in contract cases, the Wisconsin courts apply the "grouping of contracts rules." *Id.* (citing *State Farm Mut. Auto Ins. Co. v. Gillette, 2002 WI 31, 251 Wis. 2d 328, 330 (Wis. 1970).* This rule requires that the contract rights must be "determined by the law of the [jurisdiction] with which the contract has its most significant relationship." *Id.* (quoting *American Std. Ins. Co. v. Cleveland, Wis.2d 258 (Wis. Ct. App. 1985).* In applying this rule, the Court also pointed out that "[t]he 'first rule' in the choice-of-law analysis is 'that the law of the forum should presumptively apply unless it becomes clear that non-forum contacts are of the greater significance.' "(quoting *Drinkwater v. Am. Family Mut. Ins. Co., 2006 WI 56 (Wis. 2006).* However, the Court went on to add, that Wisconsin courts will apply the law of the non-forum state if it's clear that the contract has more significant contacts with the non-forum state. *Id. (citing Heath v. Zellmer, 35 Wis.2d 578 (Wis. 1967).* The Court identified five factors to be considered in determining which state's law has the more significant relationship to the contract. *Id.* These factors include: (a) the place of contracting; (b) the place of negotiation of the contract; (c) the place of performance; (d) the location of the subject matter; and (e) the respective domiciles, place of incorporation, and place of business. *Id. at 650* (citing *Hystro Prods., Inc. v. MNP Corp. 18 F.3d 1384, 1387 (7th Cir. 1994).*

In the case at bar, the Court found that Jafari was in Nevada when he negotiated his credit arrangements, executed the credit applications, and executed the markers. *Id.* The Court also found that these agreements were performed in Nevada and that Jafari used the proceeds of the loans for gambling in the Nevada casinos. *Id.* The Court further found that the debt was payable to both casinos in Nevada. *Id.* In contrast, the Court found that Wisconsin's only contact with the contracts was the fact that Jafari lived in Wisconsin. *Id.*

Based on the foregoing, the Court the determined that the "significant contacts in this case strongly favor Nevada." *Id.* Thus, the Court held that Wisconsin choice-of-law principles would also result in the determination that Nevada law applies to the Marker Claims. *Id.* at 650. Given that Nevada law applied to the Marker Claims, the Court determined that Wynn's and Caesars claims should be allowed and it affirmed the bankruptcy court's decision (on remand). *Id.*

While Wynn and Caesars prevailed in this case,

Court of Appeal did recognize that several jurisdictions have determined that the forum state's conflict-of-law principles may apply in bankruptcy court. This issue could be problematic if the forum state's conflict-of-law principles result in the application of a state law that prohibits the enforcement of markers. Therefore, Nevada casinos should consider this risk when deciding whether to litigate or settle cases involving markers. If a case involves a significant debt, the casino should: (1) consult with legal counsel in order to determine whether a particular bankruptcy court will apply federal or state choice-of-law principles; and (2) include this determination in formulating a strategy to collect the marker debt.

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