

NGC REG. 15C's INVESTMENT MEDICINE FOR COVID-19's FINANCIAL ILLS

By Dennis Gutwald

Many of Nevada's top gaming operators continue to nimbly and admirably weather and adapt to the changing operating requirements, crippled tourism market, and financial harm caused by COVID-19. But the nature and extent of the financial damage to the gaming industry will likely take years to determine as the equity holders, creditors, and landlords of financially troubled gaming companies ("Distressed Companies"), negotiate with each other and jockey in court to resolve what they really still hold in the Distressed Companies and what is to become of those companies. Non-gaming business entities, including private equity funds, hedge funds, institutional investors, Indian tribes and other sovereign entities (together "Investors"), will be part of the resolution process and, for them, the ability to acquire equity interests in Distressed Companies will be an important consideration in that process. While many areas of law will have to evolve considerably due to the new realities of COVID 19, Nevada already has the gaming laws and regulations ("Nevada Gaming Laws"), in place that will allow Investors to acquire equity interests in Distressed Companies and help get them on a stable, more firm financial footing.

INVESTORS' ROLE

Investors are particularly well suited to invest in and guide Distressed Companies because they generally have reliable sources of funds, continuing motivation to invest them, and access to a wide array of financial experts – while not being governed by entrenched expectations regarding how business operations should be conducted or to show quick, short-term investment profits. As a result, Investors have more flexibility and resources to help Distressed Companies develop solutions to solve their financial difficulties and enhance their value by readjusting their balance sheets through refinancings, acquisitions, consolidations, asset sales, work force reductions, and using specialized management, expert consultants and directors. With the gaming industry's constant growth, today's Investors are looking for more opportunities to take an equity interest in gaming companies, and Distressed Companies in particular.

HOW NEVADA'S GAMING LAWS EVOLVED TO HELP INVESTORS

Privately Held Companies

Nevada's comprehensive, expensive (sometimes over \$1,000,000), and long (often taking over 10 months to complete) gaming investigation process ("Investigative Process"), has always played a major role in determining whether an Investor acquires a Nevada gaming licensee.

Nevada Gaming Laws first required that any individual who had any ownership interest in a gaming licensee had to be found suitable or licensed ("Approved"), and go through the Investigative Process no matter how small that interest was. An individual with an indirect .00001% beneficial ownership interest in a gaming licensee would still have to go through the same Investigative Process as a person acquiring 100% of the gaming licensee. For entities



with ownership spread between many persons, having all of them go through the Investigative Process often was too expensive or simply not practical. Notably, publicly traded companies (PTCs) couldn't acquire gaming licensees because there was no way to get all of their shareholders Approved.



Publicly Traded Companies and Institutional Investors Allowed to Invest

Nevada's lawmakers recognized the value of allowing PTCs to invest in and own gaming operations. Accordingly, they amended Nevada Gaming Laws so that PTCs could own gaming licensees. PTC shareholders that held over 10% or voting interest were automatically required to go through the Investigative Process. But those with less were not. NGC Approvals were formally documented in Orders of Registration, which also provided customized regulatory requirements for the PTCs being approved. Over time, these Orders of Registration took on an essentially standardized form, all having similar requirements. Nevada Regulators found that what worked for one PTC, worked for many.

Nevada Gaming Laws were also amended to allow institutional investors, like banks, to acquire an ownership interest in gaming companies without institutional investors' owners having to go through the Investigative Process, if their percentage of equity

interest didn't exceed certain thresholds. This greatly increased gaming licensees' ability to obtain financing from institutional investors.

As gaming throughout the country grew, Investors became increasingly interested in investing in gaming companies. The Nevada Gaming Control Board and Nevada Gaming Commission ("Nevada's Gaming Regulators"), creatively using existing Nevada Gaming Laws for PTCs, worked with private equity funds to find an ownership arrangement for those companies' funds to invest in gaming licensees without every owner of the privately held fund having to go through the Investigative Process.



The private equity companies would form an entity ("Holdco") that then filed an SEC Form 10, submitting to the jurisdiction and regulatory requirements of the SEC as a de-facto PTC, including the SEC's extensive reporting requirements. Holdcos were then allowed to acquire gaming licensees as PTCs, even though none of their securities were actually publicly traded. Another entity ("Votecco"), owned and managed by select individuals from the private equity company, would hold all of the voting rights in Holdco. Those individuals would go through the Investigative Process and be Approved. The funds would hold all economic interest in Holdco either directly or through an entity but would have no voting rights or ability to control Holdco or the gaming licensee. Because only owners with a voting interest or control of a PTC holding a gaming licensee



were required to go through the Investigative Process, none of the fund owners had to go through the Investigative Process since they ultimately held no voting interest or control. Part of the justification for the foregoing arrangement was that SEC jurisdiction, oversight, reporting requirements, and other regulatory requirements provided additional levels of regulatory assurance such that Nevada Regulators could be confident that the foregoing arrangement (“Holdco Structure”) posed no concerns.



Like other PTCs, Holdcos were subject to Orders of Registration.

Initially, Nevada Regulators required that at least one or two of the private equity companies’ top-level principals also serve as owners of Votecos, go through the Investigative Process, and be Approved to serve as owners of Votecos. After the Holdco Structure was successfully used for several years, Nevada Regulators became more willing to let the private equity companies’ mid-level management, those actually controlling the funds rather than a company’s top-level principals, play a greater role as owners of Voteco, as long as there was some assurance that the top-level principals wouldn’t ultimately be controlling the gaming licensee. This ability to use mid-level management to serve as Voteco’s owners increased the utility of the Holdco structure. A requirement that top-level principals must go through the Investigative Process often would make an equity investment impracticable. The investment in the gaming licensee usually was an extremely tiny piece of the overall portfolio of businesses that the top-level executives managed and the Investigative Process required a substantial amount of their attention and resources that was hard to justify, given the reality they exercised no actual control over the investment. Also, the top-level principals’ very substantial and complex

financial holdings made the Investigative Process far longer and more expensive.

While the Holdco Structure did increase Investors investment in gaming licensees, the SEC reporting requirements (one of the main justifications for Nevada Gaming Regulators adopting the Holdco Structure) discouraged its use considerably. Complying with those requirements cost a lot of money, well over \$500,000 a year in most cases. And because SEC reports were available to the public, private equity companies had to surrender a great deal of the privacy and confidentiality that they believed was critical for implementing their investment strategies.

More Recent Changes

As gaming expanded throughout the U.S., most jurisdictions other than Nevada adopted a standard whereby any person with over 5% direct or indirect control or economic interest in a gaming licensee would have to go through their Investigative Process and be Approved.

Nevada lawmakers, at the behest of Nevada Gaming Regulators, amended Nevada’s gaming statute to require that only persons with

a direct ownership interest greater than 5% in a gaming licensee were automatically required to apply for approval and go through the Investigative Process. By itself, the statute amendment eliminated the need for an SEC Form 10 requirement for private equity companies to acquire gaming companies without their fund investors having to submit some sort of gaming application. But the changes Nevada Gaming Commission (“Commission”) Regulations made to address and supplement the amendment added requirements that:

Any person owning an indirect ownership interest greater than 5% in a gaming licensee still had to go through the Investigative Process and be Approved.

Any person owning less than 5% had to go through a very much abbreviated Investigative Process and be registered as a minority owner.

Because of the changes to Commission Regulations, the statutory amendment did little to help Investors because of the impracticality of having everybody in their investment entities ownership structure apply for registration. And even in the limited circumstance where everybody in the ownership structure could

apply, getting everybody to comply with the new regulations proved very cumbersome.

But, after 15 years of regulating Holdcos that filed SEC Form 10 filings and acquired gaming licensees, the time period for which included the 2008 recession, Nevada Regulators had enough experience to determine that:

The Holdco Structure didn't create regulatory problems;

SEC jurisdiction over Holdco entities provided little in the way of additional regulatory scrutiny; and

The SEC reporting requirements added little regulatory protection and a great deal in financial burden to gaming companies.



As a result, they created Commission Regulation 15C ("NGC Reg. 15C"). NGC Reg. 15C essentially codified the rules Nevada Regulators used to govern the Holdco Structure and eliminated the need for any involvement with the SEC. The new privately held Holdcos were referred to in the regulation as Private Investment Companies ("PICs"), and defined as:

"... any privately held legal entity except a natural person which holds or applies for a license, or owns, directly or indirectly, a beneficial interest in any corporation, firm, partnership, limited partnership, limited-liability company, trust or other form of business organization which holds or applies for a license, and which has the following characteristics:

- (a) 100% of the economic securities of the company are held, directly or indirectly, by
- (i) one or more private investment funds

that are managed by an investment manager or managers, which investment manager or managers collectively have more than one billion dollars in assets under management or (ii) one or more institutional investors as defined in Regulation 16.010(14) that each has assets of more than one billion dollars;

(b) 100% of the voting securities of the company are held by one or more legal entities that is controlled by one or more controlling persons or key executives of the investment managers or institutional investors; and

(c) The company is not a "publicly traded corporation" as defined in NRS 463.487 or has received Commission approval to convert its registration from a publicly traded corporation to a private investment company."

Voting control of PICs, like the Holdcos that preceded them, are held by Voteco-type entities. Importantly, NGC Reg. 15C provided the Commission with the discretion to waive or modify the PIC characteristic requirements above. It also provided the Commission discretion in deciding which individuals associated with the PIC must serve on the Voteco, go through the Investigative Process, and be Approved.

No Orders of Registration were required for PICs because the standardized requirements found in such Orders of Registration were included in NGC Reg. 15C. Thus, NGC Reg. 15C, to a large degree, acts as a standard Order of Registration for PICs.

WHAT NGC REG. 15C MEANS FOR INVESTORS AND DISTRESSED COMPANIES

With the adoption of NGC Reg. 15C, the Commission made the acquisition of equity, and loans that could be converted into equity, more attractive for Investors contemplating investing in Distressed Companies.

Because PICs aren't subject to SEC reporting requirements, more money is available to invest. And perhaps more importantly to some Investors, the elimination of SEC reporting requirements also means details regarding the ownership, business operations, financial condition and performance of the Investors and the Distressed Companies aren't available to the prying eyes of competitors, unions, or plaintiff's attorneys.

NGC Reg. 15C affirms the Commission has the discretion to allow mid-level management of private equity companies, hedge funds, and institutional investor (especially banks) to be the owners of Voteco,



if the Commission determines it is reasonable to do so. As a result, many of those entities are likely to find investing in Distressed Companies more feasible.

NGC Reg.15C also affirms that the Commission has the discretion to allow entities that don't meet the definition of a PIC to still utilize a PIC for its investment. Investors that might fall short of meeting the requirements to be considered a PIC still may be able to be treated as one for the purpose of investing in Distressed Companies if the Commission deems it in Nevada's interest.

In addition, partly because of the foregoing, NGC Reg.15C lays out a new pathway for Indian tribes and other sovereign entities to invest in Distressed Companies. The Commission discretion established in NGC Reg.15C, together with the Commission discretion established in NRS 463.1665 which provides:

"An applicant which is a governmental entity or which is owned or controlled by a governmental entity must file such applications for licenses, registrations, findings of suitability or any other approvals as the Commission may prescribe..."

provides the Commission with the ability to permit Indian tribes and sovereign entities to use PICs and the other framework already established in NGC Reg.15C to facilitate their investment in Distressed Companies in a way that satisfies Nevada Gaming Laws.

With the complete economic shutdown of the gaming industry, followed by the many months or years it will take to restore airline travel and certain gaming business segments to their pre-COVID-19 levels, many areas of law, including gaming law in many jurisdictions, may have to adapt considerably to address the financial problems caused by the virus. With NGC Reg.15C, the Commission already has the laws in place needed to help resolve financial issues that Distressed Companies will face.



Dennis Gutwald is a Partner in McDonald Carano's Gaming & Administrative Law Group. He has more than 20 years of experience helping investment companies, banks and other financial institutions, and high-net-worth individuals navigate the multi-jurisdictional gaming law requirements for acquiring equity interest in, or lending to, premier national gaming companies. In his practice, Dennis counsels clients pursuing liquor, land use, and cannabis regulatory approvals both locally and at the state level in Nevada. He has assisted numerous clients in obtaining the requisite gaming and liquor regulatory approvals required for acquisition or ground-up development of many major casino resort hotels and other liquor, gaming, and cannabis businesses.