

The Evolution of Large Private Investments in Nevada Casinos:

New Nevada Gaming Commission Regulation 15C Facilitates New Opportunities for Private Equity

By Sonia Church Vermeys and Erin Elliott

Nevada's recent adoption of Regulation 15C helps provide clarity to the state's licensing structure, which could encourage new private equity funds and large financial institutions to invest in the Nevada gaming industry. Nevada's increasingly streamlined licensing system will likely bring even more stability and growth to the gaming industry.

Before 1999, private equity firms interested in investing in the Nevada gaming industry were deterred by Nevada's licensing requirements, which mandated that the private equity firms' numerous passive investors would need to file applications. This was an onerous task and as a result, a significant source of funds and investment were left on the table. That changed in January 1999, when the Nevada Gaming Control Board (the "Board") and the Nevada Gaming Commission (the "Commission") considered the application of Colony Capital to acquire Harvey's Casino Resorts ("HCR"). Colony Capital is a private equity firm that sponsors billions of dollars of equity in a variety of distinct investment funds and vehicles. The members of both the Board and the Commission did not want to discourage Colony Capital's investment and recognized the importance of creating a licensing structure that both avoided onerous application requirements for passive, minority investors and yet protected the integrity of the gaming industry. To that end, the Board recommended and the Commission approved the first "VoteCo" licensing structure in the State of Nevada.

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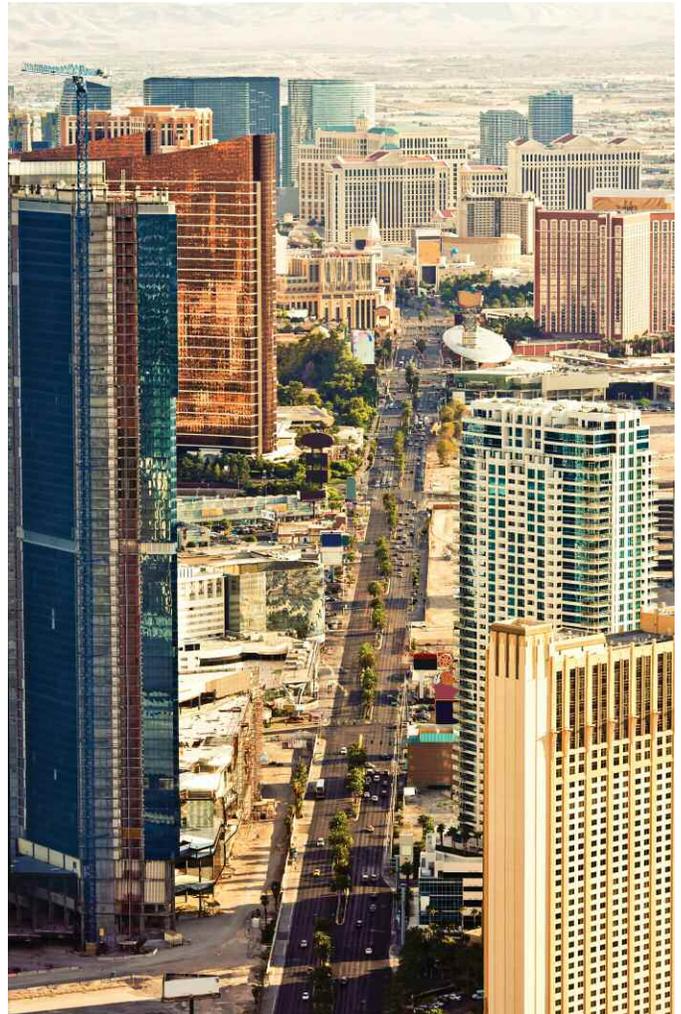
The **“Voteco” licensing structure** takes advantage of the distinction made in Nevada gaming law between a publicly traded corporation (“PTC”), as that term is defined in Nevada Revised Statutes (“NRS”) 463.487, and a privately held company. For a PTC, only individuals that possess a beneficial ownership of more than ten percent of any class of the voting securities of the PTC are required to file an application and be found suitable.¹ Under the **“Voteco”** licensing structure, the PTC issues two classes of shares to two separate entities. One entity holds all of the voting shares. This entity must be registered as a holding company, and its equity holders must be investigated and found suitable. The second entity holds all of the economic shares, but has no voting power or control. The investors of this second entity do not have to file applications to be found suitable because the licensing requirement is tied strictly to the voting shares. Of course, the Board and the Commission have the discretion to call any investor forward for licensing, but under the **“Voteco” licensing structure** licensing structure, licensing is no longer mandatory for these passive investors.

The Commission’s belief that the **“Voteco” licensing structure** would generate significant new sources of financing for the Nevada gaming industry not only proved true, but exceeded all expectations. Subsequent to the Commission’s approval of the Colony Capital transaction, numerous private equity firms have invested in the Nevada gaming industry. Some of those transactions are as follows:

1. **June 2004: Colony Capital/ Las Vegas Hilton**
2. **August 2004: Bay Harbour Management/Planet Hollywood Resort and Casino**
3. **September 2006: Oaktree Capital Management/Cannery Resorts**
4. **October 2007: Colony Capital/ Station Casinos Inc.**
5. **November 2010: Onex Corporation/Tropicana Las Vegas**
6. **July 2014: Apollo/American Gaming Systems Inc.**

7. **August 2014: Stockbridge Capital Partners/SLS Las Vegas**

8. **December 2014: The Blackstone Group/The Cosmopolitan At Las Vegas**



Based upon the success of the “Voteco” licensing structure for private equity investments via PTCs, in 2006, the Commission took another step to encourage additional investment in the Nevada gaming industry. Like private equity firms before the approval of the **“Voteco” licensing structure**, large financial institutions were also reticent to acquire substantial direct interests in Nevada gaming licensees. In June 2006, the Commission approved the use of the **“Voteco” licensing structure** by the Goldman Sachs Whitehall Funds (the real estate investment arm of Goldman Sachs) in their purchase of a 40% interest in the Las Vegas Hilton.

The Board and the Commission recognized that not only would the sheer size of Goldman Sachs make licensing extremely challenging, but that the top executives at Goldman Sachs would not be eager to

submit gaming applications. The Board and the Commission determined that the top executives within the Whitehall Funds were actually the individuals who would be controlling the investment in the Las Vegas Hilton and be responsible for all interaction with the gaming licensee. Therefore, the Board and the Commission felt comfortable in allowing the **“Voteco” licensing structure** to be utilized and directed just those individuals in control of the Whitehall Funds to be the owners of Voteco and to file applications for findings of suitability.

The Commission’s wisdom in allowing this modification of the **“Voteco” licensing structure** has resulted in other large financial institutions investing in the Nevada gaming industry. For example, Credit Suisse through its subsidiary, DLJ Merchant Banking, Inc., was approved to invest with the Morgans Hotel Group in the purchase of the Hard Rock Hotel and Casino in January 2008. Deutsche Bank was approved to own The Cosmopolitan At Las Vegas in October 2010, and Deutsche Bank and JP Morgan were approved to invest in Station Casinos, Inc., in 2011.



The **“Voteco” licensing structure** has resulted in the investment of tens of billions of dollars directly into the Nevada gaming industry from sources that had not invested in the Nevada gaming industry previously. Their financial resources and commitment to not only maintain, but also to improve the properties they invested in, have been instrumental in the recovery and stability of Nevada’s gaming industry during and since the great economic recession. As examples, Apollo and TPG, through Caesars Entertainment Corporation, have reinvested hundreds of millions of dollars during this time upgrading their properties (such as the Cromwell), purchasing new properties (like Planet Hollywood), and developing new concepts (like The Linq). Deutsche Bank not only spent more than a billion dollars completing the construction of The Cosmopolitan At Las Vegas, but after its opening, Deutsche Bank continued to reinvest tens of millions of dollars and underwrite substantial losses to create a viable property whose potential will now be realized by its new owner, The Blackstone Group.

The one drawback to the **“Voteco” licensing structure** is the requirement that an entity in the ownership chain be a PTC as defined in NRS 463.487. In most of the transactions that have utilized the **“Voteco” licensing structure**, there was no actual public company involved in the initial ownership chain. Therefore, in order to avail themselves of the **“Voteco” licensing structure**, most of the private equity firms and large financial institutions formed a new affiliated entity and voluntarily registered that entity with the Securities and Exchange Commission (“SEC”) on a Form 10 Registration Statement. The Form 10 entity satisfies the definition of a PTC pursuant to NRS 463.487, even though it does not list any of its securities for trading on a public stock exchange.

The perceived regulatory benefits in having a PTC were the belief that there would be SEC oversight of the Form 10 companies and that the production of financial and other information required to be filed by the Form 10 companies with the SEC would assist the Board in monitoring those companies. However, the formation and maintenance of a Form 10 SEC reporting company is very expensive and the associated costs can, over a few years, exceed a million dollars. In addition, the SEC requires Form 10 companies to file a significant amount of proprietary financial information concerning the operations of the licensee(s) they have invested in.

The public availability of this proprietary financial information can produce adverse economic results.

In June 2015, a petition was filed with the Board that proposed a new regulation, Regulation 15C, to eliminate the requirement of having a PTC in the **“Voteco” licensing structure**. Commission Regulation 15C was adopted in March 2016. In addition to eliminating the costs and public disclosures necessary in the former “Voteco” structure, Commission Regulation 15C also provides interested parties with a single regulation setting forth all of the requirements to be licensed and regulated as a private investment company (“PIC”).

In order to qualify as a PIC, as defined in the regulation, an entity must issue two classes of securities. One hundred percent (100%) of the non-voting economic securities of the PIC must be 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 that each has assets of more than one billion dollars. One hundred percent (100%) of the voting securities of the PIC must be held by one or more legal entities that is controlled by one or more controlling persons or key executives as defined in the regulation.²

Commission Regulation 15C requires PICs to produce proprietary information, but it is provided solely to the Board and the Commission on a confidential basis. For example, the PIC must provide information regarding (1) the organization,

financial structure and nature of the business of the PIC; (2) the names of all key executives and employees actively and directly engaged in the administration or supervision of the activities of the licensee; (3) the names, addresses and percentage of ownership interest held by each economic security holder and each voting security holder; (4) the terms and conditions of outstanding loans, mortgages, trust deeds, pledges or any other indebtedness or security device directly relating to the gaming activities of the gaming licensee; and (5) balance sheets and profit and loss statements.³

This clear regulatory guidance provides private equity firms and large financial institutions with an understanding of the qualifications necessary to become a PIC and the procedures they must follow to obtain any required regulatory approvals and maintain compliance, which will continue to foster the growth of Nevada’s gaming industry.

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¹ An exception may be made for an “institutional investor” as defined in NGC Reg. 16.010(14).

² NGC Reg. 15C.010(1).

³ See NGC Reg. 15C.050.

