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The Nevada Gaming Debt Collection Experience

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The Nevada Gaming Debt Collection Experience

Abstract

In the discussion - The Nevada Gaming Debt Collection Experience - by Larry D. Strate, Assistant Professor, College of Business and Economics at the University of Nevada, Las Vegas, Assistant Professor Strate initially outlines the article by saying: "Even though Nevada has had over a century of legalized gaming experience, the evolution of gaming debt collection has been a recent phenomenon. The author traces that history and discusses implications of the current law."

The discussion opens with a comparison between the gaming industries of New Jersey/Atlantic City, and Las Vegas, Nevada. This contrast serves to point out the disparities in debt handling between the two.

"There are major differences in the development of legalized gaming for both Nevada and Atlantic City. Nevada has had over a century of legalized gambling; Atlantic City, New Jersey, has completed a decade of its operation," Strate informs you. "Nevada's gaming industry has been its primary economic base for many years; Atlantic City's entry into gaming served as a possible solution to a social problem. Nevada's processes of legalized gaming, credit play, and the collection of gaming debts were developed over a period of 125 years; Atlantic City's new industry began with gaming, gaming credit, and gaming debt collection simultaneously in 1976 [via the New Jersey Casino Control Act]."

The irony here is that Atlantic City, being the younger venue, had or has a better system for handling debt collection than do the historic and traditional Las Vegas properties. Many of these properties were duplicated in New Jersey, so the dichotomy existed whereby New Jersey casinos could recoup debt while their Nevada counterparts could not.

"It would seem logical that a "territory" which permitted gambling in the early 1800's would have allowed the Nevada industry to collect its debts as any other legal enterprise. But it did not," Strate says.

Of course, this situation could not be allowed to continue and Strate outlines the evolution. New Jersey tactfully benefitted from Nevada's experience.

"The fundamental change in gaming debt collection came through the legislature as the judicial decisions had declared gaming debts uncollectable by either a patron or a casino," Strate informs you. "Nevada enacted its gaming debt collection act in 1983, six years after New Jersey," Strate points out.

One of the most noteworthy paragraphs in the entire article is this: "The fundamental change in 1983, and probably the most significant change in the history of gaming in Nevada since the enactment of the Open Gaming Law of 1931, was to allow non-restricted gaming licensees* to recover gaming debts evidenced by a credit instrument. The new law incorporated previously litigated terms with a new one, credit instrument." The term is legally definable and gives Nevada courts an avenue of due process.

Keywords

Larry D. Strate, The Nevada Gaming Debt Collection Experience, Statute of Anne, Debt Collection Act in Nevada, Full-faith and credit clause

The Nevada Gaming Debt Collection Experience

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Even though Nevada has had over a century of legalized gaming experience, the evolution of gaming debt collection has been a recent phenomenon. The author traces that history and discusses implications of the current law.

There are major differences in the development of legalized gaming for both Nevada and Atlantic City. Nevada has had over a century of legalized gambling; Atlantic City, New Jersey, has completed a decade of its operation. Nevada's gaming industry has been its primary economic base for many years; Atlantic City's entry into gaming served as a possible solution to a social problem. Nevada's processes of legalized gaming, credit play, and the collection of gaming debts were developed over a period of 125 years; Atlantic City's new industry began with gaming, gaming credit, and gaming debt collection simultaneously in 1976.

A recent article discussed the importance of gaming credit and debt collection to the developing casino gaming industry in Atlantic City, New Jersey.¹ Equally relevant to the discussion of gaming credit is the experience of the other state with legalized casino gaming, gaming credit, and debt collection—Nevada.

It would seem logical that a "territory" which permitted gambling in the early 1800s² would have allowed the Nevada industry to collect its debts as any other legal enterprise. But it did not. It would be well into the next century, about 125 years after statehood,³ that the Nevada legislature would legalize the collection of gaming debts. For the first time in the history of gaming in Nevada, the primary industry of the state could collect its debts through the courts. Only two "forms" of debts, recovery of gaming debts by licensees⁴ and recovery of gaming debts by patrons,⁵ are permitted under the new statutes; all other forms of gaming debts, even in Nevada, are still unenforceable and uncollectible according to the rule of the "Statute of Anne."

This old statute became a part of the body of every state's law when the Common Law of England was adopted in the United States. As a result of the Statute of Anne, wagering and gaming contracts met with little countenance from the courts, and, consequently, in nearly every state, including Nevada and New Jersey, gaming contracts have been determined illegal as inconsistent with the interests of the community

or at variance with the laws of morality (2 Smith's Lead. Cas. 343):

That all notes, bills, bonds, judgments, mortgages, or securities or conveyances whatsoever given, granted, drawn or entered into, or executed by any person or persons whatsoever, where the whole, or any part of the consideration of such conveyances, or securities shall be for any money, or other valuable thing whatsoever, or by betting on the sides or hands or such as do game at any of the games aforesaid, or for the reimbursing or repaying any money knowingly lent, or advanced at the time and place of such play, to any person or persons so gaming or betting as aforesaid, or that shall, during such play, so play or bet shall be utterly void, frustrate and of non effect, to all intents and purposes whatsoever. (9 Anne, C. 14, 4 Bac. Abr.)

The Statute of Anne has impacted upon every state because of its "prohibitions" regarding the collection of gaming debts. The major impact has been in the states where legalized gaming was available—because the Statute of Anne specifically prohibits the collection of gaming credit. The majority of states do not recognize gaming debts, domestic or foreign. Some states allow for the collection of a gaming debt like New Jersey, New York and Nevada; one state declared a gaming debt not to be a gaming debt, but a contract and collectible.⁶ Others have allowed the collection of gaming debts as judgments under the full faith and credit clause of the U.S. Constitution.⁷

Nevada Pioneered Legalized Gambling

Nevada pioneered legalized casino and other forms of gaming statewide in the early 1800s. It is not restricted to a geographical location as is Atlantic City. The first official restrictions on gambling appeared in 1861.⁸ Its checkered history has seen the range of tolerance to unacceptability when public gaming was outlawed by statute from 1909 to 1931. When public opinion changed favoring gambling in 1915, the legislature permitted it on a restricted scale once more. Since 1931 when the legislature passed the "Open Gaming Law," legalized gambling has been the primary industry of Nevada. Its early beginnings in casino gambling followed World War II, and with it came nontraditional sources of funds for capital expansion. A formalized policy statement was codified in the 1955 "Nevada Revised Statutes" gaming code section, unlike New Jersey where the statutes related to gaming are included among its criminal statutes. The official policy statement of Nevada indicates that the gaming industry is vital to the state and to its inhabitants, that the growth and success of the industry is based upon public confidence and trust, and that strict regulation of all persons, locations, practices, associations, and activities is essential.

Nevada's primary industry continues to be gaming. In the State of the State Message delivered by Governor Richard Bryan in January of 1987, he indicated that 45 percent of the general fund of the State of Nevada came from gaming revenue. Gaming has been the mainstay industry of Nevada, and historically when much of the country experienced economic problems, Nevada singly has been the state that has felt only

minimally the effects of recession and high unemployment. The basis of Nevada's economic success story is the thriving gambling industry and related tourist enterprises.

Former Governor of Nevada Mike O'Callaghan stated in testimony in 1975 before the Commission on the Review of the National Policy Toward Gambling: "...no other business is as stringently regulated as the gambling business in Nevada." Court cases also support the regulatory scheme in Nevada requiring gaming licenses to be administered "for the protection of the public and in the public interest in accordance with the policy of this state," and granting the gaming commission full power to deny any license application "for any cause deemed reasonable."⁹ This paper is concerned primarily with the nonrestricted licensee¹⁰ as only nonrestricted licenses casino operations may hold "credit instruments"¹¹—gaming debts now collectible in Nevada. There are some 280 nonrestricted licensees. According to statistics from the Gaming Control Board in 1986, there were some 1496 restricted licensees¹² in Nevada. Restricted licensees are not allowed to extend credit.

Prior to 1969, it was virtually impossible for a publicly traded corporation to purchase and operate a casino in Nevada. The state required all casino owners to be licensed by the state's gaming agency. This statute was to prevent undesirables from holding interests in casinos through public purchase of a company's stock, but it severely limited raising capital through equity financing and excluded otherwise legitimate publicly-traded corporate forms entering into the gaming industry.¹³

Capital came from nontraditional sources in the early years of Nevada. The most important of these was the Teamsters' Central States Pension Fund, which itself was riddled with scandals over the years.¹⁴ Las Vegas casinos were characterized by the presence of organized crime figures in important industry positions. It would be after Bugsy Siegal when major investors such as Howard Hughes who took an interest in Nevada that the infiltration of organized crime would be significantly reduced.

During the 1970s the gaming industry gained access to financial capital with the passage of the "1969 Corporate Gaming Act" in Nevada. This act allowed publicly-traded corporations to enter the gaming industry and a number of reputable corporations in related industries, such as Hilton, MGM, Hyatt, and Holiday Inns, entered the industry.

Industry Perceives Self As Legitimate

In addition to the corporate entry in the gaming industry, the gaming industry perceives itself as a legitimate industry. Steve Wynn, chairman and chief executive officer of the Golden Nugget, Inc., in testimony before the Senate Judiciary Committee in 1983, stated: "It is important to remember...that the gaming industry is but one segment of the growing entertainment/leisure time industry..." The United States perception of gaming has also changed, according to the report of the Senate Committee on the Judiciary in 1983: "The laws have lingered over into the present era when fully forty-five states permit wagering or bingo, when

thirty six states allow betting on horse races and twenty six states currently have lotteries...”

Another aspect of the gaming industry that has influenced its structural makeup is related to the economies of large scale production.¹⁵ Large casinos in Nevada have consistently outperformed middle-sized and small casinos in their geographical markets in terms of net operation income as a percentage of total revenues.¹⁶ This reflects the ability of larger casino operations to offer a broader array of gambling activities, as well as a greater variety of non-gaming services, such as food, entertainment, shopping, and other facilities.

In 1986, according to the Nevada Gaming Abstract, 25 casinos, 8.8 percent of the nonrestricted licensees, (275 casino operations) grossed 47.7 percent of the total gaming revenue in the state. These casinos are owned by 13 publicly-held corporations.¹⁷

Prior to 1983 in Nevada and 1976 in Atlantic City, gaming debt collection had been practiced by owners and operators of gaming establishments if they allowed collection methods were effectively used for over a century. The Ninth Circuit Court observed this in the Flamingo case, noting that the casino's estimate of collectibility was as high as 96 percent without legal enforceability of gaming debts, and that it was doubtful that legal enforceability of “markers” would or could increase the recovery rate.¹⁸

Such effective collection methods may well have been one of the contributing factors explaining why the gaming industry waited for over a century to have gaming debt collection legalized. But when New Jersey entered into casino gaming in 1977 with the passage of the “New Jersey Casino Control Act,” Nevada was no longer the only game in town.¹⁹ From the player's perspective, it was better to repay a legally collectible debt in New Jersey than a legally unenforceable one in Nevada.

Debt Collection Was Issue for Many Years

The idea of legalized gaming debt collection had been a consideration of the industry for many years. However, until the early part of this decade, the casinos were successful in collecting debts without resorting to court action. A primary argument against enacting such a law was that the casinos would have incurred an immediate federal tax impact of millions of dollars by reporting uncollected casino credit as income. The tax situation arose because several major resorts had not included gaming credit instruments as income. The gaming licensee took the position that because they had no legal right to receive payment on the instruments, no tax was due until cash was received in payment. And, for the longest time, the U.S. tax courts agreed with the gaming licensees.

Then in 1982 the Ninth Circuit Court decided that the prevailing idea of not including gaming credit as income for federal tax purposes by the gaming industry until payment was collected would be changed.²⁰ Despite the unenforceability of gaming debts in 1982, the U.S. court ruled that the “accrual basis” casino must include in its income the receivables arising from an extension of credit to gaming patrons. The receivables in dispute arose from uncollected loans by the Flamingo in the course

of its business. This casino, an accrual basis taxpayer, excluded \$676,432 of casino receivables in its 1967 tax return. Approximately 60 percent of the casino's total play resulted from such credit extensions. Flamingo's estimates of collectibility of those receivables ranged as high as 96 percent. This extension of credit and high incidence of payment occurred despite the fact that Nevada did not recognize the legal enforceability of gambling debts and led the court to conclude that the lack of legal liability did not interfere with the Flamingo's operations, and that it was doubtful that legal enforceability of the "markers" would or could increase the Flamingo's recovery rate. The industry would have to change its accounting procedures.

Following the Flamingo case ruling, the industry sought legal debt gaming collection. The legislature examined statistics showing that Nevada's gaming credit collection rate, historically about 95 percent, had dipped below 90 percent for the first time in history. Hearing examples of patrons who paid gaming debts owed in New Jersey, where gaming debts were enforceable, but ignored in Nevada, the legislature passed the bill without a dissenting vote.

New Jersey entered into casino gaming, gaming credit, and legalized debt collection simultaneously in 1977, with the passage of the New Jersey Casino Control Act. Although located on the eastern seaboard, New Jersey gave Nevada competition for its famous gaming industry. When New Jersey ventured into casino gaming, New Jersey Statute 5:12-101 (f) (1977) stated that "checks issued in conformity with the requirements of this act shall be valid instruments, enforceable at law in the courts of this state." Nevada enacted its gaming debt collection act in 1983, six years after New Jersey. The very presence of this statute in New Jersey encouraged a similar statute in Nevada when the same names of casinos appeared—Caesar's Palace, Harrah's, Bally, and the Golden Nugget.

Changes Come Through Legislature

The fundamental change in gaming debt collection came through the legislature as the judicial decisions had declared gaming debts uncollectable by either a patron or a casino. This court precedent was neither popular among bewildered patrons nor with the gaming industry. The frustration was expressed by Burton M. Cohen:²¹ "Gaming is not a pariah industry. It should be allowed to lawfully collect its debts just as any other enterprise." Aware of continued attempts to find a different solution to the court's precedent, the Nevada Supreme Court offered some advice: "If the law is to change, it must be done so by legislative action."²²

For more than a century Nevada's court decisions were rendered in conformance with the guidelines of the "Statute of Anne." Whether it was a note in McLusky's Bar in Pioche, Nevada, in 1872, or a check at the Ormsby House in Carson City in 1980, debts incurred or checks drawn for gaming purposes were void and unenforceable. For nearly 125 years, any debt incurred, such as a note²³, a certificate of deposit²⁴, a stock pledge²⁵, or check(s) given²⁶, or defenses raised such a "holder-in-due-

course” status²⁷ were unenforceable. Nevada’s gaming climate permitted the patron to gamble—to win or to lose; but the effect of the Statute of Anne was to permit one to gamble, to lose, and then not to pay.

The 1983 Nevada legislature modified the common law prohibition against collection of gaming debts with the passage of Nevada Revised Statutes (NRS 463.367–368) entitled “Recovery of Gaming Debts by Licensees” and “Recovery of Gaming Debts by Patrons” at (NRS 463.361). This section specifically stated that not every gaming debt in Nevada was legally enforceable.²⁸

The fundamental change in 1983, and probably the most significant change in the history of gaming in Nevada since the enactment of the “Open Gaming Law” of 1931, was to allow nonrestricted gaming licensees²⁹ to recover gaming debts evidenced by a credit instrument.³⁰ The new law incorporated previously litigated terms with a new one—“credit instrument.”³¹

Legislative draftsmen were also cognizant that the test for the new term would probably be whether or not a credit instrument was a negotiable instrument. This issue was discussed in “Casino Markers and Article 3.”³² But the issue would be resolved in the Sands Hotel and Casino case.³³ Mr. Jackson, a resident of Texas, gambled in Las Vegas on several occasions and negotiated credit instruments totalling \$30,000; he failed to pay these instruments when they were presented. Jackson’s argument was that a credit instrument was neither commercial paper nor a negotiable instrument, and accordingly he could not be negotiating commercial paper. The magistrate who heard this case said: “to treat a credit instrument otherwise than negotiable would not have been a reasonable or practical application of the careful drafting by the legislative process.” In 1985 the legislature enacted an additional section to strengthen the concept of negotiability: to provide that “the commission may adopt regulations prescribing the conditions under which a credit instrument may be redeemed or presented to a bank for collection or payment.”³⁴

The Statute of Anne was also a shield against a patron’s attempt to recover winnings, whether from faro,³⁵ keno,³⁶ or a bet.³⁷ The historical rationale was stated in an early case in Nevada: “It would therefore seem to follow, that money won in such house by the keeper could not be recovered, because everything connected with or growing out of that which was illegal partook of its character, and was tainted with its illegality.”³⁸ With precedent established, the Nevada Supreme Court concluded: “This court has refused to aid in the collection of gambling debts for nearly a century, and we will not depart from these cases.”³⁹

Issue Is One of Due Process

The historical position gave way to the new statute, and subsequently the state Supreme Court would address other issues. However, the most important issue the court would address immediately would be a question of due process. Access to the courts even in gaming debt collection was a fundamental requirement of procedural due process. The

first case that appeared was eagerly watched by the industry, but was dismissed for lack of standing.⁴⁰ A year later another case asked the question: "Was allowing a nonrestricted gaming licensee access to the courts to enforce a gaming debt evidenced by a credit instrument without giving the patron the same direct access to the courts to enforce a debt constitutional?"⁴¹

In Nevada, a patron and a licensee are provided unequal procedures in the judicial review of a Gaming Control Board decision. Since 1983, either patron or licensee has had access to the courts, but by different means. The gaming licensee could maintain a direct action in the courts, but only if the gaming licensee were a holder of a credit instrument; the licensee had a property right in the retention of its license to do business. In the normal course of business it was only the nonrestricted licensee who would be involved in obtaining a written document evidencing the patron's obligation to pay the gaming debt.

The statute provided a way for the patron to collect on what was considered to be a winning bet by bringing the matter to the attention of the gaming authorities. It was determined to be in the state's best interest to know if gaming licensees were or were not paying patrons who won gaming bets in the casino. The concern of the state to ensure fair treatment of its patrons was legitimate and to that end there was a rational basis for the difference in the classification of rights.

Even after the enactment of the Debt Collection Act in Nevada, the issue of gaming debt collection is unsettled for the other states. Most states resolved the non-collectibility issue of gaming debts as being contrary to their state's public policy interests. A few, like California, Nevada, New York, and New Jersey, recognize gaming debt collection by statute. Within its boundary a state may exercise its own judgment as did the Commonwealth of Virginia.⁴² This case was not originally tried in New Jersey, although the debts involved were gaming debts legally enforceable under New Jersey law, but was brought in a Virginia court. The court dismissed the case stating it would not enforce a contract "that offends two centuries of state policy." In another case a New Jersey casino filed suit in Illinois to collect gaming debts. The Illinois court explained public policy in Illinois like this:

Gambling contracts to contrary to Illinois public policy; and were we to apply Illinois law, we would not enforce Resort's claims. This is so because under the public policy doctrine, a court will refuse to apply the law of a foreign state if it is contrary to pure morals or abstract justice, or ...the enforcement would be of evil example and harmful to its people.⁴³

Is there value to the full-faith and credit clause? The most significant change in the law was to provide a jurisdiction where gaming debts are legal, and, ultimately, enforceable judgments collectible through courts of other states. An action proceeds to judgment in Nevada in favor of a casino. The enforcement of that valid judgment in another state would not be a matter of discretion for that other state to dismiss an original action based on public policy arguments.

In a test case, a Nevada gaming debt judgment was taken to Califor-

nia for enforcement. The court rejected the local public policy argument:

In view of the fact that the original debt sued upon in Nevada, which gives rise to the Nevada judgment seeking to be enforced here, was a legally enforceable debt in Nevada, the Court sees no justification, legally, equitably, or morally, to set it aside.⁴⁴

Gambling on credit issued by casinos is big business in Nevada. The amount of gaming credit issued through the state in 1986 totaled \$1.775 billion, according to state gaming control board figures. The collection of gaming credit by casinos was nearly \$1.739.8 billion for the same fiscal period. Credit play represented approximately 50 percent of total gaming revenue for the state in the same period. Even a slight increase in collection of gaming debts translates into millions of dollars, and that is income for the casino operations, taxes for the federal government, and revenue for the general funds of the state of Nevada. The role of credit in casino gambling is substantial for both Atlantic City and Nevada. The development of legalized debt collection will finally allow the legalized gaming industry the protection of the court system to enforce obligations owed. As illustrated, this was not always the case for the industry. Now Nevada and Atlantic City have someone else with whom they may address common industry concerns—casino gaming, gaming credit, debt collection, due process, and judicial review. It isn't easy to be the only game in town.

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³Constitution of Nevada, Preamble, Section 1.

⁴Nevada Revised Statutes (N.R.S.) 463.367-368.

⁵Nevada Revised Statutes (N.R.S.) 463.362.

⁶National Recovery Systems v. Harry G. Martorella, No. 381, Pittsburgh, 1982.

⁷An Act Adopting the Common Law, approved January 24, 1883.

⁸In *Resorts International Hotel, Inc. v. Agesta* (No. 83-0215-R, E.D. Va, Aug 5, 1983); In *Resorts International, Inc. v. Peter (Pierre) Zonis*, 577 F. Supp. 876 (N.D. Ill. 1984); In *Hotel Conquistador Corporation v. Fortino*, 298 N.W. 2d 236 (WISC App. 1980.); *Hotel Rivera, Inc. v. Griffith*, No. 282047 (March 26, 1984).

⁹*State v. Rosenthal* 93 Nev. 36, 559 P.2d 830 (1977) appeal dismissed, 98 S.Ct 32 (1977).

¹⁰“nonrestricted licensee” and “nonrestricted operation” refers to the license for or operation consisting of 16 or more slot machines or a license for or operation of any number of slot machines together with any other game, gaming device, racebook, or sports pool at one establishment, N.R.S. 463.0177.

¹¹“credit instrument” is defined as a writing which evidences a gaming debt owed to a person who holds a nonrestricted license at the time the debt is created and includes any writing taken in consideration, redemption or payment of a prior credit instrument, N.R.S. 463.367.

¹²“restricted licensee” and “restricted operation” refer to a state gaming license for or an operation consisting of not more than 15 slot machines and no other game or gaming device at the establishment, N.R.S. 0189.

¹³William R. Eadington, "The Political Economy of the Legal Casino Gaming Industry in the United States," Paper No. 841-, College of Business Administration, Bureau of Business and Economic Research, University of Nevada, Reno.

¹⁴*Ibid.*

¹⁵*Ibid.*

¹⁶*Ibid.*

¹⁷Nevada Gaming Abstract, 1986, State Gaming Control Board. Bally Grand Resorts, Inc., Caesar's World, Circus Circus Enterprises, Inc., Dunes Hotels and Casinos, Inc., Elsinore Corporation, Golden Nugget, Inc., Hilton Hotel Corporation, Holiday Inns, Inc., Ramada Inns, Sahara Resorts, Scott Corporation, Showboat, Inc., and Del E. Webb Corporation.

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²⁶AGO 173, October 22, 1974; Scott v. Courtney, 7 Nev. 1045 (1872), Menardi v. Wacker, 32 Nev. 169 (1909), Burke v. Buck, 31 Nev. 74 (1909), Craig v. Harrah, 66 Nev. 1, Wolpert v. Knight, 74 Nev. 323 (1958).

²⁷Burke v. Buck, 31 Nev. 74 (1909), Craig v. Harrah, 66 Nev. 1, (1949), Wolpert v. Knight, 74 Nev. 323 (1958).

²⁸Nevada Revised Statutes (N.R.S.) 463.361,1. Except as provided for in N.R.S. 463.362 to 463.366 inclusive, gaming debts not evidenced by a credit instrument are void and unenforceable and do not give rise to any administrative or civil cause of action.

²⁹For definition, see reference 10.

³⁰For definition, see reference 11.

³¹For an indepth analysis of the term "credit instrument," Anthony N. Cabot, see *Hotel and Casino Law Letter*, (May 1984), p. 48.

³²For a discussion of markers and negotiable instruments, see "Casino Markers and Article 3, UCC," *Hotel and Casino Law Letter*, (November 1981).

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⁴¹*Jose Hernandez v. Circus Circus and the Nevada State Casino Control Board*, Case A-230071 (1985).

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