Z Capital angles for control of casino operator Affinity

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By Nick Brown
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Distressed investor Z Capital Partners has upped its ownership stake in Affinity Gaming Corp, the latest twist in a brewing dispute over control of the formerly bankrupt casino operator.

In filings with the U.S. Securities & Exchange Commission on Monday night and Tuesday afternoon, Z Capital said it raised its stake in Affinity to 30.5 percent from 24.97 percent. The investor has been steadily raising its stake since first earning an equity share through the company's bankruptcy.

Affinity, previously called Herbst Gaming Inc, declared bankruptcy in Nevada in 2009, with a plan to split off its slot machine company and give creditors the equity in a new casino operator that became Affinity. Large investors like Z Capital and Silver Point Capital have been buying up shares in Affinity ever since.

Silver Point, the second-largest shareholder, owned 24.9 percent of Affinity as of December, according to SEC filings.

Affinity owns hotels and casinos in Nevada, including Primm Valley Casino Resorts and Terrible's Hotel & Casino, as well as resorts in Colorado and Missouri.

Z Capital has made no secret of its aim to own a substantial chunk of Affinity, saying in SEC filings last year that it may ultimately acquire a controlling stake.

And, in an Oct. 19 letter to Affinity's board it said it would "seek representation on the company's board to permit us to fulfill our fiduciary duty to our own investors." It also heaped praise on Chief Executive David Ross and his team, saying the "current management team is an outstanding one that should be fully supported."

Affinity has not commented publicly on Z Capital's aspirations or its efforts to earn board membership, and the company declined to comment for this story.

But on Dec. 20 Affinity's board updated bylaws in ways that appear to reduce shareholder influence over its operations.

Under the new rules, submitted to the Nevada Secretary of State, directors have discretion to determine suitability of shareholders, and appointing new directors now requires a majority, rather than plurality, of stockholder approval.

The board can also adopt shareholder rights agreements that would allow it to issue new securities without shareholder votes, essentially giving it the power to create poison pills.

Ross did not return a call seeking comment. Z Capital declined to comment for this story.

In its filing on Tuesday, Z Capital hinted that it could sue the board over the governance changes, saying it reserved the legal right to challenge the rights agreement.

Bernard Black, a governance expert and professor at Northwestern University School of Law, said the board may be willing to risk getting sued for the chance to keep control of Affinity's operations.

"Board members might have adopted the idea of 'Let them sue us,'" Black told Reuters. "You might think it's not a great way to think, but they wouldn't be the first board to do that."

The new provisions strip language giving shareholders the right to vote on mergers or sales, and make it more difficult for them to inspect the company's books and records.

Z Capital has also objected to Affinity's use of its chairman, Don Kornstein, a former Bear Stearns investment banker, to represent the company in asset sales since Affinity has come out of bankruptcy, namely a 2012 asset swap with Golden Gaming Inc. Z Capital in its letter said that constituted a "conflict of interest."

Asset sales have been a key component of Affinity's restructuring. On Friday, it closed a deal to sell three Nevada casinos to Truckee Gaming LLC in a $17.4 million deal. According to SEC filings, it hired Jefferies & Co Inc to solicit bids in that deal.

Lucian Bebchuk, who directs Harvard Law's corporate governance program, said the new provisions sound like "serious departures" from good governance.

"Especially troubling are the provisions denying shareholders any right to vote on fundamental changes such as a merger," Bebchuk told Reuters on Monday.

The company's directors are also free under the new rules to pursue business opportunities that compete with Affinity, and are safe from liability for breach of fiduciary duty for failing to tell the company about such opportunities.