

Community Developments Investments (August 2013)



The Federal Reserve Bank of Minneapolis uses this private business development model in its approach to economic development in Indian Country.

Q&A

Secured Transactions Codes: A Stepping–Stone to Economic Development in Indian Country

With Susan Woodrow, Community Development Adviser, Federal Reserve Bank of Minneapolis, Helena, Mont., Branch

There is some evidence that economic growth in Indian Country has improved over the past two decades. Yet the economies of Indian reservations still post unemployment and poverty rates that are among the highest in the nation. While there are many obstacles to economic growth on Indian reservations, lack of access to capital remains one of the most significant.

Because Indian reservations are sovereign nations where not all U.S. laws apply, many non-Native lenders and businesses are ambivalent about investing and doing business in Indian Country. One frequently cited reason for this uneasiness is the insufficiency or absence of commercial laws on Indian reservations—specifically, laws addressing secured transactions. These laws are essential in protecting the interests and rights of businesses that extend credit, such as banks. Some tribes have adopted secured transactions codes to varying degrees of success, but many tribes lag behind.

The Federal Reserve Bank (FRB) of Minneapolis has been a leader in educating the public and tribes about the importance of up-to-date, clear, and comprehensive secured transactions laws, as well as modern and reliable Uniform Commercial Code (UCC) filing systems to bolster business investment and lending. As a community development adviser with the FRB Minneapolis, Susan Woodrow has devoted more than a decade to writing and presenting on this issue.

Below is an interview we in OCC Community Affairs conducted with Woodrow. We hope it illuminates the importance of secured transactions codes in tribal jurisdictions, and in turn helps banks understand

the importance of knowing the laws of the tribes in whose jurisdictions they are seeking to do business.

OCC: Let's begin by defining our terms. What are secured transactions?

Woodrow: In the United States, loans and other types of credit may be made on a secured or unsecured basis. "Secured" means the creditor requires collateral, typically property of the debtor or another obligor, such as a surety, to be pledged as a secondary source of repayment in the event of default. "Unsecured" means no collateral is required to secure the credit. A credit card purchase, for example, is typically an unsecured credit transaction.

Secured lending can be described within two broad categories. One is the type of lending that involves the use of real property as the underlying collateral to secure a creditor's interest. Real property is land or things attached or affixed to land—think of "immovable" property. Extensions of credit in which real property serves as the underlying collateral tend to be long-term transactions. Repossession of such property can sometimes involve extensive legal procedures, as well as comparatively lengthy periods to liquidate such collateral.

The other category of secured lending relies on the use of personal property as collateral to secure a creditor's interest. Personal property basically includes everything other than real property, with the exception of a hybrid group called "fixtures." Examples of personal property are "movable" things, such as equipment, inventory, cut crops, and timber; a variety of payment obligations and financial instruments, such as accounts receivable, letters of credit, and documents of title; and intangibles of value, such as copyrights, licenses, and patents. Extensions of credit that rely on personal property as the collateral are called "secured transactions." These types of transactions tend to be shorter term and more frequently used for day-to-day business and consumer transactions, because personal property tends to be easier to repossess and liquidate than real property in the event of debtor default. A few common examples of secured transactions are loans for vehicles, equipment, and inventory that are typically necessary for business start-ups and expansions, as well as a wide variety of consumer purchases.

Secured transactions lending is of particular relevance to Indian Country because credit of any significant size generally cannot be obtained there on an unsecured basis. Also, real property collateral lending in Indian Country can be difficult because large areas of land within tribal jurisdictions are held in trust or otherwise restricted and often cannot easily be used as collateral.

OCC: Why the emphasis on secured transactions codes?

Woodrow: Because, among other things, they are designed to protect creditors' rights, such as those governing when and how collateral can be collected as repayment upon default. Where laws governing secured transactions lending are insufficient, uncertain, or absent, there is likely to be limited or no access to the affordable credit that is essential for business growth and investment in general.

OCC: How does secured transactions lending work, and can the debtor still use the collateral, even though the creditor owns an interest in it?

Woodrow: In a secured transaction, a debtor or other obligor, such as a surety, grants a security interest to the creditor in the personal property being offered as collateral. A security interest is a type of lien. But unlike liens that arise as a matter of law, such as statutory or common-law construction or mechanic's liens, or liens that arise by order of a court, called judicial liens, security interests are consensual, meaning they are created by agreement between a creditor and debtor. Security interests under this

scheme can be possessory, meaning the creditor takes physical possession or control of the collateral and holds it until the debt is paid, or nonpossessory, where the creditor has a security interest in the collateral but does not have actual possession or control of it.

It is crucial to point out that in the latter case the debtor can continue to operate equipment, circulate inventory, collect accounts receivable, and use a business or consumer vehicle, even though such property may be subject to one or more security interests. This ability enables credit to easily and efficiently flow for business and consumer purposes.

OCC: What's the current state of secured transactions laws in Indian Country?

Woodrow: In the United States, laws governing secured transactions generally fall within the jurisdiction of the states and not the federal government and are encompassed in Article 9 of the UCC as adopted by all 50 states and several U.S. territories. It is difficult to assess the adoption of these laws by tribes accurately, because there is no comprehensive, up-to-date repository of all tribal laws.

We know that some tribes have enacted secured transactions laws, but many have not. Of the tribes that have, a number of them have modeled their codes on the official text of Article 9 of the model UCC, while other tribes have used Article 9 as adopted by the state in which the tribe's reservation or community is located as their template. Some tribes have adopted verbatim the law of the states in which they are located, while others have incorporated the state law by reference into tribal law, in some cases carving out a few provisions or making the state law subject to a few specified tribal laws.

Also, a number of tribes have modeled their codes after the model law drafted by the University of Montana's Indian Law Clinic in the 1990s. Others have incorporated into contracts either the official text of Article 9 or the state Article 9 for individual transactions only. A few tribes have adopted more narrowly purposed collection codes that govern repossession procedures only. Still others have enacted some unique provisions or versions of a secured transactions law. For example, they have incorporated real property mortgage-lending provisions into the secured transactions law.

Many of the tribes that have enacted some version of a secured transactions law did so in the 1980s and 1990s. Of these, many have not updated their laws to reflect significant revisions that were made to the official text of Article 9 in the early 2000s and since adopted by all the states.

OCC: Can you tell us about some options for tribes to address their need for good commercial law? What about the so-called MTA?

Woodrow: In 2001, at the request of several tribes, a committee of the National Conference of Commissioners on Uniform State Laws together with advisers from 10 tribes began working on a draft Model Tribal Secured Transactions Act (MTA). The MTA, which was completed in August 2005, provides a comprehensive model law for tribes to use as a template to build sound legal infrastructure for secured transactions. The committee also drafted a comprehensive implementation guide to accompany the model code. The guide provides a plain-language commentary on each code provision, lists optional provisions where the committee is aware that tribes may have differing needs or issues, offers guidance to tribal legislative bodies for adapting the code into tribal law, and serves as a general educational tool for tribal judges and attorneys as well as tribal credit, economic development, and business managers.

OCC: Let's say a tribe adopts the MTA. Is that all the tribe needs to do to facilitate secured transactions

lending?

Woodrow: Unfortunately, no. Although many tribes have enacted secured transactions laws, such laws are often underutilized or not used at all because of the lack of a publicly accessible, modern, and reliable UCC lien-filing system designation. You see, at the heart of a secured transactions system is a public UCC filing or registry system in which a creditor will publish notice of its nonpossessory security interests. This accomplishes two things. First, it puts other potential creditors of a given debtor on notice that the debtor's property in question is already being used as collateral for another debt or debts. Second, it establishes a "first-in-time" method by which to determine which creditor, if there is more than one, will have a first, or "prior," interest in that collateral.

There are other problems that are specific to the nature of tribal governments and cultures. For example, administration of the secured transactions law requires extensive training and familiarity by the tribal governing body and tribal courts. The stability, competence, and impartiality of a tribal court are important qualities for the success of these laws. Also, some tribes conduct official business in their ancestral language. This often requires the translation of the law to native languages, many of which have no equivalents for English business terms. Addressing these issues requires additional resources that make the whole process more expensive and cumbersome.

OCC: How are the tribes that have adopted the MTA addressing these challenges?

Woodrow: As far as filing systems are concerned, some tribes have forged agreements with the states in which they are located, effectively making the state the tribe's UCC filing agent at no cost to the tribes. This arrangement enables creditors to file liens seamlessly and conduct searches in a system they are already familiar with. The arrangements these states and tribes have entered into conform to the tribes' laws, respect tribal jurisdiction, and maintain the confidence of lenders and nontribal businesses, with the expectation that businesses and lenders will be encouraged to do business on the reservations. For example, the Crow Nation and Chippewa-Cree Tribe in Montana, the Oglala Sioux and Cheyenne River Sioux tribes in South Dakota, and the Leech Lake Band of Ojibwe in Minnesota have entered into such agreements with their respective secretaries of state offices.

OCC: You have pointed out that secured transactions codes and lien-filing arrangements aren't the only legal elements necessary for supporting business and economic development in Indian Country. Can you expand on that?

Woodrow: Yes. Adopting secured transactions laws and modern lien-filing system arrangements is important, but it's equally important to have tribal courts that are perceived to be fair and impartial and that are known to be competent to adjudicate commercial cases. Lenders and other potential business partners want assurance that tribal judges understand the complexities of the commercial laws they may need to adjudicate. Because many tribal judges and attorneys have traditionally adjudicated and advocated primarily in areas of criminal, family, and sometimes environmental law, judicial education and training are absolutely critical if a tribe adopts a secured transactions law.

Providing easy access to tribal laws and court decisions, either by publishing them on a Web site or in a readily accessible written format, is also very important. If an outside party cannot access a tribe's law or does not know it exists, business is likely to be hindered. Similarly, tribal court decisions should be published and accessible so parties can determine how a tribal court is interpreting the law. And, there are many other important commercial and business laws and regulations tribes should consider as part of a solid legal infrastructure that will support a robust business environment. These may include business organization laws, zoning regulations, and codes addressing other types of commercial transactions

encompassed in the various articles of the UCC, such as sales and commercial leasing. While adoption of a comprehensive and culturally tailored secured transactions law is an important foundational component of a strong and sustainable business environment, it is just one piece of the foundation.

OCC: Finally, what about lenders? How do the disparities in the law or its absence influence decisions about doing business in Indian Country?

Woodrow: The lender should first seek to determine whether the tribe has such a law, and second, ensure it does a thorough review of the law so it understands the rules. The lender should also determine where to file a financing statement or conduct lien searches, according to the tribe's law. If the tribe doesn't have a secured transactions law or the filing location is unclear, the lender will need to determine whether it is confident that a contract provision specifying that state law be the governing law would be upheld in the tribal court if an issue were to arise. Basically, the lender will need to conduct appropriate due diligence and, as with all other transactions, simply assess the risk, which would include a review of the legal environment.

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Community Developments Investments is produced by the OCC's Community Affairs Department. Articles by non-OCC authors represent their own views and not necessarily the OCC's.

'Commercial Lending in Indian Country' (*Community Developments Insights*, March 2006)

In March 2006, the Community Affairs Department of the OCC published an Insights report titled "Commercial Lending in Indian Country: Potential Opportunities in an Emerging Market." The report explored the commercial lending environment in Indian Country, including the relationships between governmental, legal, institutional, organizational, and financial infrastructures. The report also examined the major community development challenges and constraints facing Native American communities and described banking and tribal community responses to these barriers. In addition, the report discussed several federal programs that have helped banks mitigate the risks related to lending and investing in Indian Country. Here are some of the report's important takeaways:

- One major obstacle is lenders' unfamiliarity with the unique characteristics and dynamics of the Native American economy and community.
- Tribal sovereignty has substantial implications for jurisdiction, collateral, and arbitration practices that can discourage a bank from undertaking economic development activities in Indian Country.
- Indian tribes and communities exist and operate in a unique legal and governmental framework that can complicate business and financial contracts and their enforcement mechanisms.
- The lack of standard commercial practices and codes is another obstacle facing lenders interested in doing business in Indian Country.
- Tribal sovereignty requires that banks and tribes work together to ensure that lenders can use litigation, arbitration, or other methods of adjudication to enforce contracts and resolve contract disputes that arise from commercial transactions.
- Some tribes have used different business and legal codes to address some of the long-standing barriers to lending in Indian Country.
- Government programs are available to help banks mitigate the risk of doing business in Indian Country.

