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Overcoming Transactional Obstacles to On-Reservation Lending

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Introduction

Historically, obtaining financing for on-reservation projects has been quite difficult, often impossible, whether for a tribal business or for an individual tribal mortgagee. The obstacles to successful financing have included both the obvious--such as land status issues--and the insidious--such as intentional institutional discrimination.[1]

This paper offers some legal solutions to traditional transactional barriers, while recognizing that institutional and other social obstacles remain to be overcome. Traditional transactional obstacles reflect a lender's serious concerns. Two of the primary transactional obstacles include:

1. a lender's need to **enforce** its transactional agreements, and even to know what its remedies are, should the borrower default; and

2. a lender's need to **protect** its investment by taking collateral and, in particular, a secured interest in the project and the project land. This requires, among other things, that a lender know who owns the project land and whether that owner legally can encumber the land.[2]

Other obstacles to lending include:

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[1] The Equal Credit Opportunity Act, 15 USC § 1691 et seq., and the Fair Housing Act, 42 USC § 3610 et seq., prohibit lending discrimination in Indian Country, whether such discrimination be overt, or whether it be evidenced by disparate treatment or impact.

[2] For starters, any transaction that is "relative to" tribal lands is required by 25 USC § 81 to have approval of the Secretary of the Interior. In additional, other federal laws and regulations affect how and whether tribal trust and restricted lands can be alienated and encumbered. Land owned by a tribal individual may be treated quite differently from land owned by a tribe. Leasing terms and conditions imposed on a tribal individual's land, for example, are different from those imposed on tribal lands themselves.

1. frequent lack of tribal business-oriented infrastructure, ranging from a lack of relevant laws and codes to a failure to disengage tribal business from tribal government from tribal politics;

2. tribal lack of familiarity with banking products and services and with business expectations and requirements, coupled with lenders' lack of understanding of tribal politics, policies, values, and priorities; and

3. a lender's desire for efficiency, e.g., the desire to get the transaction closed quickly and with a minimum of interference from the governments involved.[3]

Are these the exclusive obstacles to on-reservation financing? Of course not. They do not exhaust even the large generalized obstacles. But for every barrier--and every general category of barrier--that can be overcome, the ease and reality of providing financial services on-reservation improves.

Primary Transactional Obstacles

The two primary transactional obstacles are, in many ways, the easiest to overcome. In any lending transaction, enforceability is an issue, and many of the methods for ensuring enforceability are the same for an on-reservation transaction. However, because tribes are governments and, as such, are immune from suit, enforcing agreements with them poses additional problems. Obviously, if you can't sue the entity you lent money to, your deal is suboptimal.[4]

Immunity. Many of the enforcement problems in the past were created when lenders either didn't know about sovereign immunity or forgot to deal with it, relying on boilerplate language in most unboilerplate circumstances. The difficulty posed by a tribe's sovereign immunity is less troublesome these days, as most lenders are at least aware of the immunity issue and insist on its being addressed.

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[3] In transactions involving a tribe, not only are the tribal government and its various agencies and entities involved, but usually the Secretary of the Interior and/or the Bureau of Indian Affairs ("BIA") are involved, as often are the Department of Housing and Urban Development ("HUD"), the Indian Health Service ("IHS"), and the Environmental Protection Agency ("EPA").

[4] It is worth noting, though, that attorney contracts with tribes do not include waivers of immunity. While attorneys, more than most, "want it in writing," they, singularly, do not have it in writing. Yet tribal attorneys keep working and keep getting paid, as strange an example of political, financial symbiosis as one can find.

Addressing the issue of sovereign immunity often means requesting a waiver, and waivers of sovereign immunity are becoming increasingly common in one form or another. While they must be clear and expressed, they can range from being extremely limited to being quite general. The former is far more common. For example, they can be limited in time;[5] in amount;[6] in nature of the remedy;[7] to a specified beneficiary;[8] to the extent necessary to enforce a particular transaction; and/or to the extent of specified collateral.[9]

Waivers of immunity are not the exclusive means of ensuring enforceability of an agreement, and a tribe's refusal to waiver does not necessarily doom a transaction. Occasionally, a tribe may offer off-reservation collateral in order to avoid a technical waiver of immunity. In such a case, escrowed funds or documents, or assets held by the lender itself, ensure the enforceability of the agreement. In other cases, a surety bond or letter of credit may provide the necessary credit enhancement.

Of course, the lender and tribal borrower may agree to submit to and agree to be bound by alternative forms of dispute resolution, either prior to or in place of enforcement litigation, without necessarily waiving immunity. Some disputes are never resolved on the merits merely because the parties spend their time and money contesting jurisdiction. To the extent that the parties can avoid dealing with the more complex issues of waivers and jurisdiction, they are more likely to get to the heart of the dispute and resolve it. At that point, from a practical standpoint, immunity may not matter.[10]

Often, too, tribes unwilling to waive their immunity are willing to create a separate entity, usually a tribal corporation,[11] with the ability to sue and be sued. Tribal corporate entities offer several advantages in addition to providing the lender with a suitable entity. The creation of a tribal corporation separates the corporate assets from the tribal governmental assets, simultaneously limiting the tribe's liability and providing a source of collateral and repayment for the lender. It can also accomplish the important separation of

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[5] Not to exceed a certain date.

[6] Again, "not to exceed."

[7] E.g., limited to injunctive relief.

[8] E.g., as to only the lender and its assignees.

[9] E.g., limited to insurance proceeds, to pledged assets, to a tribal credit, or to a particular revenue stream.

[10] See previous footnote on attorneys' contracts.

[11] These are typically chartered pursuant to tribal laws, though state corporations and even federal corporations are not uncommon.

the tribe's economic goals from its governmental duties, and may even separate both from tribal politics.

Jurisdiction. Overcoming sovereign immunity is one of the more obvious requirements for ensuring enforceability of a tribal transaction. Unfortunately, it is often confused, even by attorneys, with the issue of jurisdiction. Frequently, a lender predetermines, usually erroneously, that tribal court jurisdiction is inadequate, unpredictable, or unfair. In such instances, the lender might compound its error by insisting that the tribal borrower consent to jurisdiction in a state or federal court.

To the extent that such consent is specified to be a consent to in personam jurisdiction, there may be no error or harm.[12] However, if the consent is to subject matter jurisdiction, it is of no force, for two parties cannot, by contract, either bestow jurisdiction where it does not exist, or strip a court of jurisdiction that it validly has.[13]

Jurisdictional issues can be complex and must be resolved by the courts on a case-by-case, court-by-court basis, as they occur . . . not by agreement of the parties. Jurisdiction may be determined by where the cause of action arose,[14] what state is involved[15], what law or

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[12] In such case, the parties agree that they will accept service and appear in the court. It does not indicate that they will forego their right to challenge the subject matter jurisdiction of the court, an entirely different matter.

[13] SAMPLE: "The tribe hereby expressly, unequivocally, and irrevocably i) waives any immunity from suit it may enjoy with respect to any and all controversies arising out of or related to the leasehold mortgage and the loan documents; ii) agrees that any legal action or proceedings brought against the Tribe with respect to the leasehold mortgage and the loan documents may be brought in the state courts; and iii) consents and attorns to the personal jurisdiction of such courts. This provision is not intended by the parties to confer jurisdiction and shall not limit the right of either party to bring any legal action or enforcement proceeding in any court having subject matter jurisdiction."

[14] In which state did it arise? On-reservation or off? The law of the case, as well as the jurisdiction, may be affected by the answers to such questions.

[15] Some state courts exercise jurisdiction over Indians in Indian Country for loans secured by individual Indians' lands, courtesy of Public Law 280 (18 USC § 1162, 25 USC §§ 1321-26, and 28 USC § 1360). The courts in states that did not opt for Public Law 280 jurisdiction, however, do not have that ability, nor does Public Law 280 provide state court jurisdiction if trust or allotment land is involved.

promise is broken,[16] or a dozen other, occasionally idiosyncratic, considerations.

A few years ago, in Montana, different parts of a contract case were simultaneously litigated in tribal, state, and federal court. Understandably, jurisdiction was a central issue. In this case, a disgruntled contractor sued the tribal housing authority in tribal court for breach of contract. The housing authority was broke and couldn't afford an attorney. As a result, the housing authority either did not know or did not care about the complaint and did not file an answer or defend itself.

The tribal court judge issued a default judgment, and the contractor took the judgment it to state court, got full faith and credit, and served the judgment upon the housing authority's two banks. One bank paid the account amounts to the contractor; the other interpled the funds (which were held in the name of the housing authority and HUD) into the federal court and asked for a ruling. The housing authority hired an attorney who raised the jurisdictional issues, among others.

Ultimately, the housing authority lost in state court and so lost the first set of funds. The housing authority won in federal court, which ordered the second set of funds to be returned to the housing authority. The default judgment was overturned in tribal court, and a tribal court judgment was entered against the contractor who, by now, was broke and therefore judgment proof. Presumably, a similar scenario is unlikely to occur twice. The point is, in most cases, it is not worthwhile to get into arguments with lender's counsel on the subject of jurisdiction: it lies where the courts say it lies.

If lender's counsel insists on language assigning jurisdiction, a tribe is probably not harmed by allowing it to remain. However, if tribal counsel is asked to opine as to the enforceability of the transaction document(s) and the nature of the waiver and jurisdiction, tribal counsel would be wise to decline to so opine. Following a spirited discussion, the jurisdiction language is likely to be eliminated or properly limited.

Security. Enforceability is not limited to crafting language on waiver and jurisdiction. The enforceability of a transaction is also determined by the lender's ability to perfect a security interest in its collateral, which requires as a prerequisite the lender to understand and evaluate the nature and quality of the collateral itself.

For example, no off-reservation loan would be made without requiring a title search

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[16] A violation of environmental laws will probably give rise to federal court jurisdiction. If criminal laws are violated, the nature and severity of the activity, and whether a non-Indian or Indian is accused, will determine the jurisdiction. If the federal government is named as a party to the suit, the case may be filed in federal court or as an administrative action. If the dispute concerns a tribal lease, the case may be filed in tribal court or, again, as an administrative action. And so it goes.

and title insurance; however, on-reservation financing often occurs without searching in the BIA Land Titles Office for title and liens on tribal lands.[17] Of course, a security interest must be properly filed with the Land Titles Office to perfect the interest, though this, too, is often overlooked. Without a proper search or filing, the quality of the collateral is impaired.

Knowing the owner of a piece of real estate underlying a financing transaction is **always** a primary consideration. It is even more critical in on-reservation transactions. Land owned by a tribe, or by the United States in trust for a tribe, often has a different nature--and different restrictions on it--than does land owned by a tribal individual. Even personal property or non-real estate assets may be difficult to attach.[18] A lender must be familiar with the applicable prohibitions and restrictions.

Individual fee simple land or allotments can be mortgaged and even foreclosed upon under certain circumstances, subject to approval by the Secretary of the Interior ("Secretary") and, under certain circumstances, the tribe. As such, they offer greater flexibility to lenders in search of collateral than do tribal trust[19] and restricted[20] lands, which cannot be alienated[21] and therefore cannot serve as collateral eligible for foreclosure. Encumbrancing both of individual tribal members' lands and of tribal lands, while permissible, is subject to Secretarial approval and to various regulatory conditions. However, several tools are available to increase the lender's comfort level with an on-reservation transaction.

Leasehold Mortgage. Probably the most common method for providing an enforceable security interest in reservation lands is to have the tribal owner of the land lease it. When the lessee, often a tribal corporation, borrows money for commercial development on the land, it offers the leasehold as collateral. While the land itself cannot be mortgaged,

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[17] This statement is not meant to indicate that such records are either accurate or up-to-date, only that the filing mechanism actually exists, and exists independently of state and county filing mechanisms.

[18] For example, tribes' power to exclude individuals from the reservation--or to prevent their original entry--can be used to prevent attachment and repossession. In addition, judgments acquired in state court are not necessarily enforceable in tribal court, and judgment liens not properly filed are not of much use.

[19] Trust lands in this context refer to tribal lands that are held in the name of the United States, in trust for a particular tribe.

[20] Restricted lands in this context refer to lands that are held in the name of the tribe itself, but that have legal restrictions on whether and how they can be alienated or encumbered.

[21] Without the consent of Congress.

the leasehold can, and, in the event of default, can be foreclosed upon. In this way, while the ownership of the land itself does not change, the owner's right and ability to use the land does, and the lender is permitted to remain on the land or sell the right to remain on the land to another, pursuant to the conditions of the lease.

The transaction documents should clarify the procedures for assigning[22] or encumbrancing[23] the lender's security interest in a leasehold. Federal regulations impose general guidelines, but the lease itself should provide for specific and adequate cure opportunities instead of automatic or optional termination, and should specify the effect of default not only on the lease but on any subleases.[24]

Opinion Letter. Other methods of protecting a lender's investment can be used in combination with a leasehold mortgage. For example, the value of a formal attorney opinion letter is tremendous. Typically, such an opinion letter requires the attorney to opine as to the enforceability of the transaction documents. The seriousness of providing such an opinion tends to ensure that the opining tribal attorney--who has better access to the tribe's records, motives, practices, and laws than does the lender--has read all relevant documents, including tribal ordinances; knows the laws and guidelines for encumbrancing tribal assets; and has not held back relevant information that may be harmful to the lender.

If a lender asks a tribe to provide such a letter, and the tribe turns to its attorney, that attorney will want to be sure (1) that her malpractice insurance is stout enough to cover the cost of her errors, if they occur, and (2) that she is confident about the truth and accuracy of her opinion. Once a tribal attorney subjects her assets, reputation, license, and malpractice insurance to exposure, she is unlikely to dissimulate in her analysis of enforceability.[25]

Representations and Warranties. A similar motivation underlies the practice of providing representations and warranties. Typically, the parties provide at least minimum, often mirror, representations and warranties concerning their legal authority and ability to act, the accuracy of facts, and the existence of documents, ordinances, and requirements. And typically, the transaction documents provide that misrepresentations or breaches of such warranties constitute an event of default.

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[22] Sample language is included as Appendix A to this paper.

[23] Sample language is included as Appendix B to this paper.

[24] Sample language is included as Appendix C to this paper.

[25] This analysis is not necessarily applicable to in-house counsel.

The immediate and most valuable use of requiring representations and warranties, however, is their preventive effect. While many are willing to remain silent about relevant, even critical, facts, few parties are willing to certify and swear to facts they are not positive are true and accurate . . . or that they know for a fact to be false. Representations and warranties highlight a party's areas of discomfort and uncertainty. In this way, the parties are forced to identify and then negotiate the potential problem issues prior to their becoming actual problems.[26]

Other Protections. Other methods of providing certainty to a lender in the event of a default by a tribal borrower include (1) the use of continuing guarantees of tribal corporate individuals or even of the tribe, (2) the use of insurances such as environmental insurance, liability insurance, and property insurance to protect assets that, in many cases, function as collateral, and (3) indemnifications and releases, which can help a lender protect itself against various claims that may arise from the transaction documents or from the development itself. All of these methods are standard mechanisms for protecting lenders but have additional value in on-reservation lending transactions in which the security may not be quite as strong as in more routine dealings.

Other Transactional Obstacles

Lack of Infrastructure. As discussed earlier, the use of tribal corporations is one of the more common, most useful ways of separating tribal business from tribal politics. In addition, a tribe that sets about creating a legal infrastructure for commercial lending can have a tremendous influence not only in attracting economic development, but also in controlling it. Adoption by a tribe of laws and regulations regulating in the following areas goes a long way in encouraging hesitant lenders:

1. building (construction and zoning codes);

2. recording real estate transactions including leases, liens, and other encumbrances;

3. sales of goods (commercial codes);

4. licensing and taxes (e.g., sales, utility, possessory interest, and gross receipts taxes, for example);

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[26] A typical set of Lessor/Lessee representations and warranties is included as Appendix D to this paper. They cover many issues of validity and enforceability.

5. business and corporate activities (with registration and reporting requirements);

6. employment, including Indian preference; and

7. environment.

This certainly can, but does not necessarily, mean that tribe must write its own laws and regulations from scratch . . . an expensive proposition that, in many cases, involves reinventing a perfectly good round wheel. Many tribes adopt uniform codes, in whole or in part, or piggyback on state law, incorporating it into tribal law by reference. Those portions of uniform or state law that are inapplicable or offensive can be deleted or modified. Lenders--and their attorneys--are understandably calmed by having a set of laws to refer to and depend upon, especially if the laws look familiar to them.

A variation on the need for infrastructure is the need of lenders not to be surprised by the enactment of new tribal laws, especially tax and environmental laws, after the transaction has been closed but before the loan has been repaid. Covenants against adopting future laws can be absolute, or they can be limited in many ways.[27] Some tribes will agree to forego their rights; others will not.[28] If they will not, it is still possible to provide financial and other remedies, including shifting the burden of compliance from the lender to the tribal corporation.[29]

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[27] For example, by the magnitude of their effect (e.g., not to interfere with the commercial viability of the lease), by subject-matter (e.g., limit to promulgation of environmental laws only), and by time (e.g., not during the primary lease term).

SAMPLE: "Tribe hereby agrees that, except for exercising its authority to promulgate environmental laws and regulations reasonably calculated to protect the environment, it will not exercise its authority as a sovereign to create any statutory, administrative, common law, or other obligations of [tenant] that may not be reasonably anticipated in the normal course of [tenant's] use and occupancy of the property, that result in the imposition upon [tenant] of an unreasonable or extraordinary expense, or that materially or unreasonably interfere with [tenant's] use and enjoyment of the property."

[28] And keep in mind that, if a lender lends to a tribal corporation, as opposed to the tribe, a promise in the lending documents not to tax has little or no effect. The covenant must be from the tribe, as a government, not as a landowner/lessor to the tribal corporation.

[29] SAMPLE: "The tribal corporation may negotiate with some or all of its sublessees and agree to accept from them a payment in lieu of taxes, assessments, licenses, fees, and other like charges; however, such negotiation and agreement is not binding upon the Tribe which has not agreed and does not agree to waive its sovereign right to impose and collect such taxes, assessments, licenses, fees, and other like charges from the tribal corporation."

Lack of Lender Understanding of Tribal Practices, and Tribal Understanding of Business Practices. Tribes tends not to know much about lenders, and lenders tend not to know much about tribes. As a result, economic development has been slow to arrive on-reservation. Despite their unfamiliarity with lending practices, tribes tend to remain interested in borrowing. The problem is that, because of their unfamiliarity with tribes, lenders tend to shy away from lending. The people, laws or lack of laws, uncertainties, lack of precedent, and difficulties with enforcement all contribute to create a higher risk. Most traditional lenders, being unswervingly conservative, detest risk. Unless the opportunity for return is high, lenders have tended away from on-reservation lending.

Lenders who understand tribal politics, policies, cultural values, and priorities are more likely to be productive than those who are not. From simple things like appreciating how and how often tribal leaders are changed, to more complicated issues involving lengthy historical and religious rivalries, lenders who take the time and interest to learn their market will close more loans, and such loans will be more successful, if the lender does not take the approach that "lending is lending." Such an attitude inevitably either will cause the lender (or the tribe) to walk away from the loan in frustration (or anger) before it is completed, or will result in overlooking the steps or provisions necessary to protect the collateral or to increase the chances of satisfactory and timely repayment.

A lender interested in on-reservation financing should make every effort to become familiar with the character, values, and needs of the individual tribe or tribal entity it is dealing with, as well as with the individuals. Lender's counsel should be well-versed in the idiosyncracies of on-reservation financing; if not, the fights with the tribal attorney will likely start early and become intense quickly, as misunderstandings or ignorance are perceived as heavy-handedness, combative injustice, or even evil[30] on the part of the lender.

From its standpoint, the tribe (or the borrowing tribal corporation or other entity) should take upon itself the responsibility not only of educating the lender in tribal ways, but also of educating **itself** and the relevant tribal individuals with the lender's products and with business expectations and requirements in general. The tribal attorneys must be as familiar with the lender's goals, expectations, and habits as it expects the lender to be with the borrower's goals, expectations, and habits. A tribe that is aware of and responsive to the lender's business concerns is more likely to experience an actual closing. For example, a tribe that develops a business plan, providing cash flow projections, feasibility studies, financial statements, sources of debt repayment, and realistic budgets, will help the lender to conclude that the project is viable and that the tribe is a good candidate for a loan. Capital

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[30] Many years ago, before waivers of sovereign immunity were common, an associate attorney representing a lender asked for a tribal waiver to ensure that the lender could enforce its loan. The tribal leader and tribal council were so outraged by the request that they immediately dispatched a strong letter to the managing partner, demanding that the associate be fired!

participation by the tribe (or by respected or well-capitalized third parties) or credit enhancement is another way in which lenders can be encouraged to lend. And tribal and local community participation is often valuable not only in inducing financing, but also in increasing a project's success.

Many banks and other lenders have begun providing educational seminars and trainings to their tribal customers and tribal individuals in order to help them manage their financial resources, improve their credit, and borrow successfully. Tribal entities themselves, such as the Minnesota Chippewa Tribal Housing Corporation, the Navajo Housing Partnership, and tribal credit unions provide counseling and education to tribal members who want to borrow. And of course an increasing number of federal programs are providing help through financial management training. As communication grows, the education of lenders and tribal borrowers effective reduces the obstacles to on-reservation economic development.

Lack of Efficiency. Of course a lender wants to close transactions quickly and with a minimum of interference. Of course federal regulations and the requirement for federal approval increase the time and expense of putting together, monitoring, and enforcing an on-reservation transaction.

In addition, the documentation required to secure on-reservation loans is voluminous and complex. It requires real estate and legal experts accustomed to dealing with this specialized area of lending. And because reservation lands are typically virgin to commercial transactions, almost every move will be a first. Extra time and money are needed for environmental assessments and other compliance activities, title searches, surveys, mapping, and utility service delivery, all prepared from scratch.

A side effect of this first-time scrutiny is that a tribe may find itself facing previously unknown and unexpected problems, including unwitting violation of environmental laws,[31] invalid or inadequate leases and rights-of-way, inaccurate or non-existent surveys and land descriptions, and even violation of tribal customs or laws, many of which are not written down, much less indexed and available for referencing.

On the other hand, federal involvement, while it delays, also provides guidance and back up to the lender. Federal agencies familiar with applicable laws and regulations can be helpful to lenders woefully unfamiliar with them. And the involvement of federal agencies results in the availability of an additional layer of administrative remedies in many instances.

As tribes, lenders, and federal agencies become more active in on-reservation

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[31] The common presence of electrical lines, transformers, gas stations, individual (unmonitored) septic systems, and old buildings (compete with asbestos and radon) on reservations is common. And expanses of vacant tribal land have long provided a good source of free and abundant dumping of often-dangerous, often-illegal substances.

financing, delays resulting from the novelty of on-reservation financing will inevitably decrease. Federal guarantee loan programs offer incentives to risk-averse lenders, as does Fannie Mae's relatively recent Indian mortgage loan purchase programs. And federal legislation, such as the Native American Housing Assistance and Self-Determination Act of 1996[32] and the Indian Tribal Government Tax Status Act of 1982, increasingly provides tribal governments with more financing opportunities while minimizing the role of HUD, BIA, IHS, and other federal oversight agencies.

Conclusion

Providing financial services in Indian Country has always been challenging and risky, resulting in reduced economic development. Lenders and borrowers alike have hesitated to become involved in on-reservation commercial transactions and real estate lending. Their mutual ignorance often resulted either in an unsuccessful venture or in nothing ventured, and nothing gained at all.

Loan guarantee programs offered much-needed incentives and encouragement to lenders who discovered that, with a little extra effort, whole new markets began to open up. Today, new programs and legislation, coupled with a growing familiarity with the other party's needs, nature, and expectations, have resulted in the reduction or virtual elimination of many of the traditional transactional obstacles to on-reservation lending.

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[32] 25 USC § 4101, et seq.