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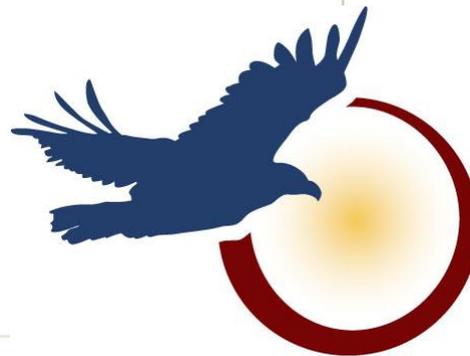


TRIBAL COMMERCIAL CODES THE IMPORTANCE OF SECURED TRANSACTIONS LAWS FOR BUSINESS AND CONSUMER CREDIT

Native Entrepreneurship and
Enterprise Development Initiative
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This webinar is presented in partnership with the
Federal Reserve Bank of Minneapolis



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AGENDA

- What are Commercial Codes?
- What are Secured Transactions Laws?
- Secured Transactions Laws in Indian Country
- Debunking the Myths
- Benefits for Tribes to Adopt
- Versions of Secured Transactions Laws for Tribes to Consider
- ULC's Model Tribal Secured Transactions Act
- Lien Filing Systems
- Important Considerations for Implementation
- Available Resources

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INTRODUCTIONS

FIRST NATIONS OWEESTA CORPORATION

- National
- Non-Profit
- Community Development Financial Institution (CDFI)
- Development of Institutions, Programs, and Systems
- Lending and Capitalization
- Policy and Advocacy



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INTRODUCTIONS

FIRST NATIONS OWEESTA CORPORATION

Our mission is to provide opportunities for Native people to develop assets and create wealth by assisting in the establishment of strong, permanent institutions and programs, contributing to economic independence and strengthening sovereignty for all Native communities.



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INTRODUCTION

FEDERAL RESERVE BANK OF MINNEAPOLIS

FRB Mpls has been working in Indian Country for more than 15 years to support Tribes' efforts to develop strong economies

FRB Mpls provides support in 3 primary areas:

- Tribal commercial law development
- Native American small business development
- Financial education



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INTRODUCTION

FEDERAL RESERVE BANK OF MINNEAPOLIS

- Worked with Uniform Law Commission (ULC) to draft the Model Tribal Secured Transactions Act (MTSTA)
- Led drafting of MTSTA Implementation Guide
- Conducts MTSTA trainings and provides technical assistance for Tribes and Native organizations across the country
- Hosts MTSTA tribal judicial training workshops
- Conducts lender trainings on Tribal ST laws



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BARRIERS TO BUSINESS IN INDIAN COUNTRY

- Many contributing factors
- Differ from Tribe to Tribe, case-by-case
- Some commonly cited key contributors:
 - Shortage of lending institutions in Indian Country
 - Poor credit scores
 - Lack of banking experience
 - Misperceptions of Tribal courts
 - **Inadequate Tribal laws or lack of awareness about existing Tribal laws that facilitate financing**

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WHAT TRIBAL LAWS MIGHT HELP REMOVE BARRIERS TO BUSINESS?

- In business, rules are needed so that lenders, borrowers, businesses, and consumers know what to expect
- No rules = uncertainty
- Uncertainty = risk = increased cost
- The same is true with doing business in Native communities—the “rules” are necessary

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WHAT TRIBAL LAWS WILL HELP REMOVE BARRIERS TO BUSINESS?

- Laws are the rules; they are necessary for communities to effectively support business activities
- As a matter of sovereignty, Tribes generally have the same right as states to establish laws that govern commerce within their jurisdictions
- Commercial codes (UCC) govern many aspects of business transactions

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COMMERCIAL CODES IN INDIAN COUNTRY TODAY

- Have Tribes enacted these kind of laws?
Yes, some have, but with little consistency from Tribe to Tribe
- What if a Tribe has not adopted these types of laws?
State law typically fills the void, but often without certainty and with a great deal of confusion

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WHAT IS A COMMERCIAL CODE?

- Uniform Commercial Code (UCC)
- UCC was drafted by the Uniform Law Commission (ULC) during the 1940s and 1950s—a model code to establish *reasonably consistent* legal environment for commercial transactions among the states
- UCC been adopted fairly uniformly by all 50 states and the U.S. territories

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WHY DID STATES ADOPT THE UCC?

- Non-uniformity among state laws was impeding “cross-border” commerce, thus hampering economic development “post-WW II”
- Issue of sovereignty: Fear by states of federal legislative intervention/preemption if states did not act to address the non-uniformity issue
- Now, *substantial uniformity* among the states’ laws, including those governing secured lending, permits ease of transactions across state lines, enabling efficient “cross-border” commerce

Are there similar concerns in Native communities?

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12 ARTICLES OF THE UCC

- Article 1 Definitions and General Rules
- Article 2 Sales
- Article 2A Leases
- Article 2B Licenses
- Article 3 Negotiable Instruments
- Article 4 Bank Collections
- Article 4A Funds Transfers
- Article 5 Letters of Credit
- Article 6 Bulk Sales
- Article 7 Documents of Title
- Article 8 Investment Securities
- **Article 9 Secured Transactions**

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ARTICLE 9—SECURED TRANSACTIONS

- Most, if not all, free market economies around the world have secured transactions laws of some sort to facilitate the flow of credit
- Because access to credit is necessary for business, developing and emerging nations have made adoption of secured transactions laws a priority for economic development purposes

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WHAT IS A “SECURED TRANSACTION”?

- Lending (providing credit) can be secured or unsecured (no collateral required)
- Two general types of secured lending (loan or other extension of credit secured by collateral):
 - Real property (land or things attached to land) as collateral—think of the broad category of “mortgage lending”
 - Personal property (everything other than real property, sometimes called “movable” property) as collateral—secured transactions lending

A secured transactions law does not generally deal with real property (some exceptions)

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WHAT IS PERSONAL PROPERTY?

- “Movable” property (equipment, inventory, cut crops and timber, livestock, minerals/gas/oil removed from the ground, etc.)
- Financial instruments or similar documents (cash, deposit accounts, investment securities, letters of credit, documents of title, etc.)
- Other “intangibles” (licenses, copyrights, patents, trademarks, etc.)
- Fixtures—have attributes of both personal and real property

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EXAMPLE OF SECURED TRANSACTION (PLEDGE)

- Bill gives Sam a loan of \$100
- Sam gives Bill his new leather jacket to “hold” until Sam repays the loan as assurance that Sam will repay (collateral)
- The collateral has been “pledged” to Bill (i.e., physically given to him—a **possessory** interest)
- If Sam defaults under the terms of the agreement, Bill may keep the jacket as the replacement value of the loan
- No written agreement is necessary because Bill has possession of the collateral

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EXAMPLE OF SECURED TRANSACTION (SECURITY INTEREST OR “LIEN”)

- Bill gives Sam a loan of \$100
- Sam and Bill sign a **security agreement** giving Bill a **security interest** (lien) in Sam’s leather jacket
- Bill now has a **non-possessory** legal interest in the jacket (lien). If Sam fails to repay under the terms of the agreement, Bill may “repossess” the jacket from Sam
- In the meantime, Sam may continue to use his leather jacket because he has possession of it
- Upon repayment, Bill no longer has a lien in the jacket per the agreement

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WHY ARE NON-POSSESSORY SECURITY INTERESTS IMPORTANT?

- The ability of a debtor to give a non-possessory security interest in property to a creditor allows the debtor to continue to use the collateral while there is a security interest attached to it
- For example:
 - Inventory
 - Equipment
 - Copyrights, licenses
 - Consumer items purchased on credit
- This is how secured transactions laws enable credit to flow

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WHAT IS A SECURED TRANSACTIONS LAW?

- **Set of rules** that govern the lender-borrower (creditor-debtor) transactions
- Using **personal property as collateral** to secure the loan or other extension of credit
- **By agreement between the parties** (as opposed to liens arising as a matter of law or by judicial order)

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SECURED TRANSACTIONS LAWS DETERMINE:

- When and how a debtor gives a security interest (lien) in the debtor's collateral
- A creditor's rights in relation to 3rd parties that also have a legal interest in the same property (i.e., trustee in bankruptcy, other creditors)
- Remedies available to a creditor if the debtor defaults
- Protections for the debtor to ensure remedies are fair, and fairly administered

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EXAMPLE OF A COMMON CONSUMER SECURED TRANSACTION

- Mary buys a washer and dryer on a payment plan from Sears
- She signs a contract with Sears Finance Company to make payments for one year
- She takes delivery of the washer and dryer immediately
- Sears Finance retains a security interest in the washer and dryer until Mary has paid in full
- If Mary defaults, Sears Finance may repossess the washer and dryer

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EXAMPLE OF A COMMON BUSINESS SECURED TRANSACTION

Native Saddle Corporation (NSC)

- manufacturer located on "x" Reservation
- owned by Dale and Joe, brothers and sole shareholders
- Dale is president and CEO
- saddles are sold retail

CDFI loan

- extends \$10,000 operating line of credit to NSC
- secured by inventory, equipment and accounts receivable of NSC (presently owned and after-acquired)
- security agreement (contract) signed specifying line of credit terms such as
 - payment terms
 - what constitutes a default
 - description of collateral

Personal Guaranty

- Also, Dale and Joe each sign a personal guaranty of repayment up to \$2,500 each to ensure NSC's repayment

Secured Transactions Law

- fills in the details of the contractual arrangements
- provides process for "perfecting" the liens (security interests)
- specifies what CDFI can do if NSC defaults
- identifies whether CDFI's security interests in NSC's collateral are valid
- sets forth processes CDFI must use if there is a default
- identifies Dale and Joe's obligations
- sets forth protections for NSC and for Dale and Joe

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SECURED TRANSACTIONS LAWS IN INDIAN COUNTRY TODAY

- Some Tribes have no secured transactions law—state law is the default (i.e., per boilerplate contract language)
- Some have comprehensive secured transactions laws
- Some have adopted the model UCC Article 9
- Some have adopted Article 9 as enacted by the state in which their Tribe's jurisdiction is located

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SECURED TRANSACTIONS LAWS IN INDIAN COUNTRY TODAY

- Some Tribes have adopted by resolution the version enacted by the state in which their jurisdiction is located for single transactions
- Some have only components, such as collection codes governing repossession
- Some have adopted “pre-revision” model Tribal versions or state versions (i.e., Montana Tribal Code -1997)

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DEBUNKING THE MYTHS

- Are we just adopting state laws?
 - Does it impact our Tribe's sovereignty, self-determination, self-governance?
- Does this law favor lenders and other creditors?
 - Said another way, will borrowers be better off if a Tribe does not enact a secured transactions law?
- Does this law just apply when a Tribal consumer, Tribal enterprise, or private sector Native business in the Tribe's jurisdiction does business with an outside lender or business?

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BENEFITS FOR TRIBES TO ADOPT

“Why would my community want to enact a secured transactions law?”

- Creates certainty and predictability about the rules for all parties
- May encourage more lenders to do business with Tribe, Tribal members, Native businesses
- Harmonization with state laws may reduce the cost of transactions
- EXERCISE OF SOVEREIGNTY

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WHAT VERSION OF “ARTICLE 9” OFFERS THE BEST MODEL FOR MY TRIBE?

- Tribes may adopt Article 9 by resolution or in full as enacted by the state in which the Tribe’s jurisdiction is located
- Tribes may adopt the model UCC Article 9
- Tribes may enact their own unique version of a secured transactions law
- Tribes may utilize a model Tribal law, such as the ULC’s Model Tribal Secured Transactions Act

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MODEL TRIBAL SECURED TRANSACTIONS ACT (MTSTA)

- ULC Committee on Liaison with American Indian Tribes and Nations
- Drafting committee made up of more than a dozen commissioners, including several that worked on 1999 revisions to Article 9 (adopted by all states), representatives from ten Tribes, other advisors with experience in Indian Country legal/development issues
- Drafting effort took four years; completed in August 2005

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MODEL TRIBAL SECURED TRANSACTIONS ACT (MTSTA)

- MTSTA is largely based on revised Article 9, with key components of Articles 1, 2 and 8 (where UCC Article 9 incorporates provisions from these Articles by reference)
- Purpose: to draft a “stand-alone” code that will, if other Articles are subsequently adopted, still harmonize (or blend) with those Articles

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MODEL TRIBAL SECURED TRANSACTIONS ACT (MTSTA)

- MTSTA was drafted for ease of use by lenders and other creditors—familiarity with the rules
- Intended to help reduce “cross-border” transaction concerns

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MODEL TRIBAL SECURED TRANSACTIONS ACT (MTSTA)

- Some of the special considerations in the MTSTA:
 - No effect on sovereign immunity
 - “Fixtures” attached to trust land (outside of this law)
 - Possible exemptions from covered property (i.e., sacred items)
 - Consumer protections—limitation on choice of law
 - Manufactured homes—interim financing
 - Coordination with other Tribal law
 - Tribal customs and traditions (i.e., tribal business day)
 - Treatment of self-help remedies (self-help repossession?)
 - Choice of law and venue issues
 - Implication of Tribal liens

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MODEL TRIBAL SECURED TRANSACTIONS ACT (MTSTA)

- Benefits
 - Significant code development cost savings
 - Revision benefit—can take advantage of ULC revision efforts
 - Reduces “incorporation by reference” of other state law
 - Implementation Guide
 - Comprehensive Tribal judicial training

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MODEL TRIBAL SECURED TRANSACTIONS ACT (MTSTA)

- Implementation Guide
 - Plain language commentary
 - Enactment guidance for legislative bodies
 - Optional provisions with explanations (policy issues)
 - UCC filing system options explained
 - Educational tool for Tribal attorneys and judges, economic and business development staff, lenders

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UCC LIEN FILING SYSTEMS—PURPOSE

- Public notice system of security interests
- Provides a way to determine priority between competing creditors
- Enables creditors to search for existing security interests in a debtor's property before agreeing to take as collateral
- Note: a debtor may give security interests in the same collateral to multiple creditors (i.e., senior and junior lien holders)

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UCC LIEN FILING SYSTEMS—PURPOSE

Let's go back to Bill and Sam:

- Sam and Bill enter in a security agreement giving Bill a lien in Sam's jacket to secure a loan
- Bill does not file a financing statement in the UCC filing office
- A month later, Sam gives Joe a security interest in the jacket as well to secure a loan from Joe
- Joe files a financing statement in the appropriate filing office describing the collateral and debtor
- Sam defaults under the terms of both agreements
- Who will have priority in the collateral?

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UCC LIEN FILING SYSTEMS—PURPOSE

- Filing systems are necessary to determine priority between competing creditors
- Filing systems are indispensable components of a secured transactions system
- They should **not** be considered as significant fee income opportunities

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UCC LIEN FILING SYSTEMS—OPTIONS

- Tribe develops and manages its own system
- Multiple Tribes develop and manage a filing system as a consortium
- Tribe enters into an agency arrangement /agreement with State
 - Crow and State of Montana Compact
 - Oglala Sioux and State of South Dakota Memorandum of Understanding
 - Tribe in MN currently considering

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IMPORTANT CONSIDERATIONS IN IMPLEMENTING A COMMERCIAL CODE

- Involve key stakeholders in addressing policy issues in the code—ensure Tribe’s law is culturally appropriate
- Ensure lawmakers, policymakers are educated about the code’s purpose and objectives
- Select appropriate filing system option, implementation plan for the system, and maintenance plan (funding, trained staff, public search capabilities, etc.)
- Avoid adopting another Tribe’s law without careful consideration of cultural issues, date of enactment, and source of the law
- Avoid conflicts of interest in drafting

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A CAUTION ABOUT TRIBAL JUDGES AS LAW DRAFTERS—CONFLICTS OF INTERESTS

- Often, Tribal judges are sought out to draft codes for the Tribes because of their legal expertise
- However, there is an inherent conflict of interest when someone participates in both legislative and judicial duties in the same jurisdiction
- It is usually not a good practice to have a law drafted by someone who may be called upon to interpret that law in a legal dispute
- This may be considered a violation of Tribal constitutional separation of powers *in fact* or *in principle*

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OTHER IMPORTANT CONSIDERATIONS

- Judicial training
- Lender training
- Community training
- Publication of laws—easy access by outside parties

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RESOURCES

- For the MTSTA, go to www.nccusl.org
 - Click on **Committees**, then **American Indian Tribes and Nations**
 - Go to **Model Tribal Secured Transactions Act** for downloadable WORD and PDF versions of:
 - The Act
 - Implementation Guide (for comprehensive information about secured transactions laws, filing systems, legislative and judicial guidance)
 - Crow-Montana Filing System Compact
 - Other related information
- See also Minneapolis Fed's **Indian Country Currents** website at www.minneapolisfed.org/indiancountry/ to access related articles and working papers

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Thank you for your time and participation in this webinar.

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