Financing Development in Indian Country

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FINANCING DEVELOPMENT IN INDIAN COUNTRY

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NATURAL RESOURCE DEVELOPMENT IN INDIAN COUNTRY

A Conference Sponsored by the
Natural Resources Law Center
University of Colorado
School of Law

June 8 - 10, 1988
I. INTRODUCTION.

For all their land, natural resources, and liquid assets, Indian tribes have had virtually no involvement in the economy outside their reservations, reservation economic activity is relatively nonexistent, and tribal resource development, when it has taken place, has almost always followed a colonial model. While there are many reasons for this phenomenon, it is our belief that lack of access to private credit markets is a major factor. Reasons for this lack of access include: (a) prejudice on the part of lenders, (b) a perception that tribes are unstable and unreliable borrowers, (c) uncertainty as to enforceability of agreements and other legal issues, (d) unavailability of tribal resources as collateral in the usual sense, and (e) lack of demand by tribes who have not thought it possible or have not known how to access credit sources. As a result, tribes have been limited for growth to
that which they can create with their own cash and that which they can accomplish with the relatively small amount of money which the government is willing to give, lend, or guarantee.

II. CHANGES TAKING PLACE.

In the last five years, however, Indian tribes have begun to break through these barriers, and several transactions have been completed which have set the stage for a new era in tribal economic activity. These transactions include:

A. Acquisition of Dragon Products Company, the only cement manufacturing plant in New England and the largest redi-mixed concrete dealer in the State of Maine, by the Passamaquoddy Tribe in 1983. In the first phase of this transaction, the cement plant was purchased by the Tribe for $12 million ($2 million in tribal cash, $3 million in bank debt with recourse only to the assets acquired, $3 million 90% guaranteed by the Bureau of Indian Affairs, and $4 million in subordinate seller debt) and leased back to the seller. In 1985
the Tribe bought out the lease, acquired the concrete operations, and took over direct operation of the entire business. In this second transaction, the original debt was retired and the BIA guaranty returned. The Tribe put in no additional cash but issued $13 million in "lower floater" bonds backed by a Letter of Credit from the Bank of Boston, arranged for a $3 million revolving line of credit from a Bank of Boston subsidiary, and increased the seller debt from $4 million to $10 million.

B. In 1984 the Lac du Flambeau Band of Lake Superior Chippewa Indians acquired Simpson Electric Company, a leading manufacturer of electronic test equipment in a transaction involving $10 million of "lower floater" bonds backed by a Letter of Credit from Barclay's Bank, $6.5 million of second mortgage debt backed by a 90% BIA guaranty, and $7.5 million of seller debt. The transaction involved no tribal equity and no recourse to other assets of the Band.
C. Carolina Mirror Corporation, the largest mirror manufacturer in the United States, was acquired by the Eastern Band of Cherokee Indians of North Carolina in 1986 in a transaction involving $35.8 million. Of this amount, $1,750,000 was provided by the Tribe in equity, and the rest was raised through private placement of high yield, tax-exempt bonds.

D. In May of 1987, the Salt River Pima-Maricopa Indian Community acquired Phoenix Cement Company, one of the two cement manufacturers in Arizona, in a transaction involving $66.8 million, of which $5.8 million was equity supplied by the Community. The remaining $61 million consisted of $40 million in 10-year fixed rate tribal bonds, backed by a Letter of Credit from The Sumitomo Bank of Japan, which in turn was backed by Letters of Credit from Lloyds Bank of London and National Bank of Canada. The remaining $21 million of subordinate debt was raised through private placement of high yield tax-exempt bonds, with institutional purchasers.
III. These four transactions benefitted substantially from the Indian Tribal Governmental Tax Status Act, 26 U.S.C. §7871, which rendered interest paid on the obligations tax-exempt for the lenders. This, in turn, made the tribal bonds more attractive and lowered the interest costs in the transactions. While the ability of tribes to use tax-exempt debt for off-reservation transactions was eliminated by Congress in Section 10632 of the Revenue Act of 1987, and the ability to use tax-exempt debt for on-reservation economic activities was significantly curtailed, the absence of tax-exempt debt should not mean the end of tribal leveraged buy-outs or other ventures, in part because the decline in interest rates over the last several years has meant that tribes can borrow on a taxable basis today at rates not significantly different than those that were available on a tax-exempt basis just a few years ago. At the same time, these early transactions have served to break down the barriers and stereotypes referred to above, and, more particularly, have provided an opportunity to address and overcome legal issues, including sovereign immunity, the applicability of the Nonintercourse Act, federal income taxation, and Article IX of the Uniform Commercial Code.
Answers to these questions, having been accepted by nationally recognized counsel for the leaders in these transactions, now serve as a precedent for future transactions.

IV. The challenge for the future is for tribes to build upon these and other early developments, to think bigger, and to seek ever-increasing access to regional, national, and world credit markets. Tribal acquisition of existing on-reservation assets, especially those which are used to exploit tribal natural resources, are a natural next step.

TNT/pom/8421M