

# WALL STREET INDIANS: INFORMATION ASYMMETRY AND BARRIERS TO TRIBAL CAPITAL MARKET ACCESS

by  
Gavin Clarkson\*

*Wall Street in New York City may be considered the financial center of the world, but the original wall on Wall Street was built to keep the Indians out. Unfortunately Wall Street has remained true to its origins and has excluded Indian tribes from equal participation in the capital markets, although Wall Street has had some help in this regard. Many of the barriers to tribal capital market access are statutory or regulatory, but a major impediment to overcoming any of these barriers is the problem of information asymmetry. Information asymmetry exists when a party possesses greater informational awareness pertinent to effective participation in a given situation relative to other participating parties. The combination of statutory, regulatory, and informational barriers further exacerbates the difficulty that tribes have when they seek capital for their emerging economies.*

*This Article discusses a typology of information asymmetry as well as information asymmetry in detail, demonstrating its relevance to tribal finance. This Article also discusses the nature of tribal economies and then examines three statutory and regulatory impediments that inhibit tribal capital market access: a) lack of accredited investor status for tribes, b) lack of meaningful tax-exempt bonding authority for tribes, and c) the liquidity premium imposed on tribal bonds because of a lack of a securities registration exemption. The Article concludes with an examination of how strategic information sharing and other methods of reducing information asymmetry can and will have a positive impact on tribal economies.*

I.	INTRODUCTION .....	944
II.	THE NATURE OF INFORMATION ASYMMETRY .....	946
	A. Horizontal Information Asymmetry.....	949
	1. Information Asymmetry and Capital Markets .....	949
	2. Horizontal Information Asymmetry in Tribal Finance .....	951
	B. Vertical Information Asymmetry.....	951
III.	INDIAN COUNTRY ECONOMICS .....	952
	A. The Accredited Investor Problem.....	954

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\* Dr. Clarkson is an Associate Professor at the University of Houston Law Center and Principal Investigator for the Tribal Finance Information Clearinghouse, which is funded in part by grants from the National Science Foundation (IIS 0712941 and IIS 0534905). DBA, Harvard Business School; JD *cum laude*, Harvard Law School; MBA, BA, Rice University. Helpful comments were provided by the participants in the 2008 Indian Law Works in Progress Symposium at the University of Colorado.

	<i>B. Tribal Bond Challenges</i> .....	956
	<i>C. Lack of Securities Registration Exemptions</i> .....	957
IV.	A BRIEF HISTORY OF TRIBAL LAW AND POLICY .....	959
V.	REDUCING INFORMATION ASYMMETRY.....	965
	<i>A. Horizontal Information Sharing and Accredited Indians</i> .....	966
	<i>B. Vertical Information Sharing and Tribal Bonds</i> .....	967
	<i>C. The Tribal Finance Information Clearinghouse</i> .....	968
VI.	CONCLUSION .....	970

## I. INTRODUCTION

Wall Street in New York City may be considered the financial center of the world, but the original wall on Wall Street was built to keep the Indians out. Despite the initial “purchase” of Manhattan Island, the mythos of which is often used to falsely enshrine Indians as incapable of understanding land ownership or capitalism,<sup>1</sup> hostilities frequently broke out between the Dutch and the Indians.<sup>2</sup> In 1653, Director-General Peter Stuyvesant ordered a wall built along the northern border of New Amsterdam to keep the Indians out. The path going along that wall was called the *Walstraat*, and when the English later took over the colony, New Amsterdam became New York and *Walstraat* became Wall Street. More than a century later, the New York Stock Exchange was founded, eventually locating at 11 Wall Street.

Unfortunately Wall Street has remained true to its origins and has excluded Indian tribes from equal participation in the capital markets, although Wall Street has had some help in this regard. Many of the barriers to tribal capital market access are statutory or regulatory, but a major impediment to overcoming any of these barriers is the problem of information asymmetry.

Information asymmetry exists when a party possesses greater informational awareness pertinent to effective participation in a given situation relative to other participating parties.<sup>3</sup> The combination of statutory, regulatory, and informational barriers further exacerbates the difficulty that tribes have when they seek capital for their emerging economies. Tribes not only face information asymmetry when they participate in the capital markets, but information asymmetry also significantly hinders the development of an empirical case to advocate for the removal of non-informational barriers. It is often difficult to effectively convey the depth of the problem faced by tribes, and such an

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<sup>1</sup> See discussion in Part III, *infra*.

<sup>2</sup> See WILLEM FRIJHOFF & MARIJKE SPIES, DUTCH CULTURE IN A EUROPEAN PERSPECTIVE: 1650 HARD-WON UTILITY 56 (2004); PAUL ANDREW OTTO, THE DUTCH-MUNSEE ENCOUNTER IN AMERICA 134 (2006).

<sup>3</sup> Gavin Clarkson, Trond E. Jacobsen & Archer L. Batcheller, *Information Asymmetry and Information Sharing*, 24 GOV'T INFO. Q. 827, 828 (2007).

understanding is required to get the attention of legislators and policy makers.

While discussions of emerging economies usually focus on development in third world countries, most Indian tribes have an economy on par with those same countries. Extensive land bases, spread out communities, and homesteads mired in one long-standing poverty cycle characterize most reservations.<sup>4</sup> Just as with other emerging markets, the need for economic development in Indian Country<sup>5</sup> remains acute and affects nearly every aspect of reservation life.

The primary fuel for economic development is capital, and Indian Country suffers from a number of capital deficits that impede its economic vitality. Upwards of \$50 billion in capital needs go unmet each year in Indian Country in such vital sectors as infrastructure, community facilities, housing, and enterprise development. Private enterprise in Indian Country is similarly challenged, as the equity investment gap in Indian Country is \$44 billion according to the United States Treasury Department.

Contrary to popular belief, gaming does not provide a significant economic stimulus for most tribal economies. Most of the more than 560 federally recognized Indian tribes<sup>6</sup> do not have any form of gaming operation,<sup>7</sup> and of those that do, only a handful generate significant revenues.<sup>8</sup> While a small number of tribes near major metropolitan centers may have started successful gaming enterprises, hundreds of tribes have not entered the gaming industry, and many that have participated actually operate casinos located far from population

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<sup>4</sup> *Entrepreneurial Sector Is the Key to Indian Country Development*, INDIAN COUNTRY TODAY, Sept. 6, 2002, at A2, available at <http://www.indiancountrytoday.com/archive/28216794.html>.

<sup>5</sup> 18 U.S.C. § 1151 (2000) defines "Indian Country" as

"(a) all land within the limits of any Indian reservation under the jurisdiction of the United States Government, notwithstanding the issuance of any patent, and, including rights-of-way running through the reservation,

(b) all dependent Indian communities within the borders of the United States whether within the original or subsequently acquired territory thereof, and whether within or without the limits of a state, and

(c) all Indian allotments, the Indian titles to which have not been extinguished, including rights-of-way running through the same."

<sup>6</sup> Indian Entities Recognized and Eligible to Receive Services from the United States Bureau of Indian Affairs, 70 Fed. Reg. 71,194 (Nov. 25, 2005).

<sup>7</sup> According to the National Indian Gaming Association, only 224 tribes have gaming operations of any kind as of 2005. See NAT'L INDIAN GAMING ASS'N, AN ANALYSIS OF THE ECONOMIC IMPACT OF INDIAN GAMING IN 2005, 2 (2005), available at [http://www.indiangaming.org/NIGA\\_econ\\_impact\\_2005.pdf](http://www.indiangaming.org/NIGA_econ_impact_2005.pdf).

<sup>8</sup> See NAT'L GAMBLING IMPACT STUDY COMM'N, NATIONAL GAMBLING IMPACT STUDY COMMISSION REPORT 2-10 (1999), available at <http://govinfo.library.unt.edu/ngisc/reports/fullrpt.html> ("The 20 largest Indian gambling facilities account for 50.5 percent of total revenues, with the next 85 accounting for [only] 41.2 percent. Additionally, not all gambling facilities are successful. Some tribes operate their casinos at a loss and a few have even been forced to close money-losing facilities.").

centers.<sup>9</sup> Thus, the economic benefits of gaming are not universally distributed throughout Indian Country. The unemployment rate, for example, hovers around 50% for Indians who live on reservations, nearly ten times that for the nation as a whole.<sup>10</sup> Almost one third of American Indians live in poverty.<sup>11</sup>

In examining the challenges facing tribes in terms of meaningful capital market access, references to a certain information asymmetry typology will be woven throughout this Article. Part II will discuss that typology as well as information asymmetry in detail, demonstrating its relevance to the examined phenomena. Part III will discuss the nature of tribal economies and then examine three statutory and regulatory impediments that inhibit tribal capital market access: (a) lack of accredited investor status for tribes, (b) lack of meaningful tax-exempt bonding authority for tribes, and (c) the liquidity premium imposed on tribal bonds because of a lack of a securities registration exemption.

Suppression of Indian economic opportunity is not new, however. Part IV of this Article discusses the nature of Indian tribes and their relationship to the federal government, highlighting the origins of federal Indian policies that have led to the current economic situation in Indian Country. Part V will examine how strategic information sharing and other methods of reducing information asymmetry can and will have a positive impact on tribal economies. This Article concludes with a brief discussion of the external generalizability of the information asymmetry typology.

## II. THE NATURE OF INFORMATION ASYMMETRY

Professor Rob Williams often refers to a Far Side cartoon by Gary Larson when discussing the origin of Indian rights in America.<sup>12</sup> Professor Williams argues that what makes the cartoon intriguing is that while almost everyone is familiar with the story of how the Indians made a supposedly bad deal selling Manhattan Island for beads and trinkets; it

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<sup>9</sup> See Donald L. Barlett & James B. Steele, *Wheel of Misfortune*, TIME, Dec. 16, 2002, at 44, available at <http://www.time.com/time/magazine/article/0,9171,1003896,00.html>.

<sup>10</sup> See e.g., Bureau of Indian Affairs Calculation of Unemployment Rates for Montana Indian Reservations (2007), available at <http://dli.mt.gov/resources/Indianlabormarket.pdf> (rate of unemployment on six Montana reservations averages 66%). See also Bureau of Indian Affairs Performance and Accountability Report, Fiscal Year 2005, at 24, available at [http://www.doi.gov/bia/docs/BIA\\_PAR\\_2005\\_FINAL\\_02242006\\_web.pdf](http://www.doi.gov/bia/docs/BIA_PAR_2005_FINAL_02242006_web.pdf) (indicating that the BIA's target unemployment rate for Indian Country was 43%).

<sup>11</sup> See, e.g., KRISTIN FLANAGAN & JEN PARK, U.S. DEP'T OF EDUC., AMERICAN INDIAN AND ALASKA NATIVE CHILDREN: FINDINGS FROM THE BASE YEAR OF THE EARLY CHILDHOOD LONGITUDINAL STUDY, BIRTH COHORT 3 (2005), available at <http://nces.ed.gov/pubs2005/2005116.pdf>.

<sup>12</sup> ROBERT A. WILLIAMS, JR., LIKE A LOADED WEAPON: THE REHNQUIST COURT, INDIAN RIGHTS, AND THE LEGAL HISTORY OF RACISM IN AMERICA xiii (2005).

is not clear why the chief was in trouble if the Indians did not appreciate the value of the land that was transferred.<sup>13</sup> In reality, the Manhattan Indians were probably quite aware of the value of their land, and the fact that the Dutch “bought” the land from the non-resident Canarsie Indians was probably one of the reasons that the wall on Wall Street was erected in the first place.<sup>14</sup>

An alternative interpretation of the “sale” of Manhattan would be as a story of information asymmetry. As mentioned earlier, information asymmetry exists when a party possesses greater informational awareness pertinent to effective participation in a given situation relative to other participating parties. In the case of Manhattan, the Dutch may have been able to exploit an information asymmetrical advantage.<sup>15</sup> Over time, one would assume that the Indians would have been successful in reducing

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<sup>13</sup> *Id.* at xiii-xv.

<sup>14</sup> See, e.g., PAUL KUPPERBERG, A PRIMARY SOURCE HISTORY OF THE COLONY OF NEW YORK 18–21 (2006).

<sup>15</sup> It is possible, however, that the Dutch were the victims of the information asymmetry. According to one author, Chief Seyseys, the leader of the Canarsie Indians, exploited Minuet's ignorance about which Indian tribe actually held the “use and occupancy” rights to Manhattan Island. Nathaniel Benchley, *The \$24 Swindle*, AM. HERITAGE, Dec. 1959, at 62. According to Benchley, another Indian tribe, the Weckquaesgeeks, actually held title to the upper two-thirds of Manhattan Island, and thus chief Seyseys readily agreed to remove his few tribal members from lower Manhattan Island and “he took the sixty guilders' worth of knives, axes, clothing, and beads (and possibly rum), and went chortling all the way back to Brooklyn.” *Id.* at 63.

information asymmetry, but what if the information asymmetry is forcibly maintained, either through statutory or regulatory means?

Consider the treasurer for a tribe in the southeastern United States. Her tribe, like many others, suffers from high unemployment and inadequate infrastructure. Recently, the tribe successfully reclaimed some ancestral homeland containing timber resources that will produce a steady income stream. To improve tribal infrastructure, she suggests the tribe issue a tax-exempt bond backed by the timber revenues to construct a new tribal administration building, housing for older members, and to address other glaring infrastructure needs. The tribal council asks her to determine what the market would require for financial terms, but she quickly discovers that, unlike the municipal bond market generally, there is no centralized set of information regarding tribal bonds. Furthermore, she has no way to verify the accuracy of the information her tribe receives from the investment banking community regarding market rates and industry standard practices. When she inquires of neighboring tribes, she discovers that many of those tribes are similarly in the dark regarding the tribal finance marketplace.

While digital divide research has focused on information asymmetry that may exist because of disparities in access to information tools or educational training,<sup>16</sup> in an earlier article my colleagues and I found that information asymmetry is often the product of differential information sharing practices.<sup>17</sup> Some information asymmetries are due to deliberately withheld information, others to habits of information use, still others to insufficient incentives to share information. In any case, asymmetry due to information sharing practices cannot be rectified through technological grants and technical education alone. New information sharing practices are required to resolve these information asymmetries and to produce greater information awareness.

Whatever the cause, the effect of information asymmetry is frequently the same for the "information poor" in terms of their interactions with the "information rich." For example, the information poor are in a weaker position to negotiate contracts or settlements. They cannot advocate as effectively for public policy or persuade others to join their cause. Negative consequences, however, are rarely limited to the information poor, as information asymmetries can lead to negative externalities for third parties. Information asymmetries can lead to unfair agreements or unrealized opportunities in ways that harm third parties. In the case of the financial markets, the opportunity cost of lost transactions harms all parties that would benefit from greater amounts of economic activity within the given space. Additionally, stakeholders with interests in entities which are information poor may also suffer negative externalities unless the action is taken to eliminate the information

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<sup>16</sup> Liangzhi Yu, *Understanding Information Inequality: Making Sense of the Literature of the Information and Digital Divides*, 38 J. LIBRARIANSHIP & INFO. SCI. 229, 236 (2006).

<sup>17</sup> Clarkson et al., *supra* note 3, at 827.

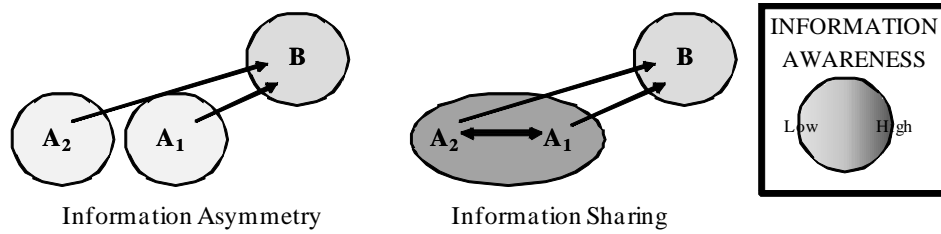


Figure 1. Horizontal Information Asymmetry and Information Sharing

asymmetry between the information rich and poor. For instance, if information asymmetries between tribes and participants in the capital markets perpetuate reservation underdevelopment, the American public must provide more welfare payments to poor tribal members.

In *Information Asymmetry and Information Sharing*, we proposed the following classification scheme: horizontal information asymmetry exists when a complete set of valuable information is scattered among similarly-situated information-poor entities; vertical information asymmetry exists when one type of entity holds information another does not, and a complete set of information does not exist in an aggregated collection of information-poor entities.<sup>18</sup> The following sections discuss that typology in more detail.

#### A. Horizontal Information Asymmetry

In the case of horizontal information asymmetry, while some members of the information poor may have more information than others, no entity has the complete set of information. External entities with access to greater information about the information poor will have informational power over any *individual* entity among the class possessing scattered information and over the *entire class* as a whole. Figure 1 depicts this situation, where entities A1 and A2 are similarly situated, but neither has the complete set of information possessed by entity B. Horizontal information sharing is a strategy available to the information poor to eliminate such information asymmetry—a strategy that does not depend on the participation of the information rich. The information poor can share and integrate information such that they are able to produce information awareness equal, or more closely equal, to the information rich.

##### 1. Information Asymmetry and Capital Markets

Issuing tax-exempt debt in the form of bonds for infrastructure development—roads, water treatment plants, and even convention centers—continues to play a catalytic role in stimulating local economic

<sup>18</sup> *Id.*

growth,<sup>19</sup> as it has for nearly two centuries.<sup>20</sup> Tax exempt debt can simply be issued at lower interest rates.<sup>21</sup>

A recent study of more than 1700 non-tribal tax-exempt bonds found not only that the “most critical consequence” of information asymmetry is higher borrowing costs, but also that “alleviating information asymmetry” reliably eliminates the risk premium and reduces borrowing costs, particularly for new or infrequent issuers.<sup>22</sup> A similar study examined 500 years of sovereign-issued debt, finding that greater transparency produced by information sharing eliminates the risk premium imposed on unseasoned borrowers.<sup>23</sup>

Explanations for these findings may be found by analyzing markets as socially-constructed knowledge networks,<sup>24</sup> relying on economic knowledge co-created by professional networks and expressed in shared information objects making putatively objective market indicia (e.g. prices) intelligible and actionable for market participants.<sup>25</sup> Non-tribal municipal officials are members of a complex knowledge network, and their tax-exempt bonds are issued in well-established markets that have

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<sup>19</sup> See generally Julia Lynn Coronado, *Tax Exemption and State Capital Investment*, 52 NAT'L TAX J., 473, 473–74 (1999); W. Bartley Hildreth, *State and Local Governments as Borrowers: Strategic Choices and the Capital Market*, PUB. ADMIN. REV., Jan.–Feb. 1993, at 41.

<sup>20</sup> See generally A. M. HILLHOUSE, *MUNICIPAL BONDS: A CENTURY OF EXPERIENCE* 31 (1936).

<sup>21</sup> To illustrate this phenomenon, assume that a taxpayer whose effective federal tax rate is 35% purchases a \$1000 taxable bond from a corporation that pays interest of 10%. She will receive an annual interest payment of \$100, but she must pay \$35 of that in taxes, resulting in a net income of \$65. If she were to purchase a \$1000 tax-exempt bond from a municipality that pays 6.5% in interest, she would still receive \$65 and would be economically indifferent between the two bonds, assuming that all other attributes of the bonds were equivalent, such as the risk of default and the dates of payment. Thus, the municipality can raise the same amount of capital as the corporation for substantially less in interest expense.

<sup>22</sup> Jun Peng & Peter F. Brucato, Jr., *An Empirical Analysis of Market and Institutional Mechanisms for Alleviating Information Asymmetry in the Municipal Bond Market*, 28 J. ECON. & FIN. 226, 226–27 (2004).

<sup>23</sup> Michael Tomz, Stanford University, Address at the 2001 Annual Meeting of the American Political Science Association: How Do Reputations Form? New and Seasoned Borrowers in International Capital Markets (Aug. 30, 2001).

<sup>24</sup> See generally Alex Preda, *Financial Knowledge, Documents, and the Structures of Financial Activities*, 31 J. CONTEMP. ETHNOGRAPHY 207 (2002).

<sup>25</sup> See generally Linda Rouleau, *Micro-Practices of Strategic Sensemaking and Sensegiving: How Middle Managers Interpret and Sell Change Every Day*, 42 J. MGMT. STUD. 1413 (2005); Edward J. Zajac & James D. Westphal, *The Social Construction of Market Value: Institutionalization and Learning Perspectives on Stock Market Reactions*, 69 AM. SOC. REV. 433 (2004); Preda, *supra* note 24; Ezra W. Zuckerman, *The Categorical Imperative: Securities Analysts and the Illegitimacy Discount*, 104 AM. J. SOC. 1398, 1399 (1999); MITCHEL Y. ABOLAFIA, *MARKING MARKETS: OPPORTUNISM AND RESTRAINT ON WALL STREET* (1996); Mitchel Y. Abolafia & Martin Kilduff, *Enacting Market Crisis: The Social Construction of a Speculative Bubble*, 33 ADMIN. SCI. Q. 177 (1988).



matured over the last four decades.<sup>26</sup> The various participants—state and local governments, credit rating agencies, underwriters, and investors—share access to their collective market experiences with the overall effect that borrowers obtain needed capital at favorable rates.<sup>27</sup> In contrast, most tribes are not established members of this network and very few tribal governments have experience with debt-financing.<sup>28</sup>

## 2. *Horizontal Information Asymmetry in Tribal Finance*

As separate sovereign governments, Indian tribes, just like state and local governments, have an obligation to improve the lives of their citizens. Unlike state and local governments, however, tribal governments are more limited in their ability to access the capital needed to fulfill their obligations. No studies of information asymmetry in the tribal finance market exist, but studies in other contexts find that poor informational awareness reduces investment and local economic development.<sup>29</sup> Interviews with tribal and non-tribal market participants indicate that non-tribal entities collectively enjoy a much broader and deeper awareness of the evolving tribal finance marketplace than all but a few tribes. Even financially sophisticated tribes are at a strategic disadvantage without a system for horizontal information sharing between tribes about the tribal financial marketplace. As discussed in Part III *infra*, tribes pay a steep price for this information asymmetry.

## B. *Vertical Information Asymmetry*

Vertical information asymmetry exists when one type of entity holds information another does not, and a complete set of information does not exist in an aggregated collection of information-poor entities. In

<sup>26</sup> Paul S. Maco, *Building a Strong Subnational Debt Market: A Regulator's Perspective*, 2 RICH. J. GLOBAL L. & BUS. 1, 1–13 (2001).

<sup>27</sup> Lisa M. Fairchild & Nan S. Ellis, *Municipal Bond Disclosure: Remaining Inadequacies of Mandatory Disclosure Under Rule 15c2-12*, 23 J. CORP. L. 439, 456 (1998); Bill Simonsen & Larry Hill, *Municipal Bond Issuance: Is There Evidence of a Principal-Agent Problem?*, 18 PUB. BUDGETING & FIN. 71, 71–73 (1998); Douglas W. Diamond, *Reputation Acquisition in Debt Markets*, 97 J. POL. ECON. 828, 828–62 (1989); David H. Downes & Robert Heinkel, *Signaling and the Valuation of Unseasoned New Issues*, 37 J. FIN. 1, 1–10 (1982).

<sup>28</sup> H. FABIAN RAMIREZ ET AL., TRIBAL GOVERNMENTS IN THE BOND MARKET, FITCH RATINGS REVENUE CRITERIA REP. (2004), <http://fitchratings.com>.

<sup>29</sup> Michaël Dewally & Louis Ederington, *Reputation, Certification, Warranties, and Information as Remedies for Seller-Buyer Information Asymmetries: Lessons from the Online Comic Book Market*, 79 J. BUS. 693, 727 (2006); Stijn Van Nieuwerburgh & Laura Veldkamp, *Learning Asymmetries in Real Business Cycles*, 53 J. MONETARY ECON. 753, 753–72 (2006); W. A. de Wet, *The Role of Asymmetric Information on Investments in Emerging Markets*, 21 ECON. MODELLING 621, 621–30 (2004); Stephan Weiler, Eric Scorsone & Madeleine Pullman, *Information Linkages in Local Economic Development*, 31 GROWTH & CHANGE 367, 367 (2000); Abhijit V. Banerjee & Andrew F. Newman, *Information, the Dual Economy, and Development*, 65 REV. ECON. STUD. 631, 632 (1998); Pervaiz Alam & Karen Schuele Walton, *Information Asymmetry and Valuation Effects of Debt Financing*, 30 FIN. REV. 289, 307 (1995).

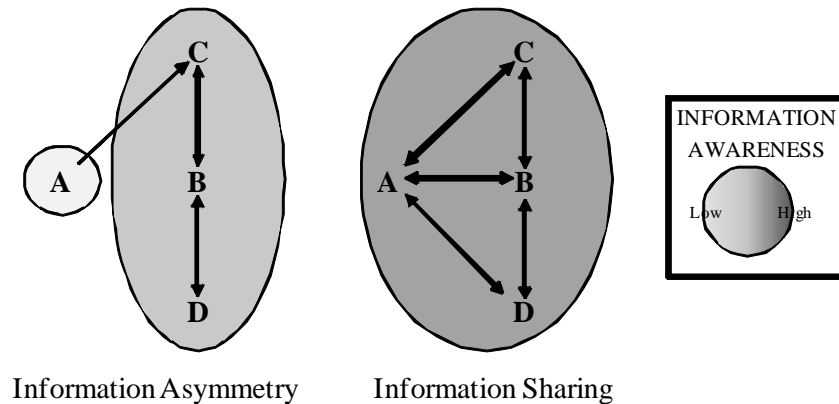


Figure 2: A Model of Vertical Information Asymmetry and Sharing

Figure 2, such asymmetry exists between entities A and C. Vertical information sharing is a viable strategy to flatten this form of information asymmetry, but such a strategy requires the cooperation of the information rich. For instance, legislation such as the Freedom of Information Act can force parties to disclose critical information for the benefit of previously information-poor parties. Incentives can encourage the information rich to volunteer important information. Financial payment or opportunities are obvious forms of incentives.

While we theorized in *Information Asymmetry and Information Sharing* that both types of information asymmetry existed in the context of American Indian tribes and their governments,<sup>30</sup> Part V of this Article will provide concrete examples of both vertical and horizontal information asymmetry in the tribal finance context. Consistent with the earlier article, this Article will also argue that solving either form of information asymmetry through information sharing will benefit both the information rich and the information poor.

### III. INDIAN COUNTRY ECONOMICS<sup>31</sup>

Extremely low socio-economic factors often burden tribal communities, including low educational achievement,<sup>32</sup> high poverty,<sup>33</sup>

<sup>30</sup> Clarkson et al., *supra* note 3, at 828–29.

<sup>31</sup> An expanded discussion of Indian Country Economics can be found in Gavin Clarkson, *Tribal Bonds: Statutory Shackles and Regulatory Restraints on Tribal Economic Development*, 85 N.C. L. Rev. 1009 (2007).

<sup>32</sup> RAYMOND C. ETCITY, ADVISORY COMM. ON TAX EXEMPT AND GOV'T ENTITIES, TRIBAL ADVICE AND GUIDANCE POLICY II-7 (2004), available at [http://ftp.qai.irs.gov/pub/irs-tege/act\\_rpt3\\_part2.pdf](http://ftp.qai.irs.gov/pub/irs-tege/act_rpt3_part2.pdf).

<sup>33</sup> The average percentage of American Indians living in poverty is 25.67 percent, compared 12.38 percent for the general population. See U.S. DEP'T OF COMMERCE, POVERTY IN THE UNITED STATES: 2000 7 (2001).

and low per capita income.<sup>34</sup> The unemployment rate hovers around 50% for Indians who live on reservations, nearly ten times that for the nation as a whole. Over one quarter of American Indians live in poverty, more than twice the national average.<sup>35</sup>

For many tribes the only source of capital to address these problems is limited to grants and other assistance from the federal government, but such funds are often insufficient to address the myriad responsibilities facing tribal governments.

Gaming activity does not provide sufficient funds to meet the needs of the majority of tribal governments, and too many tribal governments lack the ability to provide the basic infrastructure most U.S. citizens take for granted, such as passable roadways, affordable housing, and the plumbing, electricity, and telephone services that come with a modern home. According to the U.S. Census Bureau, approximately 20% of American Indian households on reservations lack complete plumbing facilities, compared to 1% of all U.S. households.<sup>36</sup> About 1 in 5 American Indian reservation households dispose of sewage by means other than public sewer, septic tanks, or cesspool.<sup>37</sup> The Navajo reservation is the same size as West Virginia, yet it only has 2,000 miles of paved roads while West Virginia has 18,000 miles.<sup>38</sup> Investors and employers, even in the most distressed inner cities of the United States, take roads, telephones, electricity, and the like for granted. The absence of such basic infrastructure in large portions of Indian country poses a daunting barrier to tribal leaders' attempts to develop their economies.

Such realities highlight the importance of stimulating economic development to create economic opportunity for tribal members. Many scholars, investors, and tribal officials charged with developing their economies are well aware that access to capital for tribes and individual Indian entrepreneurs is a significant and pressing problem. The unanswered question is one of capital formation: How do Indian Country government and businesses leaders obtain the necessary capital? The answer should be to access the capital markets in the same way that non-Indian entities do, but as this Article will demonstrate, severe impediments to a level playing field continue to plague Indian Country.

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<sup>34</sup> Per capita income for American Indians is \$12,893.00, compared to the overall U.S. average of \$21,587.00. See U.S. Census Bureau 2000, Per Capita Income in 1999, <http://factfinder.census.gov/>.

<sup>35</sup> See U.S. Census Bureau, *Poverty 2005*, available at <http://www.census.gov/hhes/www/poverty/poverty05/table5.html>.

<sup>36</sup> BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, HOUSING OF AMERICAN INDIAN ON RESERVATIONS—PLUMBING, SB/95-9, 1 (1995), available at [http://www.census.gov/apspd/www/statbrief/sb95\\_11.pdf](http://www.census.gov/apspd/www/statbrief/sb95_11.pdf).

<sup>37</sup> *Id.* at 3.

<sup>38</sup> Michael J. Kurman, *Indian Investment and Employment Tax Incentives*, 41 FED. B. NEWS & J. 578, 583 (1994).

A. *The Accredited Investor Problem*<sup>39</sup>

Because small business is the primary driver of much of the U.S. economy, an increase in small business activity is a rational step towards improving employment levels and other aspects of reservation economies. Even when Indian Country businesses initially succeed, however, lack of access to expansion capital, particularly equity capital, can severely constrain their ability to grow and create jobs. A logical source for the capital necessary to increase small business activity in Indian Country would be from the small number of tribes that have reaped significant profits from Indian gaming. Many of the wealthier tribes feel an obligation to invest back into the poorer areas of Indian Country, but historically the only mechanism of deploying capital has been through direct investment. Many tribal councils, however, have neither the necessary experience to appropriately evaluate such investments nor the time to thoroughly examine numerous direct investment opportunities. Furthermore, direct investment by only a handful of wealthy tribes will not solve the overall private equity gap in Indian Country, which is more than \$44 billion according to the U.S. Treasury Department.<sup>40</sup>

The logical alternative would be for the tribe to deploy equity capital in the same way as other wealthy individuals or corporations do: investing in a private equity or venture capital fund where financial professionals can evaluate the various businesses and select the best of those opportunities in order to maximize investment returns. Such funds, which include venture capital funds, provide financing for early- and late-stage private companies. These funds raise their capital from third-party investors seeking high returns based on both the risk profiles of the companies and the near-term illiquidity of these investments.<sup>41</sup> Unfortunately, wealthy tribes have not been able to participate in private equity because, under Regulation D ("Reg D") of the Securities Act of 1933, Indian tribes are not included in the list of "Accredited Investors."<sup>42</sup>

Reg D specifies rules governing the selling of securities by private companies and exemptions from federal and state securities registration requirements.<sup>43</sup> Small Business Investment Companies ("SBICs") and other small private equity firms regularly avail themselves of the so-called

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<sup>39</sup> A companion article, Gavin Clarkson, *Accredited Indians: Increasing the Flow of Private Equity into Indian Country as a Domestic Emerging Market*, 80 Colo. L. R. (forthcoming 2008), discusses the Accredited Investor issue in greater detail.

<sup>40</sup> CMTY. DEV. FIN. INSTS. FUND, U.S. DEP'T OF TREAS., NATIVE AMERICAN LENDING STUDY 2 (2001).

<sup>41</sup> See Roger Leeds & Julie Sunderland, *Private Equity Investing in Emerging Markets*, 15 J. APPLIED CORP. FIN. 111, 112 (2003).

<sup>42</sup> Regulation D, 17 C.F.R. § 230.501 (2008).

<sup>43</sup> Clarkson, *supra* note 39, manuscript at 4.

“Reg D exemption.”<sup>44</sup> While there are a number of pathways through which a private equity firm can avail itself of this filing exemption, as a practical business matter, the pathway most commonly followed and looked to by successful firms is to offer their securities only to accredited investors.

Rule 501(a) of Reg D defines who is or is not an accredited investor within the meaning of the Reg D exemption. Private equity funds strongly prefer to sell securities to Accredited Investors because only under this scenario are the companies assured of being in complete compliance with Federal and State securities laws.<sup>45</sup> While a private company may sell its securities to categories of investors other than accredited ones, these alternative scenarios create significant legal complexities and business risks that increase the costs of raising capital (e.g., risk premiums must be paid to investors, as well as much higher legal fees and more detailed disclosure documents).<sup>46</sup>

As a general rule, securities lawyers advise startup private equity funds to restrict the sale of securities (i.e., raise their “blind pool” of capital) to Accredited Investors, given the high risk nature of equity investments. In short, a private investment firm that must raise its capital from non-accredited investors will pay higher costs for these funds.<sup>47</sup> While some of the current federal regulations and policies that harm tribal economies are a result of overt hostility towards tribes,<sup>48</sup>

I have suggested elsewhere that the exclusion of tribes from the category of accredited investor results instead from mere oversight, or “benign neglect.”<sup>49</sup> Nevertheless, the impact of this benign neglect has been devastating, as private enterprise in Indian Country is starving for capital. The tribes who would be the primary candidates to help remedy this situation are effectively barred from doing so. It is also logical to assume that the lack of tribal investment in Indian Country’s emerging economy creates some degree of hesitation among non-Indian investors. As such, private enterprise in Indian Country is unable to get past the tipping point<sup>50</sup> created by the exclusion of tribal investment capital and the concomitant reluctance of non-Indian investment capital.

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<sup>44</sup> NATIVE AMERICAN CAPITAL, LP, POLICY BRIEFING: NATIVE AMERICAN TRIBES REQUIRE REG D CHANGE 1, <http://www.sec.gov/rules/other/265-23/nac020306.pdf>.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> Clarkson, *supra* note 39, manuscript at 5–6.

<sup>48</sup> See Clarkson, *supra* note 31, at 1072.

<sup>49</sup> See Clarkson, *supra* note 39, manuscript at 6.

<sup>50</sup> See generally MALCOLM GLADWELL, THE TIPPING POINT: HOW LITTLE THINGS CAN MAKE A BIG DIFFERENCE (2000).

B. *Tribal Bond Challenges*<sup>51</sup>

Another possible avenue to stimulate economic development is for tribal governments to issue economic development bonds that would both directly and indirectly benefit businesses on their reservations. An earlier article pointed out, however, that the Tax Code facially discriminates against tribes and makes such bonding impossible.<sup>52</sup> In addition to highlighting the inability of tribes to issue economic development bonds, the article points out that upwards of \$50 billion in capital needs go unmet each year in Indian Country. These needs occur in such vital sectors as infrastructure, community facilities, housing, and enterprise development, in part due to the restrictions imposed on tribal access to the capital markets, specifically the ability of tribal governments to issue tax-exempt debt. Section 7871(b) of the Internal Revenue Code requires tribal tax-free bond proceeds to be used only for “essential governmental function[s],” a restriction not applicable to state and municipal bonds. Section 7871(e) further limits the scope of available tax-exempt bonding to activities “customarily performed by State and local governments with general taxing powers” without providing any guidance as to when a particular activity becomes “customary” for a non-tribal government.<sup>53</sup>

The *Tribal Bonds* article also details how these restrictions have severely limited tribal abilities to access the capital markets. Although American Indians make up more than 1.5% of the population, tribes issued less than 0.1% of the tax-exempt bonds between 2002 and 2004.<sup>54</sup> These restrictions harm the poorer tribes the most, as the differential between tax-exempt and taxable interest rates often determines the feasibility of a project. Without access to tax-exempt rates, poorer tribes simply cannot afford the debt service required to address glaring economic and infrastructure deficiencies.

*Tribal Bonds* also demonstrates that the ambiguity of the statute has led to a number of Internal Revenue Service (“IRS”) enforcement actions that simply would not have happened had the issuer not been a tribe. In each of these cases, the tribes financed activities that had previously been routinely financed by state and local governments without any challenge from the IRS. The article concludes that tribal governments should have the same tax-exempt bonding authority as their state and local counterparts and that expansion of tribal bonding authority should increase federal revenues.

Critical to the article’s policy recommendation is research that resulted from a process of vertical information sharing. Based on data that was only available from the IRS, *Tribal Bonds* demonstrated that tribal

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<sup>51</sup> An exhaustive examination of the challenges tribes face when attempting to issue tax exempt bonds can be found in Clarkson, *supra* note 31.

<sup>52</sup> *Id.* at 1084–85.

<sup>53</sup> 26 U.S.C. § 7871 (2000).

<sup>54</sup> Clarkson, *supra* note 31, at 1062.

governments are victims of a disproportionate number of enforcement actions by the IRS. The IRS audits less than 1% of the tax-exempt municipal offerings each year, but direct tribal tax-exempt issuances are 30 times more likely to be audited within four years of issue than those issued by cities and states.<sup>55</sup>

*C. Lack of Securities Registration Exemptions*

In addition to the challenges associated with the scope of tax-exempt bonding authority, Indian tribes face another challenge when accessing the capital markets that does not exist for state and local governments. Unlike a typical bank loan, a bond is a “security,” subject to federal securities laws as well as regulation by the Securities and Exchange Commission (“SEC”) under the Securities Act of 1933<sup>56</sup> and the Securities Exchange Act of 1934.<sup>57</sup> Securities issued by states or local governments are generally exempt from the registration and reporting requirements of the Exchange Act.

When the securities laws were being reworked in the early 1930s, however, Congressional Indian policy was still aimed at “civilizing” the Indians. Those involved in crafting the Securities Act of 1933 and the Securities Exchange Act of 1934 probably never envisioned that tribal governments would ever be in the position to issue municipal debt, even though the Indian Reorganization Act, also passed in 1934, was intended to make tribal governments more closely resemble those of the dominant society.

Therefore, unlike state and local municipal securities, tribal municipal debt is not exempt from securities registration requirements and is thus less liquid than comparable municipal debt that is exempt from registration. This lack of an exemption is detrimental to tribes’ abilities to employ debt finance, to perform the municipal functions they are required to perform, and to lay the foundations for tribes’ economic development.

Registration of securities is an expensive proposition, and the required reporting costs the issuing entity approximately two million dollars per year.<sup>58</sup> Once an entity is already reporting to the SEC, however, the marginal costs for subsequent issues of registered debt are negligible. Securities that are exempt from registration avoid these costs while still being available for purchase by both institutional investors and individual retail investors.

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<sup>55</sup> *Id.* at 1017.

<sup>56</sup> Securities Act of 1933, 15 U.S.C. §§ 77a–77bbbb (2000).

<sup>57</sup> Securities Exchange Act of 1934, 15 USC §§ 78a–78nn (2000).

<sup>58</sup> Lane Leskela, Rich Mogull & Debra Logan, *You’ll Have to Spend to Attain Sarbanes-Oxley Compliance* (No. SPA-21-0462) (2003); Colleen Marie O’Connor, *Computershare Turns to Privates for Acquisition*, INV. DEALERS’ DIG., April 25, 2005, at 42.

A small handful of tribes have incurred the additional and substantial costs associated with registering municipal securities, such as the Mississippi Band of Choctaw Indians, the Mohegan Tribe of Connecticut, and the Seneca Nation of Indians. Most tribes opt to issue municipal bonds in special transactions called private placements,<sup>59</sup> which results in a less liquid market for their bonds because they can be offered only to certain “qualified institutional buyers” as defined under SEC Rule 144A or to a limited number of sophisticated investors as defined under SEC Rule 506.<sup>60</sup> Privately placed bonds are also restricted in terms of resale, as they can typically be resold only to other qualified institutional buyers or in limited offering situations, since transactional exemptions such as a private placement do not make the underlying security exempt from registration. Because of these limitations, privately placed bonds will be somewhat less liquid than bonds sold as registered securities,<sup>61</sup> and the investors who purchase tribal bonds in a private placement may charge the tribe a liquidity premium in the form of additional interest to offset their restrictions on resale.<sup>62</sup>

Disclosure requirements also vary depending on whether a security is registered, exempt from registration, or unregistered but sold under Rule 144A. While existing research has identified a separate premium associated with limited disclosure,<sup>63</sup> issuers have the option to voluntarily disclose more information than is minimally required, and empirical studies have documented that voluntary increased disclosure reduces the limited disclosure premium.<sup>64</sup>

In summary, the legal requirements for registration and exemption have created the following situation: municipalities wishing to finance municipal debt are exempt from registration, yet can sell securities to the combined market of both qualified institutional buyers<sup>65</sup> and retail buyers who, in turn, are permitted to sell those bonds to any buyer of their choosing. Those tribes that can afford registration, and choose to

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<sup>59</sup> See 15 U.S.C. § 697a; Regulation D, 17 C.F.R. § 230.506 (2008).

<sup>60</sup> 17 C.F.R. § 230.506; see *infra* note 65.

<sup>61</sup> See Miles Livingston & Lei Zhou, *The Impact of Rule 144a Debt Offerings Upon Bond Yields and Underwriter Fees*, FIN. MGMT., Winter 2002, at 5, 5.

<sup>62</sup> Gavin Clarkson, Capital and Finance Issues: Tribal Enterprises, at 11 (May 15, 2007) (prepared for National Native American Economic Summit for the Dep’t of the Interior), <http://www.ncai.org/ncai/econpolicy/CapitalandFinancePapers.pdf>.

<sup>63</sup> See, e.g., Paul M. Healy & Krishna G. Palepu, *Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature*, 31 J. ACCT. & ECON. 405, 429–30 (2001); Paul M. Healy, Amy P. Hutton & Krishna G. Palepu, *Stock Performance and Intermediation Changes Surrounding Sustained Increases in Disclosure*, 16 CONTEMP. ACCT. RES., 485 (1999).

<sup>64</sup> See e.g. Christine A. Botosan & Marlene A. Plumlee, *A Re-examination of Disclosure Level and the Expected Cost of Equity Capital*, 40 J. ACCT. RES., March 2002, at 21; Partha Sengupta, *Corporate Disclosure Quality and the Cost of Debt*, 73 ACCT. REV. 459 (1998); Christine A. Botosan, *Disclosure Level and the Cost of Equity Capital*, 72 ACCT. REV. 323 (1997).

<sup>65</sup> A “qualified institutional buyer” is defined in 17 C.F.R. § 230.144A (2008).



do so, have access to this same market but must first pay large registration costs, continuing and substantial reporting costs, and smaller marginal registration costs for each subsequent issuance. Other tribes simply issue securities to the limited set of qualified institutional buyers they can access in the private placement bond market. This smaller market suggests relative illiquidity, which produces a liquidity premium for these tribes. Current federal securities law forces tribal governments wishing to avoid the liquidity premium to incur large ongoing registration costs. Many tribes cannot absorb these costs and as a result, because of differential treatment under federal securities law, their governments must abandon bond-financed projects altogether or turn to more expensive private placement.

#### IV. A BRIEF HISTORY OF TRIBAL LAW AND POLICY<sup>66</sup>

The notions that led to the various restrictions of tribal economic development are not new and trace back to the origins of the United States itself. In *Cherokee Nation v. Georgia*,<sup>67</sup> the first Supreme Court opinion involving an American Indian tribe,<sup>68</sup> Chief Justice Marshall wrote “[t]he relation of the Indians to the United States is marked by peculiar and cardinal distinctions which exist no where else.”<sup>69</sup> A half century later the Supreme Court would opine that “the relation of the Indian tribes living within the borders of the United States, both before and since the Revolution, to the people of the United States has always been an anomalous one and of a complex character.”<sup>70</sup> It is important to review the origins of federal Indian law and policy before addressing the modern context.

The legal principles that existed when Europeans first made contact with the Indians had their origins in legal theories developed to justify the Crusades.<sup>71</sup> As the competing European nations began to expand their empires, the papacy began to grant exclusive rights to lands as they

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<sup>66</sup> A more detailed history of tribal law and policy can be found in Clarkson, *supra* note 31, at 1019–30.

<sup>67</sup> *Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1 (1831).

<sup>68</sup> An earlier Supreme Court case, *Johnson v. McIntosh*, 21 U.S. (8 Wheat.) 543 (1823), dealt with the issue of who could acquire title to land from Indian tribes, but no tribe was a party to the case.

<sup>69</sup> *Cherokee Nation*, 30 U.S. (5 Pet.) at 16.

<sup>70</sup> *United States v. Kagama*, 118 U.S. 375, 381 (1886).

<sup>71</sup> See, e.g., Pope Innocent IV, *Commentaria Doctissima in Quinque Libros Decretalium*, reprinted in *THE EXPANSION OF EUROPE: THE FIRST PHASE* 191, 191–92 (James Muldoon ed. & trans., 1977) (“[I]s it licit to invade a land that infidels possess or which belong to them? . . . [I]t is licit for the pope to [demand allegiance, and] if the infidels do not obey, they ought to be compelled by the secular arm and war may be declared against them by the pope and not by anyone else.”). See also ROBERT A. WILLIAMS, JR., *THE AMERICAN INDIAN IN WESTERN LEGAL THOUGHT: THE DISCOURSES OF CONQUEST* 14 (1990) (discussing the crusading era origins of the legal doctrines which governed European land claims in the Americas).

were “discovered,” including rights of sovereignty over the indigenous populations.<sup>72</sup> Even after England broke away from the authority of Rome, English law still supported this “Doctrine of Discovery,”<sup>73</sup> although the validity of the doctrine was a subject of debate among early colonial settlers.<sup>74</sup> Irrespective of conflicting religious interpretations of Indian rights, “practical realities shaped legal relations between the Indians and colonists.”<sup>75</sup> The necessity of getting along with powerful and militarily capable Indian tribes<sup>76</sup> dictated that the settlers seek Indian consent to settle if they wished to live in peace and safety, buying lands that the Indians were willing to sell rather than displacing them by other methods. As a result, the English and Dutch colonial governments acquired most of their respective lands by purchase from the Indians, including the Dutch purchase of Manhattan.

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<sup>72</sup> See, e.g., Bull “Inter caetera Divinae” of Pope Alexander VI dividing the New Continents and granting America to Spain, (May 4, 1493), in CHURCH AND STATE THROUGH THE CENTURIES 153, 156–57 (Sidney Z. Ehler & John B. Morrall trans. and eds., 1967) (“Wherefore, all things considered maturely and, as it becomes Catholic kings and princes . . . you have decided to subdue the said mainlands and islands, and their natives and inhabitants, . . . with the proviso, however, that these mainlands and islands found or to be found, discovered or to be discovered . . . be not actually possessed by some other Christian king or prince.”). See also Bull “Romanus Pontifex” of Pope Nicholas V granting the Territories discovered in Africa to Portugal, (January 8, 1455), in CHURCH AND STATE THROUGH THE CENTURIES, *supra* at 144, 145; WILLIAMS, *supra* note 71, at 14. See also generally Felix S. Cohen, *The Spanish Origin of Indian Rights in the Law of the United States*, 31 GEO. L.J. 1 (1942).

<sup>73</sup> See, e.g., Calvin’s Case, 77 Eng. Rep. 377, 397–98 (K.B. 1608). “All infidels are in law *perpetui inimici*, perpetual enemies (for the law presumes not that they will be converted, that being *remota potentia*, a remote possibility) for between them, as with the devils, whose subjects they be, and the Christian, there is perpetual hostility, and can be no peace; . . . And upon this ground there is a diversity between a conquest of a kingdom of a Christian King, and the conquest of a kingdom of an infidel; for if a King come to a Christian kingdom by conquest, . . . he may at his pleasure alter and change the laws of that kingdom: but until he doth make an alteration of those laws the ancient laws of that kingdom remain. But if a Christian King should conquer a kingdom of an infidel, and bring them under his subjection, there *ipso facto* the laws of the infidel are abrogated, for that they be not only against Christianity, but against the law of God and of nature, contained in the decalogue; and in that case, until certain laws be established amongst them, the King by himself, and such Judges as he shall appoint, shall judge them and their causes according to natural equity.” This opinion was authored by Lord Chief Justice Edward Coke who, coincidentally, wrote the charter for the Virginia Company in 1606. See WILLIAMS, *supra* note 70, at 44.

<sup>74</sup> Compare the arguments of John Winthrop (As “for the Natives in New England they inclose noe land neither have any settled habitation nor any tame cattle to improve the land by, & soe have noe other but a naturall right to those countries.”) with those of Roger Williams (“I have knowne them make bargaine and sale amongst themselves for a small piece, or quantity of Ground [and this they do] notwithstanding a sinfull opinion amongst many that Christians have right to Heathens Lands.”) recounted in Cheister E. Eisinger, *The Puritan’s Justification for Taking the Land*, 84 ESSEX INST. HIST. COLLECTIONS 135, 135–41 (1948).

<sup>75</sup> COHEN’S HANDBOOK OF FEDERAL INDIAN LAW § 1.02 (2005) (1941).

<sup>76</sup> *Id.* Despite devastating outbreaks of disease, the Indians would continue to outnumber the European settlers for several decades.

At the outbreak of the French and Indian War in 1754, treaty making assumed a new dimension, as each of the competing European powers sought to form alliances with the various tribes. The military importance of treaty alliances would continue throughout the Revolutionary War period as well. After the war, however, a powerful group of tribes who had sided with the British during the war confronted the founding fathers. Those tribes still maintained claims to the territory between the Appalachian Mountains and the Mississippi River. George Washington detailed his proposed policy for dealing with the Indians in a letter to James Duane, the head of the Committee of Indian Affairs of the Continental Congress.

[P]olicy and [economy] point very strongly to the expediency of being upon good terms with the Indians, and the propriety of purchasing their Lands in preference to attempting to drive them by force of arms out of their Country; which as we have already experienced is like driving the Wild Beasts of the Forest which will return as soon as the pursuit is at an end and fall perhaps on those that are left there; when the gradual extension of our Settlements will as certainly cause the Savage as the Wolf to retire; both being beasts of prey tho' they differ in shape. In a word there is nothing to be obtained by an Indian War but the Soil they live on and this can be had by purchase at less expence [sic], and without that bloodshed, and those distresses which helpless Women and Children are made partakers of in all kinds of disputes with them.<sup>77</sup>

Although many consider Washington's letter the founding document of American Indian policy,<sup>78</sup> its notion of Indians as "Savages" sits alongside the pragmatic necessity of entering into treaties with the Indians. As the newly formed United States began its inexorable march westward, the Indian lands usually were not taken by force but were instead ceded by treaty in return for, among other things, the

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<sup>77</sup> Letter from George Washington to James Duane (Sept. 7, 1783), in DOCUMENTS OF UNITED STATES INDIAN POLICY 1, 2 (Francis Paul Prucha ed., 3rd ed. 2000).

<sup>78</sup> See, e.g., WILLIAMS, *supra* note 12, at 44.

establishment of a trust relationship,<sup>79</sup> often in specific consideration for the Indians' relinquishment of land.<sup>80</sup>

Various political factions disagreed over whether tribalism could survive contact with white civilization and whether the appropriate course of action was to make the Indians assimilate into that society or to remove them beyond the reaches of that society.<sup>81</sup> Ultimately, notions of tribal inferiority prevailed, and Congress passed the 1830 Removal Act,<sup>82</sup> Sending dozens of tribes to the Indian Territory, often by force.<sup>83</sup>

While the formal existence of the United States began at a point in time when the prevailing policy recognized tribal sovereignty through the treaty-making process, such an orientation was not permanent. Once the removal process was essentially complete, responsibility for Indian affairs, along with the authority to negotiate on a government-to-government basis with the tribes, moved from the War Department to the Interior Department,<sup>84</sup> although such treaties still had to be ratified by Congress. In the 1870s, however, Congress ceased making treaties with the Indians<sup>85</sup> and instead developed a policy of allotting tribal lands to individual Indians,<sup>86</sup> characterizing the allotment program as a "mighty pulverizing

<sup>79</sup> The scope of the trust relationship is multi-faceted. "Many treaties explicitly provided for protection by the United States." COHEN, *supra* note 75, at §1.03[1]. *See, e.g.*, Treaty with the Creeks, Aug. 7, 1790, art. II, 7 Stat. 35. Treaty Between the U.S.A. and the Kaskaskia Tribe of Indians, Aug. 13, 1803, art. II, 7 Stat. 78. Other treaties provided the means for subsistence. *See, e.g.*, Fort Laramie Treaty, Sept. 17, 1851, art. VII, 11 Stat. 749 (providing for subsistence rations for the Sioux.); Treaty with the Western Cherokees, May 6, 1828, art. VIII, 7 Stat. 311. ("[E]ach Head of a Cherokee family . . . who may desire to remove West, shall be given, on enrolling himself for emigration, a good Rifle, a Blanket, and Kettle, and five pounds of Tobacco: (and to each member of his family one Blanket,) . . . a just compensation for the property he may abandon.").

<sup>80</sup> *See, e.g.*, Treaty with the Creeks, *supra* note 79, at 35; Treaty with the Kaskaskia, *supra* note 79, at 78; Treaty with the Western Cherokees, *supra* note 79, Fort Laramie Treaty, *supra* note 79.

<sup>81</sup> *See* Letter from President Jefferson to William Henry Harrison (Feb. 27, 1803), *reprinted in* Prucha, *supra* note 77 at 22. ("[O]ur settlements will gradually circumscribe and approach the Indians, and they will in time either incorporate with us as citizens of the United States, or remove beyond the Mississippi.").

<sup>82</sup> Removal Act, ch. 148, 4 Stat. 411 (1830) (current version at 25 U.S.C. § 174 (2000)).

<sup>83</sup> The Choctaws were one of the first tribes to be removed along what one of their chiefs described as a "trail of tears and death" *See, e.g.*, Gavin Clarkson, *Reclaiming Jurisprudential Sovereignty*, 50 KAN. L. REV. 473, 475 n.14 (2002).

<sup>84</sup> *See* VINE DELORIA, JR. & CLIFFORD M. LYTLE, *AMERICAN INDIANS, AMERICAN JUSTICE* 113 (1983).

<sup>85</sup> Treaty making with the Indians was ended by Congress in 1871: "[H]ereafter no Indian nation or tribe within the territory of the United States shall be acknowledged or recognized as an independent nation, tribe, or power with whom the United States may contract by treaty." Abolition of Treaty Making, 16 Stat. 544, 566 (1871), *reprinted in* Prucha, *supra* note 77, at 135.

<sup>86</sup> General Allotment Act of 1887, ch.119, §1, 24 Stat. 388. The statute is also known as the Dawes Act after Senator Henry L. Dawes of Massachusetts. While the

engine”<sup>87</sup> that would destroy tribalism and force Indians to assimilate into dominant society as individuals.<sup>88</sup>

If the policy objective of the Allotment Act was to improve the lives of the Indians, it was a colossal failure. By the 1930s it was clear that the United States needed to change its stance on tribal sovereignty again,<sup>89</sup> and Congress passed the Indian Reorganization Act of 1934 (“IRA”).<sup>90</sup> In an effort to reinforce tribal sovereignty, the legislation allowed tribes to adopt constitutions and to reestablish structures for governance.

Of particular interest was the provision in the IRA that allowed tribes to form corporations. While securities law reform was happening simultaneously, it appears that those involved in the IRA had little or no substantive interaction with those involved in the Securities Act of 1933 or the Securities Exchange Act of 1934.

Post-IRA federal treatment of the tribes was less restrictive, allowing for the popular election of tribal leaders according to tribal laws and constitutions.<sup>91</sup> Although Congressional policy had completely reversed itself by 1934—tribal sovereignty was now to be encouraged rather than destroyed—federal Indian policy would oscillate through one more cycle in the next half century<sup>92</sup> before President Nixon issued a landmark statement calling for a new federal policy of “self-determination” for

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Dawes Act represented the final, full-scale realization of the allotment policy, many treaties made with western tribes from 1865 to 1868 provided for allotment in severalty of tribal lands. See ROBERT WINSTON MARDOCK, *THE REFORMERS AND THE AMERICAN INDIAN* 213 (1971).

<sup>87</sup> In an address to Congress in 1901, President Theodore Roosevelt expressed his sense of the assimilation policy: “the time has arrived when we should definitely make up our minds to recognize the Indian as an individual and not as a member of a tribe. The General Allotment Act is a mighty pulverizing engine to break up the tribal mass [acting] directly upon the family and the individual.” Theodore Roosevelt, President of the U.S., Message to Congress (Dec. 3, 1901), in *A COMPILATION OF THE MESSAGES AND PAPERS OF THE PRESIDENTS 1789–1902*, at 315, 348 (George Raywood Devitt ed., Supp. 1903).

<sup>88</sup> See Gavin Clarkson, *Not Because They are Brown, but Because of Ea: Why the Good Guys Lost in Rice v. Cayetano, and Why They Didn’t Have to Lose*, 7 MICH. J. RACE & L. 317, 325 (2002).

<sup>89</sup> See, e.g., BROOKINGS INSTITUTION, INSTITUTE FOR GOVT. RESEARCH, *THE PROBLEM OF INDIAN ADMINISTRATION* (1928) (documenting the failure of federal Indian policy during the allotment period).

<sup>90</sup> 25 U.S.C. §§ 461-79 (2000).

<sup>91</sup> RUSSEL LAWRENCE BARSH & JAMES YOUNGBLOOD HENDERSON, *THE ROAD: INDIAN TRIBES AND POLITICAL LIBERTY* 209 (1980).

<sup>92</sup> The period between 1945 and 1970 is referred to as the Termination Era, and was characterized by the passage of number of statutes that “terminated” individual tribes—“these acts distributed the tribes’ assets by analogy to corporate dissolution and afforded the states an opportunity to modify, merge or abolish the tribe’s government functions.” BARSH & HENDERSON, *supra* note 90, at 132. Examples of this legislative activity include Act of August 13, 1954, ch. 732, 68 Stat. 718, and Act of August 3, 1956, ch. 909, 70 Stat. 963 (repealed 1978).

Indian nations.<sup>93</sup> By “self-determination,” President Nixon sought “to strengthen the Indian’s sense of autonomy without threatening his sense of community.”<sup>94</sup> Self-determination<sup>95</sup> led to an increase in economic development activity, but access to capital remained an impediment.<sup>96</sup> President Reagan also made an American Indian policy statement on January 24, 1983, stating his support for “self determination.”<sup>97</sup> In attempting to define “self-determination,” he stated:

Instead of fostering and encouraging self-government, federal policies have, by and large, inhibited the political and economic development of the tribes. Excessive regulation and self-perpetuating bureaucracy have stifled local decision making, thwarted Indian control of Indian resources and promoted dependency rather than self-sufficiency.<sup>98</sup>

In 1983 President Reagan established the Presidential Commission on Indian Reservation Economies. In 1984, the Commission published its Report and Recommendations again calling for a major shift in federal Indian policy.<sup>99</sup> The Commission promulgated recommendations in the following five categories: Development Framework, Capital Formation, Business Development, Labor Markets, and Development Incentives.<sup>100</sup> Pertinent to the instant inquiry, under Capital Formation, the Commission recommended: (a) allowing private ownership or management of tribal enterprises; (b) amending the Securities Act of 1933 to place tribes on the same footing as state and local governments; (c) amending the Tribal Tax Status Act to provide tribes with the same tax exemptions as state and local governments; (d) establishing an

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<sup>93</sup> RICHARD NIXON, PROPOSED RECOMMENDATIONS RELATING TO THE AMERICAN INDIANS—MESSAGE FROM THE PRESIDENT, H.R. Doc. No. 91-363, at 116 CONG. REC. 23258 (July 8, 1970). *See also* The Indian Financing Act of 1974, Pub. L. No. 93-262, 88 Stat. 77 (1974) (codified as 25 U.S.C. §§ 1451–1453). Perhaps the greatest of Nixon’s contributions to Indian tribal sovereignty was Public Law 638, which expressly authorized the Secretaries of Interior and Health and Human Services to contract with and make grants to Indian tribes and other Indian organizations for the delivery of federal services. The Indian Self-Determination and Education Assistance Act of 1975, Pub. L. No. 93-638, §3, 88 Stat. 2203 (codified as amended in scattered sections of 25 U.S.C.).

<sup>94</sup> Samuel R. Cook, *What is Indian Self-Determination?*, RED INK, May 1, 1994, available at <http://faculty.smu.edu/twalker/samrcook.htm>.

<sup>95</sup> The key legislation of this era includes: The Indian Self-Determination and Education Assistance Act of 1975 §3; The Indian Civil Rights Act of 1968 (current version at 25 U.S.C. §§ 1301–1341 (2000)); The Indian Financing Act of 1974 (current version at 25 U.S.C. § 1451 (2000)); and The Indian Child Welfare Act of 1978 (current version at 25 U.S.C. §§ 1901–1963 (2000)). *See generally* COHEN, *supra* note 75, at § 1.07.

<sup>96</sup> COHEN, *supra* note 75, at § 21.03[1].

<sup>97</sup> PRESIDENTIAL COMMISSION ON INDIAN RESERVATION ECONOMIES, REPORT AND RECOMMENDATIONS TO THE PRESIDENT OF THE UNITED STATES 7 (1984).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 25.

Indian Venture Capital Fund; (e) amending the Indian Loan Guaranty Fund and the Indian Finance Act to minimize the role of the Bureau of Indian Affairs; and (f) encouraging the private sector to invest in Indian country.<sup>101</sup>

Although some scholars are resistant to the notion that tribes should adapt and change in order to participate in the modern capitalist economy,<sup>102</sup> tribes have adapted to their environments for millennia, and the arrival of Europeans did not diminish that adaptability.

## V. REDUCING INFORMATION ASYMMETRY

In *Information Asymmetry and Information Sharing*,<sup>103</sup> my colleagues and I theorize that the directionality of the information asymmetry dictates a different strategic response in terms of resolving the asymmetry. Our research suggests that horizontal information sharing is a viable strategic response to the problem of horizontal information asymmetry. By sharing certain types of market information, tribal governments will be in a better position to identify and pursue local development opportunities in a much more cost-effective and timely manner. Such inter-governmental information sharing must overcome reluctance to share information, however, as contributing up-to-date information bears costs in resources and time, and governments may not want to disclose sensitive data they fear might compromise their interests or reputation. Nonetheless, a substantial body of literature has emerged analyzing the circumstances in which the self-interest of parties holding private information aligns with a collective interest in developing a public information good.<sup>104</sup> We similarly theorize that vertical information sharing would be required to alleviate vertical information asymmetry, as

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<sup>101</sup> *Id.* at 39–47.

<sup>102</sup> See, e.g., Robert A. Williams, Jr., *Documents of Barbarism: The Contemporary Legacy of European Racism and Colonialism in the Narrative Traditions of Federal Indian Law*, 31 ARIZ. L. REV. 237 (1989). Professor Williams criticizes the IRA and the notions of evaluating tribal corporations using westernized norms of corporate performance because such evaluations often highlight perceived differences between economic development in Indian Country and corporate America.

<sup>103</sup> Clarkson et al., *supra* note 3, at 828.

<sup>104</sup> See, e.g., Yu Yuan et al., *Individual Participation in Organizational Information Commons: The Impact of Team Level Social Influence and Technology-Specific Competence*, 31 HUM. COMM. RESEARCH 212 (2005); Janet Fulk et al., *A Test of the Individual Action Model for Organizational Information Commons*, 15 ORG. SCI. 569 (2004); Andrea B. Hollingshead & David P. Brandon, *Potential Benefits of Communication in Transactive Memory Systems*, 29 HUM. COMM. RESEARCH 607, 607–15 (2003); Andrew J. Flanagan, Peter Monge & Janet Fulk, *The Value of Formative Investment in Organizational Federations*, 27 HUM. COMM. RESEARCH 69 (2001); Peter R. Monge et al., *Production of Collective Action in Alliance-Based Interorganizational Communication and Information Systems*, 9 ORG. SCI. 411 (1998); GERALD MARWELL & PAMELA OLIVER, *THE CRITICAL MASS IN COLLECTIVE ACTION: A MICRO-SOCIAL THEORY* (1993). Much of this work centers on the specific problem of contributions of private or sensitive information to collective databases as non-excludable goods.

the necessary information could only be obtained through the cooperation of the information-rich.

While *Information Asymmetry*'s primary theoretical contribution is the development of the typology for categorizing information asymmetry along horizontal and vertical dimensions, I can now demonstrate the application of that typology in terms of actual strategic responses to information asymmetry with the real examples contained in the following sections. The first two examples illustrate information sharing that led to the development of arguments for regulatory or legal changes. The third example is a proposal for a system that will not only facilitate similar public policy endeavors, but will also directly impact the tribal finance marketplace.

A. *Horizontal Information Sharing and Accredited Indians*

As mentioned previously,<sup>105</sup> private enterprise in Indian Country is unable to get past the tipping point created by the exclusion of tribal investment capital and the concomitant reluctance of non-Indian investment capital. In *Accredited Indians*,<sup>106</sup> I describe encountering this tipping point first hand in 2005 when I joined the board of Native American Capital, the first ever native-owned, Indian Country focused, private equity fund. In addition to the Reg D hurdle, the tribes wanted to follow Wall Street's lead as they began to explore private equity, but Wall Street, cognizant of the handful of wealthy tribes, repeatedly asked, "Where is the tribal investment?"

Surprisingly, the regulatory change that could potentially push Indian Country past this private equity tipping point was simple and straightforward: amend Rule 501 of Reg D to include federally recognized Indian Tribes and their instrumentalities as accredited investors. The challenge, however, was to get such a proposed rule change on the agenda of the SEC. Working with my colleagues at Native American Capital, as well as our attorneys at Hughes Hubbard & Reed,<sup>107</sup> we developed a position paper that was submitted to the SEC in 2006.<sup>108</sup> We also began discussions with the SEC on the issue,<sup>109</sup> and we alerted the National Congress of American Indians (NCAI) to the need for a change. NCAI then in turn asked me to draft a "Red Paper,"<sup>110</sup> based in part on our original position paper, for presentation at the National Native American Economic Summit in Phoenix, Arizona in May of 2007.

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<sup>105</sup> Part III A *supra*, pp. 954–55.

<sup>106</sup> See Clarkson, *supra* note 39, manuscript at 6–7.

<sup>107</sup> Steven Paul McSloy and Paul Bernstein were instrumental in the identification of the Reg D issue and the subsequent development of the position paper.

<sup>108</sup> NATIVE AMERICAN CAPITAL, LP, *supra* note 44.

<sup>109</sup> Email exchange between Gavin Clarkson, Joe Falkson, and Gerald J. Laporte, Chief, Office of Small Business Policy, Securities and Exchange Commission (on file with author).

<sup>110</sup> As opposed to a White Paper. See Clarkson, *supra* note 62.



The intention of the Summit was to set the Bush Administration's Indian Country agenda for its final two years. Not surprisingly, proposals that were revenue neutral or, better yet, revenue enhancing, were of particular interest. Augmenting the position paper with an economic model that showed that amending Rule 501 would actually be revenue enhancing, my proposal was one of the ones that made it to the short list of recommendations.<sup>111</sup>

In part because the groundwork had already been laid, but also because of the result of the empirical data developed through horizontal information sharing, the SEC quickly responded to the Summit recommendation by incorporating my proposal into a larger set of amendments to Reg D.<sup>112</sup> The comment period closed on October 9, 2007, with no comments opposing the inclusion of tribes as accredited investors.

#### *B. Vertical Information Sharing and Tribal Bonds*

Even though information asymmetries do not directly limit the scope of tribal tax-exempt bonding authority, tribes do not have the data about either the total level of tribal bonding activity or IRS auditing activity. Thus it is difficult for tribal leaders to make an informed decision about how to proceed. Since Congress exercises plenary authority over Indian tribes, tribes must bring their grievances to Congress in order to get them resolved, but absent data, Congress would never have taken up this issue. Such vertical information asymmetries have prevented tribes from collecting the data necessary to advocate for a congressional remedy.

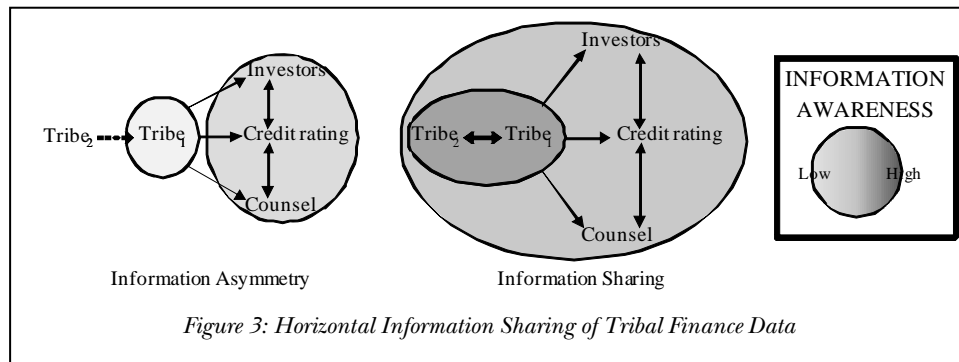
The information-poor tribes cannot obtain the necessary level of information to craft an appropriate response without the participation of the information-rich federal authorities, and thus the effectiveness of tribal participation in rectifying the clearly discriminatory levels of IRS enforcement activity against the tribes is significantly curtailed. If tribes are unable to form a clear picture of the problem, they cannot agitate effectively for legislative changes. This situation can properly be characterized as vertical information asymmetry, as data from the IRS is required to make the empirical case for change.

To determine the audit hazard rate for tribal bonds empirically, in April, 2006, my tribal finance research team and I met with officials and analysts from the Tax-Exempt Bond division of the Internal Revenue Service to discuss the issue of tribal tax-exempt bonds and to develop a research plan to examine whether or not tribal governments were subject to a disproportionate audit rate for their bonds. For this work, the IRS suggested examining a particular form that is filed by all governments,

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<sup>111</sup> DEP'T OF INTERIOR AND NAT'L CONG. OF AM. INDIANS, NATIONAL NATIVE AMERICAN ECONOMIC POLICY REPORT OF 2007, 14 (2007), *available at* [http://www.ncai.org/ncai/econpolicy/Summit\\_Policy\\_Report\\_Fnl2007NS.pdf](http://www.ncai.org/ncai/econpolicy/Summit_Policy_Report_Fnl2007NS.pdf).

<sup>112</sup> Revisions of Limited Offering Exemptions in Regulation D, 72 Fed. Reg. 45,116–45,126 (August 10, 2007).



including tribal governments, whenever they issue a tax-exempt debt obligation of any kind. When combined with data from a survey of bond lawyers, the data produced by the IRS analysts in response to specific inquiries led to the finding that between 2002 and 2005, 16.6% of all tribal bond indentures issued during that same period were audited, more than thirty-three times the 0.5% hazard rate for state and local bonds during the same period.

This data was only available through vertical information sharing, but once we had it, we were able to demonstrate that the audit hazard rate for tribal bonds in only their first four years after issuance is more than an order of magnitude greater than the lifetime hazard rate for state and local government bonds.

Fortunately, like the work on the accredited investor problem, that body of research has had some impact, as legislation was introduced<sup>113</sup> to remedy these restrictions following the presentation of the research to the Senate Finance Committee<sup>114</sup> and subsequent publication.<sup>115</sup>

### C. The Tribal Finance Information Clearinghouse

Our National Science Foundation-funded research (IIS 0534905) suggests a need for a new information infrastructure to facilitate inter-tribal sharing of market-relevant knowledge and financial information in order to alleviate additional horizontal information asymmetries that tribes currently face when attempting to access the capital markets. As a result, my research team is developing the Tribal Finance Information

<sup>113</sup> See Tribal Government Tax-Exempt Bond Parity Act of 2007, S. 1850, 110th Cong. (2007).

<sup>114</sup> *Encouraging Economic Self-Determination in Indian Country: Hearing Before the Subcomm. on Long-Term Growth and Debt Reduction of the S. Comm. on Finance*, 109th Cong. 1 (2006) (statement of Gavin Clarkson, Assistant Professor, University of Michigan School of Information, School of Law and Native American Studies), transcript available at <http://finance.senate.gov/hearings/35146.pdf>.

<sup>115</sup> See Clarkson, *supra* note 31, at 1009.

Clearinghouse (TFIC)<sup>116</sup> to aggregate and integrate market-relevant information provided by tribes. Figure 3 depicts how horizontal information sharing can alleviate horizontal information asymmetries confronting tribes. When Tribe<sub>1</sub>, Tribe<sub>2</sub>, etc. contribute to a collective information good, each can quickly assess the marketplace, identify comparables, and make decisions based on a set of information that is at least as complete as that held by external parties, such as investment banks, law firms, and credit rating agencies.

Preliminary data arising from this research and from tribal consultations indicate that tribal economic decision makers recognize the potential value of the horizontal sharing of financial information. The primary goal of the project is to provide an online financial information resource to tribal governments. Tribes will further benefit if organizations that service the tribal finance market are able to form a more complete understanding of the market. The TFIC will offer tribes and organizations servicing the tribal finance marketplace a web-based information system offering access to data sets that will reduce, if not eliminate, information asymmetry for tribal governments.

Several partners including the NCAI, the Native American Finance Officer's Association, the National Intertribal Tax Alliance ("NITA"), the National Association of Bond Lawyers ("NABL"), and a number of the most economically successful tribes are working closely with the project team to stimulate broad cooperation by tribal governments.

In consultation with tribal leaders, the IRS, and supportive organizations, the TFIC project team has developed a strategy to induce disclosure of IRS 8038 forms filed by tax-exempt bonds issuers. Tribal leaders suggest that building confidence in information sharing through limited disclosure about activities, without direct competition in the marketplace, is the most appropriate starting point. Tribal governments should benefit from a greater informational awareness about other issuers, and greater transparency should spur investors to compete to offer better terms to tribal governments.

As our research progresses, the TFIC project team will use a variety of techniques, including surveys, event history, and interviews, to test hypotheses about information asymmetry and successful information sharing strategies. Specifically, the project team will determine: (a) if differential information sharing practices create information asymmetry in the tribal finance marketplace; (b) if limited disclosure of low-risk financial information can catalyze additional and more granular inter-tribal information sharing; and (c) if using the TFIC can change perceptions about tribal economic development and investment opportunities including, but not limited to, tribes and their leaders. An information repository for a community of hundreds of tribes presents an unprecedented opportunity for academics, policy-makers, and others

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<sup>116</sup> Tribal Finance Information Clearinghouse ("TFIC"), <http://www.tribalfinance.org>.

to study an emerging market. Quite simply, there are research questions that will remain unanswerable until tribal governments begin sharing their knowledge and experiences.

## VI. CONCLUSION

As efforts succeed in removing the impediment of *access* to information technology, they may only uncover forms of information asymmetry that continue due to ingrained *practices* of information sharing. As shown in the tribal context, increased information sharing could help resolve information asymmetries impeding economic development in Indian Country. At the same time, poor informational awareness by tribes makes it difficult for them to demonstrate the cause and severity of their condition and coordinate responses. By selecting an information sharing response to a specific instance of information asymmetry based on whether that asymmetry is horizontal or vertical, tribes and entities assisting tribes can maximize the likelihood of alleviating the information asymmetry.

This typology of information asymmetry can be extended beyond the tribal context. In instances where a complete set of information exists among other underserved communities, including poor urban areas, remote rural communities, and other disadvantaged populations, these information-poor entities could use the strategy of horizontal information sharing to increase their abilities to overcome the challenges to their communities. In instances where an information-rich entity has information that does not exist among the information-poor, the information-rich must participate in the sharing in order to rectify the information asymmetry. Other examples include financial disclosure for SEC registered entities as well as the availability of the Freedom of Information Act and similar state laws to enable citizens to obtain information from the government. Although in these instances, the information-rich are compelled to provide information to the information-poor, the information-rich may also directly benefit from solving vertical information asymmetries, such as in the homeland security context. Thus, as in the tribal context, the directionality of the information asymmetry dictates the strategic response necessary for resolving the asymmetry.