



February 15, 2012

To: Members of the House Judiciary Committee

From: Kathleen A. Taylor, Kansas Bankers Association *KAT*

**Re: HB 2621: UCC Article 9 Amendments**

Mr. Chairman and Members of the Committee:

I appreciate the opportunity today to testify in support of **HB 2621**, which represents amendments suggested by the Uniform Law Commissioners to Revised Article 9 of the Uniform Commercial Code (UCC).

Of importance to the banking industry, is the Uniform Law Commissioners' efforts to provide clarity with regard to the name of an individual debtor. Courts, including Kansas courts, have struggled with determining whether a debtor's legal name is that reflected on his or her birth certificate, driver's license, passport or other identification.

The requirement under UCC Article 9 that a financing statement provide the debtor's name is particularly important. Financing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor's name.

There was a difference of opinion within the Drafting Committee as to the best approach on this matter. As a compromise, the Committee decided to provide states with two alternative sets of amendments relating to the names of individual debtors (Alternative A and Alternative B).

**HB 2621** contains Alternative A (sometimes called the "Only If Approach). Alternative A requires that a financing statement provide the name indicated on the individual's unexpired driver's license or identification card issued by the state of debtor's residence.

## HB 2621

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When a debtor does not hold an unexpired driver's license issued by the debtor's state of residence, the requirement can be satisfied in either of two ways: 1) a financing statement is sufficient if it provides the 'individual name' of the debtor; or 2) a financing statement is sufficient if it provides the debtor's surname (i.e., family name) and first personal name (i.e., first name other than the surname).

I was a part of the American Bankers Association Working Group on UCC Article 9 which studied both alternatives in detail. Composed of bank lawyers and state bankers association professionals, the Group had numerous conference calls over a two-year period. At the end of the day, we concluded that Alternative A was the best approach as it brings certainty and simplifies both filing and searching.

Particularly with respect to a debtor having the specified driver's license, the approach will provide greater certainty and more definition of the name. While neither alternative solves each and every problem with filing under a debtor's individual name, we believe that Alternative B would not have been a significant change from current law.

We are joined in this opinion by one of the foremost authorities on the Uniform Commercial Code, Barkley Clark, co-author of *The Law of Secured Transactions Under the UCC*. Please find attached, Clark's paper entitled "Four Reasons To Adopt Alternative A For Individual Debtor Names," in which he provides answers to the basic questions at issue.

UCC Section 9-801 provides for a delayed effective date of **July 1, 2013**. The hope is that the 50 state legislatures and the District of Columbia will have enacted the amendments by that time. The Legislative Note following the section highlights the importance of this effective date: "Because these amendments change the proper place in which to file to perfect certain security interests, it is particularly important that States adopt a uniform effective date...Any one State's failure to adopt the uniform effective date will significantly increase the cost and uncertainty surrounding the affected transactions."

The amendments have been introduced and are under consideration in 20 states plus Washington, DC. Eight states plus Puerto Rico have adopted UCC Article 9 legislation - eight have adopted the Alternative A approach (Indiana, Minnesota, Nebraska, Nevada, North Dakota, Puerto Rico, Rhode Island, and Texas). Connecticut and Washington generally use the Alternative B approach.

(3/17/11)

**AMERICAN BANKERS ASSOCIATION UCC ARTICLE 9 WORKING GROUP  
SECTION 9-503. NAME OF DEBTOR AND SECURED PARTY  
POSITION PAPER**

**Position:** The UCC Article 9 Working Group of the American Bankers Association representing banks and bankers associations nationwide supports the uniform adoption of Alternative A of Subsection (a) (4) of Section 9-503 of the 2010 Amendments to Uniform Commercial Code Article 9 (“Alternative A”).

Alternative A, unlike Alternative B, provides the most cost-effective, simple and certain method for lenders nationwide to identify the name of an individual borrower for the purpose of achieving a priority security interest in a borrower’s accounts, inventory, equipment and other collateral for which filing a financing statement is the preferred or necessary method of perfection under the applicable provisions of the Uniform Commercial Code (the “UCC”). Alternative A provides an easy-to-understand method for the secured lending community to follow when filing and searching against individuals, and is consistent with “know your customer” procedures already in place. By creating more certainty and simplicity in the filing and search process, lenders can expect cost savings, which may be of particular importance when dealing with low-margin secured loans to individuals.

**Background:** Banks and other lenders provide loans to individual borrowers, which loans are frequently business purpose loans to sole proprietorships secured by accounts receivable, inventory and equipment. To obtain a priority security interest in such collateral, the secured creditor most often has to file a UCC financing statement in the state where the borrower is located. This is not a consumer issue, as the type of collateral and method in obtaining consumer credit usually does not require the filing of a UCC financing statement.

The practical effect of filing a financing statement in these situations is two-fold. First, it establishes which secured creditor has the first priority interest in the collateral - the rule being that the first party to file the financing statement usually has the priority interest. Second, the filed financing statement provides notice to any potential new secured creditor that other secured parties have a prior filed interest in some or all of the borrower’s assets.

The UCC requires that the secured party identify the “name of the debtor” on the financing statement. When the borrower is an entity such as a corporation, determining the name is relatively easy, as there is an organic record of that name within the state where the entity was formed. For example, with a corporation that is a borrower, its name for filing purposes would be derived from the name listed in its filed Articles of Incorporation. But when lending to a sole proprietorship (an individual), the secured party has little statutory guidance as to the source for that name. Is it the name the individual goes by? Is it the name appearing on a tax return, a birth certificate, a social security card, a passport, a marriage license, a business card, a driver’s license or a state identification card?

Therein lies the problem for secured creditors today. Article 9 of the UCC does not clearly define what the name of an individual debtor is for these purposes. Lenders struggle to determine what name to file upon and also what name or names to search for in order to identify other secured parties who might have filed before them. Is a lender today supposed to ask for all of the documentation described above, search under all of the different names that the debtor goes by, and file financing statements under each name?

(3/17/11)

Alternative A states that the name on a financing statement filed against an individual debtor will only be sufficient if it provides the name indicated on the debtor's driver's license (if the debtor does not have an unexpired driver's license, then it is to provide the individual name or the surname and first personal name). For the lending industry, this is the clarity we have long sought. Since nearly all of our individual commercial borrowers will have a driver's license, there will finally be a definitive source that lenders can look to for the name of an individual borrower for UCC filing purposes.

The driver's license is already one of the primary components to verify an individual borrower's identity for "Know Your Customer"/Patriot Act purposes. It will not be uncommon nor unexpected to our customers that they be asked to provide us with a copy of their drivers license upon initiation of a loan or at a loan renewal. In those rare instances where a customer does not have a license or the customer had a license, but failed to renew it, Alternative A provides the other method mentioned above for determining the name of an individual that is to be shown on the financing statement.

Unlike the certainty provided by Alternative A, Alternative B allows more than one name of an individual to be used on a financing statement, which means that lenders who want to obtain a first priority security interest will continue to face uncertainty as to what names to search under. While Alternative B may be an improvement over current law in that Alternative B states that a lender who files against the name appearing on a debtor's driver's license will be perfected, it does not guaranty that filing under such a name will give the lender priority, because prior filings made by other lenders under other names may be sufficient under Alternative B. So, under Alternative B lenders can be expected to continue to deal with additional time, confusion and cost in defining an individual name for the purposes of filing and searching.

Proponents of Alternative B raise concerns about the implementation and effectiveness of Alternative A in certain circumstances. The ABA Working Group finds that the risks of these limited, if not rare, occurrences are outweighed by the advantages of Alternative A. The greater certainty afforded by Alternative A as to both perfection and priority of UCC filings should help lenders reduce their costs associated with filings, searches, legal fees and losses over time. All of this will be of particular importance to lenders who may be considering the smaller cost margin on loans to individuals and who may be trying to keep their efforts to file and search on potential individual borrowers to an absolute minimum. Also, under Alternative A, it is expected that lenders can be much more readily trained as to the simple and straightforward method of relying upon the name on a borrower's driver's license as the name to use for filing purposes.

After exhaustive discussions and canvassing of their representatives' concerns and interests over a two year period, the UCC Article 9 Working Group of the American Bankers Association strongly supports the uniform adoption of Alternative A.

ABA Working Group<sup>1</sup>

<sup>1</sup>The ABA Working Group consists of representatives of the American Bankers Association, long-time State Bankers Association General Counsel and government relations professionals, and counsel for a number of national and regional financial institutions.

## **FOUR REASONS TO ADOPT ALTERNATIVE A FOR INDIVIDUAL DEBTOR NAMES**

**\*Reason #1: Alternative A gives more certainty to filers and searchers.** Alternative A in the 2010 amendments to UCC 9-503 is called the "only-if" approach. It provides that a UCC financing statement properly designates the name of an individual debtor **only if** it indicates the name that appears on the debtor's driver's license. If the debtor has a current driver's license, use of any other name means that the security interest is unperfected. The great advantage of this bright-line rule is that it reduces compliance costs, the cost of credit, and litigation.

By contrast, the "safe-harbor" approach (Alternative B) continues the uncertainty that exists under current law because a variety of debtor names might be allowed by the courts. Under the safe-harbor approach, a court could find that a financing statement was sufficient, for example, if it contained the debtor's name as reflected on his or her (1) birth certificate, (2) driver's license, (3) passport, (4) tax return, (5) social security card or (6) bankruptcy petition. That's a lot of ships crowding into the "safe harbor". As a result, secured lenders must search under a variety of names to be sure they aren't trumped by an earlier filing under a different name—and even then, there's no certainty.

*A typical example.* As an example of problems created by the safe-harbor approach, consider this real-life scenario that arose in Texas about a year ago: Secured Creditor #2 files under the debtor's driver's license name and does a search under that name that reveals no prior security interest. Secured Creditor #2 is perfected because Texas has enacted a nonuniform amendment to Article 9 which adopts the safe-harbor approach. But perfection only protects Secured Creditor #2 from the debtor's trustee in bankruptcy; it doesn't assure **priority**. In the Texas case, a competing secured creditor (Secured Creditor #1) had filed earlier, using the name that appeared on the debtor's birth certificate. During its search, Secured Creditor #2 didn't pick up #1's security interest. A court could easily rule that the birth certificate name was a proper name for the financing statement, so that Secured Creditor #1 would prevail under the first-to-file rule. The bottom-line problem is that multiple debtor names could pass muster under Article 9. The Texas case was settled short of litigation, but it nicely illustrates the uncertainty brought by the safe-harbor approach. The harbor was not really so safe after all for Secured Creditor #2. The problems created by allowing multiple debtor names are eliminated by the only-if approach.

**Reason #2: An only-if approach for individual debtors is consistent with the UCC rules governing entity debtors, which have worked well over the years.** Under Article 9, a financing statement filed against a debtor organized as a corporation, LLC, LLP, or limited partnership perfects a security interest **only if** it uses the name that appears on the public organic record that gives birth to the entity as a legal person. That only-if standard was put into Article 9 in order to bring more certainty for filers and searchers. It has worked well. The same model should be used for individual debtors.

**Reason #3: The drafters of the 2010 amendments to Article 9 have eliminated most of the problems that raised concern about relying on driver's licenses.** During the drafting process for the 2010 amendments, the Joint Review Committee took great pains to resolve concerns raised regarding the use of a driver's license standard, particularly under an only-if approach: (1)

if the debtor doesn't have a current driver's license, then it is sufficient to use the debtor's surname and first personal name; (2) if for some reason the debtor holds two driver's licenses, the most recently-issued license controls; (3) if the driver's license expires, or the debtor gets a new license with a different name, the normal UCC rules governing change-in-name come into play and give the secured party a four-month grace period to refile the financing statement in the new name (with no deadline for presently-owned fixed assets like equipment); (4) the secured creditor will continue to have a second bite at the apple, i.e. the old name is okay if it would be found by a search under the new name, using the filing office's standard search logic; and (5) in response to concerns that some driver's license names could not be entered into the financing statement database because of incompatible character sets, field lengths and the like, the 2010 amendments include a "Legislative Note" urging the state legislatures to verify whether there are any compatibility problems of this sort; if there are, the delayed effective date of July 1, 2013 leaves plenty of time to make any necessary system adjustments. So far, no big problems of compatibility have surfaced. In short, Alternative A isn't perfect, but the drafters have done a good job of anticipating issues and resolving them.

**\*Reason #4: Those who deal with secured lending on a daily basis strongly support Alternative A.** The banking industry, under the auspices of the American Bankers Association, worked with the Joint Review Committee throughout its deliberations. Based on the hands-on experience of secured loan officers and other personnel around the country, the industry strongly supports Alternative A because of its efficiency, certainty and lower cost. Secured lenders around the country routinely use the debtor's driver's license as the baseline to comply with the "Know Your Customer" principle and the Patriot Act. For both UCC filing and searching purposes, they need a definitive source of debtor-name information, which is what the debtor's driver's license provides.

Because of frustration over the lack of certainty regarding individual debtor names and recurrent litigation, institutional secured lenders have pushed for nonuniform amendments to Article 9 that focus on the driver's license name. To date, four states—Texas, Virginia, Tennessee and Nebraska—have passed nonuniform amendments to Article 9 in response to the problem. Texas, which has the highest number of UCC filings, has been a leader in this effort. For several years, it has been working with a "safe harbor" standard similar to Alternative B. Now bankers from Texas are among the strongest voices urging a shift from safe-harbor to only-if.

Since most secured consumer lending transactions involve purchase-money security interests that are automatically perfected, or are perfected by noting a lien on a certificate of title, this is not a "consumer protection" issue. It is a secured lender issue, and the parties most strongly affected urge the only-if approach because of its certainty, simplicity and lower cost. The philosophy of the UCC from its beginning has been to recognize, codify and encourage industry practice, which is what Alternative A does. The more states that enact Alternative A, the more "uniform" the Uniform Commercial Code will be.

Barkley Clark\*

\*Co-author of *The Law of Secured Transactions Under the UCC*



## 2010 Amendments to UCC Article 9 Legislative Status

Updated & Current as of February 10, 2012

### Pending Bills:

State	Bill	Introduced	\$9-503(a) Option	\$9-521 Forms	Status
CO	HB1262	February 7, 2012	B	Omitted	In Judiciary Committee 2/7/12.
DC	B19-0222	April 5, 2011	A	Text	In Committee on Public Services & Consumer Affairs
FL	HB483	October 25, 2011	A	Non-Uniform	Passed House 2/3/12.
FL	SB1090	November 30, 2011	A	Non-Uniform	Passed subcommittee on 2/2/12. To full Budget Committee.
HI	HB2162	January 20, 2012	A	Text	Passed committee votes on 2/1/12. Status in House pending.
HI	SB2444	January 23, 2012	A	Text	To Judiciary Committee on 2/7/12.
IA	HSB619	February 7, 2012	A	Omitted	In Judiciary Committee. Hearing scheduled for 2/13/12.
IA	SSB3147	February 8, 2012	A	Omitted	To Judiciary Committee on 2/7/12.
KS	HB2621	February 2, 2012	A	Omitted	To Judiciary Committee on 2/3/12. Hearing scheduled 2/15/12.
KY	SB97	January 11, 2012	A	Incorporate**	Passed Judiciary Committee on 2/9/12 with amendments.
MD	HB713	February 7, 2012	B	Incorporate**	To Comm. on Economic Matters. Hearing scheduled on 2/21/12.
MD	SB748	February 7, 2012	B	Incorporate**	In Finance Committee.
MA	HB25	January 2, 2011	A	Text	In Joint Comm on Economic Development & Emerging Technology.
MI	HB5083*	October 18, 2011	A	Text	Passed House on 1/25/12. Sent to senate on 1/26/12. In Senate Committee on Banking and Financial Institutions.
NH	SB204	December 23, 2011	B	Text	In Commerce Committee. Next hearing on 2/14/12.
NM	HB303	February 1, 2012	A	Text	To House Rules and Order of Business Committee on 2/1/12.
OH	SB208	August 30, 2011	A	Text	Passed Senate 33-0 12/13/11. Pending in House.
OK	SB1219	January 18, 2012	A	Text	To Judiciary Committee on 2/7/12.
OR	HB4035	January 26, 2012	B	Incorporate**	To Business & Labor Committee. Hearing held on 2/1/12.
PA	HB2159	January 26, 2012	A	?	Pending - text still not available 2/10/12.
SD	HB1059	January 13, 2012	A	Images	Passed House on 2/1/12. To Senate Commerce & Energy Comm.



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TN	HB3150	January 25, 2012	A	Images	To Commerce Committee on 1/30/12.
TN	SB2931	January 25, 2012	A	Images	In Commerce, Labor & Agriculture Committee 1/30/12.
VA	SB51	January 4, 2012	A	Non-Uniform	Passed Senate on 1/27/12.
WV	HB4251	January 20, 2012	A	Omitted	Passed House on 1/27/12. In Senate Interstate Cooperation Comm.
WV	SB374	January 20, 2012	A	Omitted	To Committee on Interstate Cooperation on 1/20/12.
WI	AB549	February 8, 2012	A	Images	To Assembly Committee on Financial Institutions 2/8/12.
WI	SB416	January 31, 2012	A	Images	Passed Comm. on Financial Institutions and Rural Issues on 2/8/12.

\* Portions of the 2010 Amendments are contained in HB5051 and HB5082, which are bundled with HB5083.

\*\* Section 9-521 incorporates by reference the 04/20/2011 version forms approved by the ULC.





CORPORATION SERVICE COMPANY\*

## 2010 Amendments to UCC Article 9 Legislative Status

Updated & Current as of February 10, 2012

### Enacted 2010 Amendments Legislation:

State	Status	Date	Bill	§9-503(a) Option	§9-521 Forms	Effective Date
CT	Enacted	7/8/11	HB6274	B	Omitted	July 1, 2013
IN	Enacted	4/20/11	HB1321	A	Text	July 1, 2013
MN	Enacted	5/20/11	SB194	A	Omitted	July 1, 2013
NE	Enacted	4/14/11	LB90	A	Text	July 1, 2013
NV	Enacted	5/29/11	AB109	A	Omitted	July 1, 2013
ND	Enacted	4/4/11	HB1137	A	Omitted	July 1, 2013
PR	Enacted	12/21/11	C2965	A	1998 Rev.	December 21, 2012
RI	Enacted	7/1/11	HB5573	A	Omitted	July 1, 2013
TX	Enacted	5/17/11	SB782	A	Omitted	July 1, 2013
WA	Enacted	4/14/11	HB1492	B	Text	July 1, 2013

For additional information please contact:

Paul Hodnefield  
 Associate General Counsel  
 Corporation Service Company  
 (800) 927-9801, Ext 2375  
[phodnefi@cscinfo.com](mailto:phodnefi@cscinfo.com)