

Legislative Analysis



ALLOW PERSON TO CONTEST FRAUDULENT FINANCING STATEMENT

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House Bill 5934 as enrolled
Public Act 381 of 2008

House Bill 5935 as enrolled
Public Act 382 of 2008
Sponsor: Rep. Andy Coulouris

Senate Bill 1236 as enrolled
Public Act 383 of 2008
Sponsor: Sen. Roger Kahn

House Committee: Banking and Financial Services (SB 1236 discharged)
Senate Committee: Committee of the Whole
Second Analysis (1-28-09)

BRIEF SUMMARY: House Bill 5934 would create an expedited process by which a fraudulent financing statement could be terminated and make filing a false affidavit of fraudulent financing statement a felony; House Bill 5935 would place the statutory penalty for filing a false affidavit of fraudulent financing statement within the sentencing guidelines; and Senate Bill 1236 would establish a time period within which a financing statement having a transmitting utility named as a debtor would be effective, allow the Secretary of State to refuse to accept a filing under certain circumstances, replace the current filing form with a different one, and repeal a section of law requiring the Secretary of State to report annually on the operation of the filing office.

FISCAL IMPACT: The bills would have some fiscal implications for state and local governments. A more detailed discussion follows later in the analysis.

THE APPARENT PROBLEM:

Apparently, it is not uncommon for one individual to fraudulently claim that another person owes him or her money. If an individual files a false or fraudulent financing statement in order to injure another person by falsely identifying that person as a debtor, the person's credit record can be affected. In particular, because of their high profile positions, judges, police and corrections officers, and other public officials have been visible targets for those who feel a public employee has "done him or her wrong."

Public Act 212 of 2004, enrolled House Bill 5148, amended the Uniform Commercial Code to, among other things, require the Secretary of State to provide written notice of the filing of a financing statement filed with that office to any debtor identified in the statement, if the debtor is an individual. Public Act 212 also made it a felony for a person

to knowingly or intentionally file a false or fraudulent financing statement with the secretary of state, punishable by imprisonment for not more than five years or a fine of not more than \$2,500, or both. Those falsely identified in a financing statement can file a civil action seeking equitable relief and damages, and the court can, if the filer has been convicted of the violation, order the false record ineffective.

Reportedly, the civil action can take months to a year or more to complete, and the process to have the false lien removed can't be started until after the fraudulent filer was convicted of the criminal offense. Meanwhile, the fraudulent lien may remain on a person's credit record, making it difficult to qualify for loans to purchase a car or home, or even open a new cell phone account. Because some people may have multiple fraudulent financial statements filed against them, and because of the time and expense to clear the false statement from a credit record, legislation has been offered to create a process in which the termination of such statements could be expedited.

THE CONTENT OF THE BILLS:

According to the Department of State, a "financing statement" is a statement filed to perfect a security interest and provide a public notice of a security agreement between a debtor and a secured party. The financing statement describes certain types of collateral or property used as surety for the security agreement. In general, most financial statements are filed with the office of Secretary of State; in some instances, a filing is filed with a county register of deeds.

House Bill 5934 and Senate Bill 1236 are tie-barred to each other and to House Bill 5935; House Bill 5935 is tie-barred only to House Bill 5934. House Bill 5935 took effect December 29, 2008; the other bills will take effect March 29, 2009. A detailed description of each bill follows.

House Bill 5934

The bill would add a new section to the Uniform Commercial Code (MCL 440.9501a) to create an expedited process by which a fraudulent financing statement could be terminated.

Affidavit of false filing. Under the bill, a person identified as a debtor in a financing statement filed with the Secretary of State (SOS) could file an affidavit with the SOS stating that the financing statement was fraudulent. This provision would not apply to financing statements filed by a regulated financial institution or its representative. As used in the bill, "regulated financial institution" would mean a financial institution subject to regulatory oversight or examination by a state or federal agency and would include a bank, savings bank, saving association, building and loan association, credit union, consumer finance company, industrial bank, industrial loan company, insurance company, investment company, installment seller, mortgage servicer, sales finance company, or leasing company.

The SOS would have to terminate the financing statement effective on the date the affidavit had been filed. A fee could not be charged for filing an affidavit. The SOS would also be required to adopt and make available a form affidavit to give notice of a fraudulent filing statement. (Presumably, the notice referred to would be the notice required under the provisions of Public Act 212 of 2004 required to be sent by the secretary of state to individuals named in a financing statement that had been filed with the secretary of state.)

Notice of termination. The SOS would have to send notice of the termination of a financing statement to the filer of the financing statement advising the filer that the statement had been terminated; any filing fee paid for filing the financing statement would not be returned, regardless of whether the financing statement was terminated.

Reinstatement of financial statement. If the filer believed in good faith that the statement had been legally filed and was not fraudulent, the filer could file an action to reinstate the financing statement.

If the court determined that the financing statement should be reinstated or accepted, the court would have to provide a copy of its order to the SOS. The SOS would then have to file a record that identified by its file number the initial financing statement to which the record related and would have to indicate that the financing statement had been reinstated.

However, if the court determined the financing statement to be fraudulent, the filer of the statement would have to pay the costs and expenses incurred by the person named as a debtor in the financing statement in the action.

Penalty for filing false affidavit. An individual who filed a materially false or fraudulent affidavit would be guilty of a felony punishable by imprisonment for not more than five years, a fine of \$2,500, or both.

House Bill 5935

The bill would amend the Code of Criminal Procedure (MCL 777.14g) to specify that filing a false affidavit of fraudulent financing statement would be a Class E felony against the public trust with a maximum term of imprisonment of five years. The bill is tie-barred to House Bill 5934.

Senate Bill 1236

The bill would amend the Uniform Commercial Code (MCL 440.9515 et al.) to, among other things, repeal Section 9527. Section 9527 requires the SOS to report annually to the governor and legislature on the operation of the filing office. The bill would also delete from statute the model form currently used when filing a financing statement and would instead specify that a filing office could not refuse, unless otherwise authorized under the

act, to accept a written financing statement or amendment conforming to the current format prescribed by the National Conference of Commissioners on Uniform State Laws.

Expiration of a financing statement. In general, a financing statement is effective for five years; filing of a continuation statement extends this expiration by five years. There are some exceptions to this; for example, an initial financing statement filed in connection with a manufactured-home transaction is effective for 30 years.

Another exception states that a filed financing statement naming a transmitting utility as a debtor is effective until a termination statement is filed. The bill would revise this provision to instead specify that if a debtor is an organization identified as a transmitting utility and a filed initial financing statement so indicated, the financing statement would be effective until a termination statement was filed. (Underlining denotes new language.)

In addition, the bill would provide that a financing statement that was filed before the bill's effective date (March 29,2009), would be effective for a period of five years after the date of filing and could not be continued under this section of the act if the financing statement indicated either that 1) the debtor was an individual purporting to be a transmitting utility; or 2) the debtor was an individual showing his or her name as an organization and purporting to be a transmitting utility.

("Transmitting utility" is defined in the code as meaning a person primarily engaged in the business of 1 of the following:

- Operating a railroad, subway, street railway, or trolley bus.
- Transmitting communications electrically, electromagnetically, or by light.
- Transmitting goods by pipeline or sewer.
- Transmitting or producing and transmitting electricity, steam, gas, or water.)

Non-acceptance of a record for filing. Currently, a filing office must refuse to accept a record for filing for a reason set forth in Section 9516(2), and may do so only for the reasons listed in that provision. The bill would expand this provision to apply also to records filed with the SOS and lists in a new subsection, MCL 440.9520(5) the only reasons under which the SOS could refuse to accept a filing.

Subsection 5 provides that if a person presented a record to the SOS for filing or recording the SOS could refuse to accept it if one or more of the following circumstances existed:

- The record was not required or authorized to be filed or recorded with the SOS.
- The record was being filed or recored for a purpose outside the scope of Article 9 (Secured Transactions).
- The SOS had reasonable cause to believe the record was materially false or fraudulent.
- The record asserted a claim against a current or former employee or officer of a federal, state, county, or other local governmental unit that related to the

performance of his or her public duties, and for which the filer did not hold a properly executed security agreement or court judgment.

- The record indicated that the debtor and the secured party were substantially the same or that an individual debtor was a transmitting utility.

If a correction statement filed under Section 9508 alleged that a previously filed record has been wrongfully filed, the SOS would have to, without undue delay, determine whether the contested record had been wrongfully filed. In making the determination, the SOS could require the filer of the correction statement or the secured party to provide any additional relevant information so requested, including an original or copy of a security agreement related to the record. If the SOS determined the record to have been wrongfully filed, the record would be terminated, void, and ineffective. The SOS would have to notify the secured party named in the contested record of the termination.

Subsection 5 would not apply to a financing statement filed by a regulated financial institution or its representative. The SOS could request verification of regulation or licensing for out-of-state institutions attempting to file a financing statement.

Recourse if a record was refused. If the record was not accepted by the SOS for filing or recording, the person could bring an action to compel the SOS to accept it. A record ordered by the court to be accepted would be effective as a filed record from the initial filing date except as against a purchaser of the collateral which gives value in reasonable reliance on the absence of the record from the files.

Liability of SOS employee. A filing officer who improperly refused to accept a record for filing or recording under subsection 5 would not be personally liable for the improper refusal or determination – if the employee acted in a manner that did not subject him or her to personal liability under state statutes.

FISCAL INFORMATION:

House Bill 5934 would have minimal fiscal impact on the Department of State. Any impact would be related to increased administrative costs stemming from the bill's requirement that the secretary of state adopt and make available a form affidavit for use to give notice of a fraudulent filing statement.

Regarding the impact to the judiciary, there would be an indeterminate, if not negligible, fiscal impact on state or local government as any fiscal impact would depend on the number of court proceedings emanating from this amendment.

The impact on state and local correctional systems by House Bills 5934 and 5935 would depend on how they affected the numbers of felony convictions and severity of sentences. There are no data to indicate how many people might be convicted under the bills. The offense to be created by HB 5934 would be a Class E offense against the public trust. Under sentencing guidelines, the recommended range for an offender's minimum

sentence for a Class E offense varies from 0 - 3 months, for which a local sanction is required, to 17 - 30 months, for which a prison sentence is required.

To the extent that the bills increased the number of offenders sentenced to prison or to felony probation supervision, the state could experience increased costs. Average appropriated costs of prison incarceration are roughly \$32,000 per prisoner per year, a figure that includes various fixed administrative and operational costs. Costs of parole and probation supervision average about \$2,000 per supervised offender per year. To the extent that more offenders were sentenced to jail, affected counties could experience increased costs; jail costs vary by county.

Any increase in penal fine revenues could benefit local libraries, which are the constitutionally-designated recipients of those revenues.

Senate Bill 1236 would have a negligible fiscal impact on the Judiciary.

ARGUMENTS:

For:

Reportedly, the bills were offered to assuage the "paper terrorism", as one judge called it, that several judges have faced in recent years by disgruntled people who had been sentenced in their courts. For instance, several Saginaw County judges have reported multiple fraudulent UCC liens filed against them by individuals sentenced in their courts. One judge reported that he was unable to finance the purchase of a new car because of the false liens and resulting havoc to his credit score that the false liens created.

Even though Public 212 of 2004 allows a person to have the false lien terminated, it takes time to resolve the issue and requires hiring an attorney and paying court costs. Plus, the process is only triggered if the person who filed the false lien is convicted of doing so. Because of the nature of their jobs, public officials often make easy targets for those who feel they need to get even with the "system" and so may have multiple false liens filed against them.

House Bill 5934 would create an easy, efficient, and inexpensive way for a public officer or employee, or any individual, to have false liens terminated. The bill would also create a harsh penalty for filing a false affidavit claiming that a financial statement had been fraudulently filed: up to five years in prison and/or a flat fine of \$2,500.

Against:

Some believe that requiring the liens to be automatically terminated upon receipt of an affidavit, without further investigation into the merits of the affidavit's validity, could result in many legitimate liens being terminated. Though House Bill 5934 would allow a lien to be reinstated, the filer of the lien would have to mount a court challenge. Though the bill does include a felony penalty for filing a false affidavit claiming the financing statement was bogus, it could be argued that if the amounts in question were small, the temptation would be greater for the person named in the financing statement to deny a

legitimate claim, believing the filer to be less likely to pursue the matter to have the claim reinstated in light of the additional court costs.

Response:

The provisions of Senate Bill 1236 mitigate the concerns raised above. One complaint about these false liens has been that some are so clearly fraudulent, they never should have been accepted by filing officers. The bill addresses this problem by setting forth circumstances under which an SOS employee could refuse to accept a record for filing or recording. Thus, clearly inappropriate and fraudulent filings will be nipped early on. The bill also includes a mechanism by which a legitimate filing that was denied could go forward. It is conceivable that someone named in a financing statement may falsely refute it, taking the chance that the filer will not be willing to put in the time and costs to substantiate the filing, but at what a cost! The risk of a felony record, with all the damage to reputation and opportunities that entail, is a strong deterrent to that course of action.

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