In Brief

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The 2010 Amendments to Article 9 of the Uniform Commercial Code

The 2010 Amendments to Article 9 are a tune-up for the digital age when computer name searches demand precision, chattel paper and vehicle titles may reside in a computer, and collateral is auctioned online. Other changes stem from problems that have arisen in practice since July 1, 2001.

Correction Statements

One of the practice problems relates to correction statements. Filing a correction statement was available only to a debtor and provided notice of an unauthorized filing. The secured party, who may have been subject to an unauthorized amendment, such as a termination, did not have the same right. The amendments rename the "correction statement" an "information statement" and allow a secured party to file an information statement if it believes an amendment was not authorized. However, the secured party is not required to police its financing statements for unauthorized financing statements and file information statements.

Online Auctions

Some of the changes in the 2010 Amendments are found in the Official Comments. The philosophy of the drafting group was that if a change in the Official Comments would remedy an issue, the black letter law would remain untouched. That was the situation with Part 6 and online auctions of collateral. The Official Comments are amended to provide that online auctions are an available means of disposition and that the safe harbor forms of notice can be amended for use in an online sale. The amendments specify that the time of the sale is the time the electronic disposition is scheduled to begin. The place is the Uniform Resource Locator (URL), or other Internet address, where the site of the public disposition can be accessed.

Debtor Names

The issue of debtor names was the primary driver of the revision process. For registered organizations the current name standard is the name as it appears in the public record of the office in which the organization was formed. However, the question arose of what is the public record: the database of the office or the actual documents on file? The 2010 Amendments answer the question in favor of original documents by creating a new defined term, "public organic record", meaning the records initially filed with or issued by a government in the formation of an organization, including both paper and electronic filings.

Better guidance is also provided for the name of common law trusts: the name of the trust as provided in the trust's organic records if the name is indicated there, otherwise the name of the settlor or testator together with sufficient additional information to distinguish a particular trust from others held by the same settlor or testator.
The most significant problem with debtor names arose from individual names. After four states offered their own

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non-uniform legislation to determine the proper individual name under which to file, it was decided that a uniform approach was necessary. The Joint Review Commission provided two solutions to this problem in the 2010 Amendments from which the states must choose.

Alternative A is the "only if" test. It provides that "if the debtor is an individual to whom this State has issued a [driver's license] that has not expired," the name of the individual debtor is stated correctly "only if" it provides the name from the license. If the individual does not hold an unexpired driver's license, the fall back is to perfect under the individual's name or surname and first personal name. Many financial institutions prefer this alternative as it gives guidance on the search side of the secured transaction as well as the filing side. This is the alternative adopted in Kentucky.

Alternative B is known as the "safe harbor" option. It provides that if a secured party perfects under the "individual name of the debtor; the surname and first personal name of the debtor; or provides the name which is indicated on a [driver's license] that this State has issued to the individual which has not expired;…" the name is sufficient to satisfy the sufficiency test as a matter of law. Perfection under Alternative B will establish priority as to lien creditors (e.g., the trustee or debtor in possession), but it does not rule out prior perfection under some other form of the individual's name (birth certificate, passport, etc.) by another secured party, meaning priority among secured parties can remain an issue under the first to file or perfect rule of 9-322.

The driver's license test was selected in both alternatives because identification of customer rules ordinarily result in a copy of the driver's license being obtained by the secured party. There is also a new and extensive Official Comment for 9-503 to aid filers in the use of the new name standards for individuals, particularly for individuals whose names do not follow standard Anglo-Saxon naming conventions.

Transition Rules

The transition rules provide for a 5 year transition period with rules very similar to those of the transition to Revised Article 9. In general, a secured party need not do anything to amend a filing on an individual name until it is time to continue or amend an existing financing statement. However, to avoid any issue as to whether an existing financing statement properly states an individual's name, it might be wise to review and amend prior to the statutory deadline.

Effective Date of 2010 Amendments

The model effective date for the amendments is July 1, 2013. However, an issue arose in Kentucky as to the effective date, which is described in the legislative note appearing after each section of Article 9 that was amended. In summary, there was a difference in the effective dates of the Article 9 revisions, which was intended to be July 1, 2013, but may arguably be July 12, 2012arguably July 12, 2012, and the transitional Article 9 changes, which is July 1, 2013. The legislative note recognizes the model effective date and references the Opinion of the Attorney General, 12-010, issued July 3, 2012, stating that a "manifest clerical error" occurred in the drafting as it relates to the effective date of the substantive revisions. The L.R.C. admits it was a clerical error; however, it does not agree that the error rises to the standard of "manifest clerical error" for it to make the change in the non-codified section of SB97. Although the Attorney General has found the effective date of the entirety of the 2010 Amendments in Kentucky to be July 1, 2013, out of an abundance of caution, there is likely to be a "fix it" bill run early in the 2013 legislative session.

Properly Perfecting a Security Interest Under the 2010 Amendments.

As noted, Kentucky adopted Alternative A, so financing statements on individuals should be filed under the name appearing on a valid driver's license most recently issued by the Commonwealth. If the individual does not have a valid driver's license, the individual's surname and first given name should be used. Since an individual's driver's license might lapse during the pendency of the filing, we recommend preparing the financing statement as though it is filed on three different debtors: i) the name on the driver's license; ii) the surname and first given name; and iii) any other name by which the individual may generally be known in the community. Using the example of John Anthony Smith, who goes by Tony Smith, whose current driver's license is under John A. Smith, and who does business under Anthony Smith, the prudent secured party would file under John A. Smith, John Smith, Tony Smith and Anthony Smith.

Should an individual debtor's valid driver's license lapse, or should the debtor change his or her name on the license, it is treated as a name change for the debtor. Section 9-507 requires an amendment to correct the debtor's name within 4 months of the date of the name change. Secured parties will have to develop their own policies on policing name changes.

For registered organizations, obtain a copy of the actual organizational documents and any name change amendments filed with the Secretary of State. It is the name as it is reflected on the "public organic record" that will control whether a secured party has filed under the correct name.

The New Safe Harbor Forms for Financing Statements and Amendments

Changes were required to the forms of 9-521 because of the 9-503 amendments regarding the form of individual names and the 9-516 amendments deleting the right of a filing officer to reject a filing if it does not contain information about debtors that are registered organizations. The safe-harbor financing statement is amended to work with both alternatives for individual names. However, as a result of software issues, Kentucky and many other states were unable to replicate the updated forms in the statutory text. Consequently, Kentucky has adopted the forms by specific reference to the official text of Article 9. The Secretary of State will amend the online template to reflect the changes in 9-503 and 9-516.

The Amendments have been enacted by 29 states and Puerto Rico. All states surrounding Kentucky, except Missouri (and an enactment effort is under way there), have enacted the Amendments and, specifically, Alternative A.

Melinda T.Sunderland
Shareholder

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Shareholder

** John T. McGarvey was a member of the Joint Review Commission and on the Uniform Law Commission's Uniform Commercial Code, Article 9, Drafting and Enactment Committees*

Time to Review Your Bank Secrecy Act Compliance.

Originally enacted in 1970, the Bank Secrecy Act ("BSA") has again become a focal point of federal bank examiners as part of the government's efforts to combat money laundering activities and the funding of terrorism. Recent trends indicate that examiners are scrutinizing financial institutions' compliance with the BSA and, in at least some instances, are assessing substantial penalties when violations are identified. Specifically, within the past two years, a number of large financial institutions have been subjected to cease-and-desist orders and have been fined for their failure to comply with the BSA.

Immediately after the September 11, 2001, attacks, Congress enacted a number of amendments to the BSA as one way of counteracting terrorism. The 2001 amendments criminalize the financing of terrorism, strengthen customer-identification procedures, require inquiry into sources of funds in some loan payoffs and sales of bank collateral, prohibit financial institutions from engaging in business with foreign shell banks, require financial institutions to have due diligence procedures (and, in some cases, enhanced due diligence procedures for foreign correspondent and private banking accounts) and improve information sharing between financial institutions and the U.S. government. Regulations interpreting and enforcing these changes became effective in 2011.

There are several notable examples of bank examiners' increased focus on BSA compliance. In April of 2012, the OCC issued a cease-and-desist order against Citibank, N.A., ordering that the bank institute comprehensive corrective actions to improve its BSA compliance program. In August of 2011, JPMorgan Chase Bank was fined $88 million for BSA violations related to $178 million in wire transfers involving Cuban nationals and the issuance of a letter of credit for a transaction involving an Iranian tanker ship. In 2010, Wachovia Bank agreed to pay $160 million as a combined penalty and forfeiture for its BSA violations, which included illegal wire transfers, bulk cash deposits and remote deposit capture services it had provided to Mexican currency exchange houses. The same year, the OCC filed a consent order against HSBC Bank USA ("HSBC") for failure to implement adequate BSA controls. Deficiencies included failure to monitor wire transfers initiated by customers in certain countries, failure to collect customer due-diligence data, consistently late reporting of Suspicious Activity Reports, and failure to designate high-risk customers. Thus far, HSBC has not been fined for its violations. These recent actions are a clear indication that examiners are refocusing on BSA compliance.

With the new regulations and recent enforcement efforts, it is important that financial institutions review their compliance procedures and ensure that those procedures properly address the 2001 statutory changes and the 2011 regulations. Failure to properly comply puts a financial institution at risk for both a fine and a forfeiture of the funds involved in the act that violated the BSA.

Sarah S. Mattingly
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Clyde H. Foshee Jr.
Of Counsel

Happy Holidays!

At this time of year, we enjoy the opportunity to remember those whom we have had the personal and professional pleasure of working with during 2012. To each of you, we express our most sincere appreciation for the trust and confidence you have placed in our firm. We are excited about 2013 and the opportunity to continue to work as part of your team.

Our offices will be closed on Monday afternoon, December 24, and on Christmas Day, December 25.

From all of us at M&P

M&P Wins Kentucky Supreme Court Ruling in Favor of Bank Lenders in Dispute Against Tax Bill Purchasers

On September 20, 2012, the Kentucky Supreme Court unanimously ruled that a mortgagee bank has standing to contest the charges and fees that a private real estate tax bill purchaser claims to be owed after purchasing the unpaid tax bill from the taxing authorities. In *Tax Ease Lien Investments 1, LLC v. Commonwealth Bank & Trust*, No. 2011-SC-277-DG, Tax Ease brought a lawsuit to enforce tax liens it had purchased on property mortgaged to Commonwealth Bank. Without any advance notice to Commonwealth Bank, Tax Ease persuaded the property owner to tender to the Circuit Court an "Agreed Judgment" approving various administrative charges and legal fees being added to the tax bill and declaring that these sums, along with the unpaid taxes, were prior to Commonwealth Bank's mortgage. When Commonwealth Bank learned of this filing, it promptly objected claiming that it was entitled to advance notice and the right to challenge the fees. When the Circuit Court refused to give Commonwealth Bank "standing" to make such a challenge, Commonwealth Bank appealed. With the backing of the Kentucky Bankers Association and the assistance of Commonwealth Bank's local counsel, the case ultimately reached the Kentucky Supreme Court. M&P attorneys argued Commonwealth Bank's position before the Kentucky Supreme Court, which unanimously ruled that "Commonwealth Bank has first-party standing" to "contest the monetary amount awarded in the Agreed Judgment."

M&P regularly assists bank mortgage lenders in protecting their mortgage collateral and other creditor rights. We are pleased to have helped in obtaining a published decision of the Kentucky Supreme Court recognizing that mortgage lenders have "standing" to preserve these rights.

Thurman Senn
Of Counsel

Firm News

M&P is pleased to announce:

Morgan McGarvey was sworn in on December 4, 2012, as the Kentucky State Senator for District 19.

M&P has received a Tier 1 ranking in the 2013 Edition of U.S. News – *Best Lawyers* "Best Law Firms".

Morgan McGarvey has been named to the Prichard Committee on Teacher Effectiveness.

Dan Kubacki has joined the firm as Of Counsel. Kubacki is a 2002 graduate of the DePaul University College of Law. He also obtained his MBA in 2002 from DePaul University, Kelstadt Graduate School of Business. Kubacki's practice will be concentrated in the area of retail and commercial collections. He is licensed to practice in Illinois and Florida. Kubacki can be reached at 502-589-2780 or dkk@morganandpottinger.com.

In other news:

Tom Coffey has been named to the Board of Directors for the Brain Injury Alliance of Kentucky.

John McGarvey and **Thurman Senn** were presenters at the 32nd Annual Conference on Legal Issues for Financial Institutions hosted by the University of Kentucky College of Law.

Mindy Sunderland has been named Chairperson of the Eastwood Fire District Board of Trustees.

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