

MEMORANDUM

To: Uniform Law Commissioners Revised Article 9 Review Committee

From: Susan E. Collins*

Agreed with and approved by:**

**State Bar of Texas Business Law Section
Uniform Commercial Code Committee Members:**

Karen M. Neeley
W. David East

ULC Revised Article 9 Review Committee Observers:

Bob Downey
Robert Zadek

Date: May 27, 2009

Re: Support for an “only if” limited “waterfall” approach to individual debtor names

The views expressed here are those of the individual indicated and do not necessarily represent the views of the individual's employer or groups with whom the individual may be associated. No formal approval by the Texas Business Law Section Council or others for the positions expressed has been sought yet at this point in the debate.

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Robert Zadek focuses his practice on matters involving factoring, asset-based lending, purchase order financing, commercial loan documentation, trade finance and letters of credit, loan workouts and bankruptcy. Mr. Zadek is a past Chair of the Commercial Financial Services Committee of the Section on Business Law of the American Bar Association. He served on the Executive Committee of the Business Law Section of the State Bar of California and Chaired its Uniform Commercial Code Committee. He has served as an attorney advisor on the American Law Institute committee to revise the Restatement of the Law of Suretyship, and was an advisor to the Drafting Committee on Revision of Article 9 of the Uniform Commercial Code. Mr. Zadek's column, "You Be The Judge," is a regular feature in *The Secured Lender*, the journal of the Commercial Finance Association. He co-authored "Insurance Considerations" in *Asset-Based Financing – A Transactional Guide*, published by Matthew Bender & Company. He was a faculty member at Rutgers University School of Law, teaching a course on secured transactions. He also is a former faculty member at both Hofstra and Adelphi Universities. In addition, he teaches workshops across the country on loan documentation issues and was named "Educator of the Year" by the Commercial Finance Association for his course, "Negotiating, Documenting and Administrating Asset-Based Loans." Mr. Zadek is a former Vice President and Senior Counsel at Wells Fargo Bank, San Francisco, and is a certified public accountant. He can be contacted at RZADEK@Buchalter.com or by phone 415-227-3585..

Note: This memo assumes a familiarity with the history of the R9 Review Committee discussions and the Interim Drafts.

This memo aspires to “sharpen the issues” (using Ed Smith’s phrase) relating to individual debtor names by (1) discussing priority, comparing the “safe harbor” to the “only if” approach, (2) discussing a workable transition and (3) discussing perfection, using a limited “waterfall” (a prioritized list of names).

Here is the proposed “only if” limited “waterfall” approach recommended, succinctly stated:

Proposed uniform amendment to 9-503(a):

(4) if the debtor is an individual who has an [unexpired or valid: use of some word intended to mean valid at the time of filing, which is consistent with when other Section 9-503 names are ascertained] state-issued driver’s license or, if no driver’s license, an [unexpired or valid] state-issued identification certificate, only if the financing statement provides the individual’s name shown on such [unexpired or valid] driver’s license or identification certificate; and

(5) [note: the current uniform rule follows] in other cases:

(A) if the debtor has a name, only if the financing statement provides the individual or organizational name of the debtor; and

This approach provides the most simplicity and certainty to both filers and searchers following a workable transition.

Texas is the number one state as to UCC financing statement filing volume, based on information verified for the author by Randy Moes, Director of Uniform Commercial Code, Texas Secretary of State, followed by California, New York, Florida and Delaware (in that order, in rounded numbers based on calendar year 2007). For the period from May 1, 2008, to May 14, 2009, Texas had 147,156 individual (53%) and 131,508 business (47%) names indexed.

The hope of this memo is to influence the national debate towards this “only if” limited “waterfall” approach as a uniform solution, as opposed to potential non-uniform Texas action in 2011. This memo will first advocate the “only if” approach as the best choice among the several possible approaches being considered, then will discuss shaping that particular approach through suggestions for a workable transition and use of a limited “waterfall” for perfection purposes.

This memo does not address individual debtor name and location changes because those issues permeate all possible approaches. Those issues can be resolved only through increased “know your customer” due diligence by secured parties for the entire category of non-public-record debtors, including not only individuals but also trusts, decedents and general partnerships.

1. PRIORITY under an “only if” approach

The “safe harbor” approach adopted in Texas in 2007 and subsequently by Tennessee and Virginia does not move the dial enough to give the secured party priority on anything other than a perfectly clean lien search.

Consider a hypothetical lien search pulled by a 22 year old clerk in connection with a new loan on an unlaywered deal for an individual debtor named “Brooks Louis Dickerson” on his driver’s license. On a “wild card” lien search using a commercial vendor, there are two prior filings showing up in the names of “Brooks L. Dickerson” and “Louie Dickerson” corresponding to the same individual.

For all purposes of this hypothetical, let’s assume “Brooks L. Dickerson” and “Louie Dickerson” would not show up on a filing office standard search logic search under Section 9-506 and that neither of those names was a prior valid driver’s license name for that individual at the time of those filings.

Under both the current uniform rule of Section 9-503 (the “do nothing” approach) or under a “safe harbor” approach, a judge could find either or both of “Brooks L. Dickerson” and “Louie Dickerson” to be sufficient names, thus having priority over a driver’s license name filing. The hypothetical is a variation of facts in People’s Bank v. Bryan Brothers Cattle Company, 504 F. 3rd 549 (5th Cir., 2007).

Under an “only if” approach, after a workable transition, the 22 year old clerk pulls the same lien search. She can then – and only then -- safely conclude with certainty that neither “Brooks L. Dickerson” or “Louie Dickerson” are sufficient and that a filing under the driver’s license name, “Brooks Louis Dickerson,” will have both perfection and priority (again, given the same two assumptions above combined with the workable transition below).

2. Workable transition

What would be needed for a workable transition rule as to priority for an “only if” approach? If, under an “only if” approach, after a workable transition period, the lien search reflects that, pursuant to transition rules, the filings under the names of “Brooks L. Dickerson” and “Louie Dickerson” had been amended by a financing statement amendment during the transition period to be the driver’s license name, then there is a question of priority to be addressed under the transition rules (again, given the same two assumptions above). Under the uniform priority rules of Section 9-322, would the driver’s license name filings have priority (1) in the order of the original filing (which may turn on the question of whether they were then a sufficient filing) or (2) as of the date of the amendment pursuant to the transition rules (which the author recommends, to give the 22 year clerk the certainty needed during the transition period). So a workable transition rule for an “only if” approach might state that effectiveness as to priority hinges on when the filing stated the driver’s license name.

An “only if” approach at its best needs not only a workable transition period but also uniformity among the states (thus the Texas desire for effective uniform action). Revised Article 9 provided a 1-year transition period to “fix” names to be sufficient under Section 9-503. Ideally, the new uniform rule would have a suggested uniform effective date (perhaps too much to dream of, but ideal for secured parties with a multi-state presence) and a 5-year transition rule, so secured parties could “scrub” their portfolios in the normal course of doing continuations, if not earlier upon renewals. A global portfolio review or a 1-year period is impractical for most large volume secured parties.

A workable transition is the best answer for secured parties not currently filing in the driver’s license name for those individual debtors who have one. Those secured parties are currently at risk in any event if they are not currently filing in either the driver’s license name and/or all possible individual name variations. The “only if” approach, combined with the workable transition detailed here, gives certainty to both filers and searchers as to priority.

3. PERFECTION under a limited “waterfall” approach

Secured parties need certainty as to perfection and priority when one individual (with no name or location changes) has a variety of possible names. That is the problem that needs to be solved, not the problem of debtor changes, which is for the most part irresolvable except, as noted above, by due diligence. The limited “waterfall” approach discussed below yields certainty for the vast majority of individual debtors seeking credit secured by accounts, inventory and equipment. It is simple enough that a 22 year old clerk can understand it.

The author notes that a “true” or “real” legal name for an individual would be based on the same sorts of primary documents the issuers look at in issuing a driver’s license name as the highest level of a “waterfall.” Section 9-503 seeks to relieve searching creditors of the burden and duty to search for trade names or nicknames such as the name an individual may be known by in

the community (or a DBA for a registered organization), as opposed to what a provable legal name for an individual should be as based on primary documents.

Driver's licenses. All approaches (other than “do nothing”), including this one, have driver's licenses as the highest level “waterfall” name for individual debtors. A number of related questions have come up over the course of the discussions. With the help of Carl Ernst, the author has located the individual who publishes the guide for driver's licenses (similar to Carl's publications in the UCC arena) and who liaisons with those public agencies. His contact information follows:

Mike Sankey
480-829-7475
msankey@brbpub.com

Mike and Carl are making this publication's webpage available, *gratis*, for purposes of our discussion of these issues. Access information follows:

mvrdecoder.com
User (Mike set up all users to use Author Collins's email address for access): susan.e.collins@jpmorgan.com
Password: ucc (all lower case)

Mike has set this up so 10 users from our groups can be on simultaneously with this login information and can increase that number if needed.

Based on Mike's information, it appears that 87% of the total population has a driver's license. See <http://www.fhwa.dot.gov/policy/ohpi/qfdrivers.cfm> Highway Statistics, 2006, the second chart, Licensed drivers--Ratio of licensed drivers to population (DL-1C).

Mike walked the author through the webpage on the phone in response to other questions and would be happy to do so for others. The following points are worth noting:

- (a) *It's against the law to have multiple licenses, and safeguards are in place.* A 50 state “one driver one license record system” has evolved within the last 10 years or so, that has made multiple licenses a non-issue. On the log-in page, go to the 3rd bullet point: Programs and Agreements Affecting Motor Vehicle Records, especially page 360, detailing the various compacts, etc. The concept of “SOR,” or “state of record,” is important, including a requirement that states have to transfer records to a new state. In Mike Sankey's words to the author: “So granted, just because it is against the law does not mean that people won't try to get away with this. But the reality and practicality is that there are a myriad of federal agencies and state agreements in place to insure this does not happen – that a state will not issue a license to a person licensed in another state.” He adds, the text below is taken or summarized from portions of The 2009 MVR Book and is found at the web page as well:

For example, the American Association of Motor Vehicle Administrators (AAMVA) has been instrumental for helping states to comply with federal statutes. Founded in 1933, the AAMVA is comprised of administrators and public service executives who are responsible for motor vehicle administration, driver licensing issues, and the enforcement of state and national laws that govern the safe use of vehicles in the United States and Canada. AAMVA has long worked to govern the one state-one license issue.

Another example is the National Driver Register (NDR) which functions under the control of the National Highway Traffic Safety Administration, an agency of the U.S. Department of Transportation. The NDR is a

national repository for information on problem drivers. One purpose of the NDR is to prevent the issuance of a driver's license to drivers whose licenses have been withdrawn or denied. State motor vehicle agencies provide NDR with names of individuals who have lost their driving privilege or who have been convicted of a serious traffic offense. Before issuing a license, states query the NDR to determine if the applicant has revocations, suspensions, denials or cancellations in other states. The states use NDR to access the Problem Driver Pointer System (PDPS) and for the Commercial Driver License Information System (CDLIS).

The Driver License Compact (DLC), developed in 1961, gives states the means for a cooperative method to control problem drivers through the use of consistent reporting devices and the exchange of information contained in driver records. The Compact procedures include the reporting of convictions for major moving violations to a driver's home state and **requiring the surrender of all other states' driver licenses before the issuance of a new license**. Thus, the major objective is to promote the one state-one license concept.

However, the author would note <http://www.fhwa.dot.gov/policy/ohpi/qfddrivers.cfm> Highway Statistics, 2006, the third chart, Licensed drivers, by sex and percentage in each age group (DL-20), reflects that some states have in excess of 1,000 licensed drivers per 1,000 driving age population (see Alabama, Connecticut and Vermont).

- (b) *Public record verification.* 17 states allow the public to verify driver's license numbers, within privacy parameters, many for free. For an example, on the log in page drop down menu, select Minnesota from the first drop down and "Driver Related Records" from the second drop down, and go to "Accessing Driving Records." So within the category of non-public-record debtors such as individuals, trusts, decedents and general partnerships, there is at least some public record information available for individual debtors, compared to none for some other types of non-public-record debtors (such as revocable trusts, for example). Again, in Mike Sankey's words to the author: "One reason online verification is successfully operated is because the states have a one state-one license system in place."
- (c) *On-line driver's license renewals.* Another check on accuracy of names and addresses on driver's licenses is on-line renewal, available in many states. The name and address have to match the records or the individual can't renew on-line. Aside from that, all states require prompt action in event of name or location change, but enforcement is an irresolvable issue to some extent.

The webpage does not address name standards (full middle name [the Real ID approach] versus middle initial, for example).

Back to Mike's information that 87% of the total population has a driver's license (<http://www.fhwa.dot.gov/policy/ohpi/qfddrivers.cfm> Highway Statistics, 2006, the second chart, Licensed drivers--Ratio of licensed drivers to population (DL-1C)): Mike notes that, "If you look closely at one of those charts you see that states with major metro areas differ from the overall average. For example the number of females with a DL in NY is about 65%... Overall, I would suspect the reasons that most of the 13% who do not have a DL is that they either have an ID card, or are not eligible for one reason or another, or are elderly, or youths and just becoming of age...and percentages are skewed by those living in a metro area and who do not drive."

Mike said that he suspects “a certain high percentage of this group who do not have a DL do have a state-issued ID. A quick Google search led [Mike] to this table for CA [author’s note: this table also indicates that CA does issue both driver’s licenses and IDs for the same individual] <http://www.dmv.ca.gov/about/profile/official.pdf> .”

See also http://www.fhwa.dot.gov/policyinformation/pubs/pl08021/fig4_3.cfm. Mike says that that chart: “merely shows the split between men and women, and does not reflect non-drivers. The population in 2006 was about 296,000,000.”

On the issue of foreign characters, Randy Moes has checked with the Texas driver’s license issuance department and has confirmed that they use a QWERTY keyboard, as does his office. The name fields for Texas driver’s licenses are limited to fewer characters than are the Texas Secretary of State’s name fields for financing statements. The author would note that discrepancy between name field lengths between the two permeates all possible approaches and has not percolated factually into the case law as an issue so far.

Limit the “waterfall.” The author suggests limiting the “waterfall” to: (1) the driver’s license name, (2) if none, then the state-issued identification and (3) if neither, then the flexibility of the current uniform rule for individuals. That is all that is needed.

Adding a U.S. passport for U.S. debtors without a driver’s license or ID does not move the dial much, if at all, for individual debtors seeking credit secured by accounts, inventory and equipment (understanding that certain major metro areas may be an exception). Use of the passport name would already be permissible as a provable legal name in that situation under the uniform provision retained in this approach.

But more persuasively, the author suggests it is desirable to have the least deviation from the current uniform rule as is possible. Otherwise, these changes important to secured creditors may unintentionally serve as a lightning rod in the enactment process for both sides of the immigration debate without adding anything of significant value for secured lenders. From reading the newspapers, the author’s understanding is that the immigration debate has influenced the current status of Real ID, which Google reveals to be as follows: “As of April 2, 2008, all 50 states have either applied for extensions of the original May 11, 2008 compliance deadline [for Real ID] or received unsolicited extensions. With several states having approved resolutions not to participate in the program and Obama’s selection of Janet Napolitano, a prominent critic of the program, to head the Department of Homeland Security, the future of the law remains uncertain, and bills have been introduced into Congress to amend or repeal it” (Google “Real ID”).

The “waterfall” approach in the Interim Drafts of next providing a foreign passport and then the Canadian rule (first name, middle initial, last name) does not resolve the issues posed by Hispanic surnames or foreign individuals without a passport. In Canada, the rule is coupled with the “seriously misleading” rule which existed under prior Article 9 in the U.S plus it does not resolve the issue of which of the myriad of potential names to plug in or the Hispanic surname issue.

Having to move up and down a waterfall, given the suggested shortfalls of these lower level “waterfall” proposed names, adds nothing for a secured party, especially if the last stop is not the current flexible uniform rule. It is much better merely to leave the current structure untouched for individual debtors without a driver’s license/ID and for secured parties to use a greater degree of due diligence combined with possible listings of additional debtor names on the financing statement for that minority (13% of the total population less ineligible age groups, those with IDs, etc.).

No foreign debtor or individual without a driver’s license/ID case has percolated factually into the case law so far. Rather, the case law deals with (what can be assumed to be U.S.) individual debtors with a variety of possible names, which is the problem that needs to be solved. As noted with approval by Harry Sigman, the current uniform rule has been in place for 60 years. That is sufficient for the minority.

In other words, this limited “waterfall” approach is sufficient to solve the real problem.

4. **Summary**

The “only if” limited “waterfall” approach is the very best approach, especially for unlaywered transactions, because of its simplicity combined with its certainty.