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FINANCING STATEMENTS: FALSE & FRAUDULENT FILINGS

House Bill 5148 (Substitute H-3) First Analysis (1-21-04)

Sponsor: Rep. Scott Shackleton
Committee: Government Operations

THE APPARENT PROBLEM:

Article 9 of the Uniform Commercial Code specifies how enforceable security interests are to be created, perfected, and enforced, and who has the first rights in the collateral when competing creditors have legally enforceable interests. Perfection of a security interest occurs when a creditor establishes priority over other creditors for the same collateral, and usually results from the filing of a financing statement in the appropriate public record, such as the office of the secretary of state. (See Background Information for further explanation.)

Reportedly, there are instances where individuals file false or fraudulent financing statements in order to injure other parties by falsely identifying them as debtors, thereby affecting their credit records. One recent case cited by supporters of the bill involved a disgruntled litigant who filed a false financing statement identifying himself as a creditor of the judge in his case. There were said to be nearly 30 such cases discovered in a recent year. Legislation has been introduced to address this problem by requiring the office of the secretary of state to notify individuals named in financing statements as debtors, allow individuals falsely named as debtors to bring court actions that would result in rendering the financing statement ineffective; and making the filing of false or fraudulent financing statements a crime.

THE CONTENT OF THE BILL:

The bill would amend the Uniform Commercial Code to do the following:

- Require the secretary of state to provide written notice of the filing of a financing statement to any debtor identified in the statement, if the debtor is an individual.
- Make it a misdemeanor for a person to knowingly or intentionally file a false or fraudulent financing statement with the office of the secretary of state, punishable by imprisonment for not more than 93 days or a fine of not more than \$2,500, or both.

- Modify the fees charged for filing or searching records.

Notification Provisions. The secretary of state would be required to determine the form of written notice to debtors of the filing of financing statements. The notice would have to contain at least all of the following information: the debtor's name and address as shown on the financing statement; the secured party's name and address as shown on the financing statement; and the remedies available to the debtor under the act if he or she believes the financing statement is erroneously or fraudulently filed. In addition to the notice, the secretary of state would have to provide at no charge to the debtor a copy or image of the filed financing statement and any attachments. If the debtor requested additional copies or searches, statutory fees would apply.

False and Fraudulent Filing. As mentioned above, the bill would prohibit a person from knowingly or intentionally filing a false or fraudulent financing statement and create misdemeanor penalties, which would be in addition to any other penalty provided by law. If a person was convicted of a violation, the court could find that the financing statement was ineffective and order the office of the secretary of state to terminate the financing statement.

In the case of a false or fraudulent statement, a debtor named in that financing statement, a debtor named in that statement could file an action against the person who filed the statement seeking appropriate equitable relief or damages, including an order declaring the financing statement ineffective and ordering the office of the secretary of state to terminate the financing statement.

Filing and Indexing Fees. Under the bill, the usual fee for filing and indexing a record would be \$15. Currently, the act requires a standard \$10 fee, but adds \$7 if the record is a financing statement or an amendment to a financing statement not in the standard form; an additional \$12 if the record contains more than 100 pages; and an additional

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charge of \$2 per name if the filing office is required to index more than two names. The bill would also specify that the filing and indexing fee where the debtor was a “transmitting utility” would be \$100. (A “transmitting utility” is an entity primarily engaged in the business of operating a railroad, subway, street railway, or trolley bus; transmitting communications electrically, electromagnetically, or by light; transmitting goods by pipeline or sewer; or transmitting or producing and transmitting electricity, steam, gas, or water.) Further, there would be no fee for filing and indexing a correction statement filed by an individual named as a debtor on a record indexed by the secretary of state.

Search Fees. The fee for a search of records filed with a filing office concerning a debtor would remain unchanged, except that the bill would eliminate the additional fee of \$6 charged if a person requests a certificate and the search discloses more than 100 presently effective records filed concerning the debtor.

BACKGROUND INFORMATION:

The Department of State provides the following background information on its web site:

Financing Statements. “Financing statements are filed as a public notice of a security interest in collateral. Record searches are requested to reveal financing statements filed against an organization or individual. For example, when a debtor (borrower) pledges collateral to obtain a loan, a UCC financing statement tells a secured party (creditor) whether others have financing statements against the same collateral. Filing a UCC financing statement is a protective measure because it provides a public notice to other parties. Debtors also benefit because the notice system helps them obtain business funding. Legally, it puts the creditor in the position of a secured creditor; and a perfected UCC financing statement may be acted on in case of default. In the event of a bankruptcy proceeding, the creditor will be in a better position to enforce its legal rights.”

Correction Statements. “A correction statement may be filed by the debtor, not secured interests, if it is believed that a particular record is inaccurate or was wrongfully filed. *The filing of a correction statement does not affect the effectiveness of a previously filed document.* (Emphasis added.) The Michigan Secretary of State UCC office files the correction statement with the initial filing, but no information in the initial filing is changed. The UCC office does not determine whether the correction statement is

effective or legitimate. A financing statement amendment must be used to make changes on previous filings.”

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, House Bills 5148 (H-3) would not have a fiscal impact on the Department of State. Due to administrative efficiencies – the elimination of some of the filing and search fees and increases in the amounts of other filing and search fees – it is anticipated that the bill would be revenue neutral to the Department of State. The bill would have an indeterminate impact on local units of government. Correctional costs could increase, depending on the number of convictions. Any increase in the collection of penal fine revenues would go to local libraries, which are the constitutionally-dedicated recipients of such revenues. (HFA analysis 1-21-04)

ARGUMENTS:

For:

The bill aims at discouraging the filing of false and fraudulent financing statements with the office of the secretary of state, a practice that can harm the financial standing of those falsely identified as debtors. Under the bill, knowingly making such filings would be a misdemeanor, carrying criminal penalties. Further, those falsely identified could file a civil action seeking equitable relief and damages. The false record could be rendered ineffective. By requiring the secretary of state to notify all individuals identified as debtors in a financing statement, the bill will allow those affected to set the record straight expeditiously (rather than discovering it later, possibly after suffering significant harm or inconvenience).

POSITIONS:

The Department of State indicated support of the bill to the House Committee on Government Operations. (1-20-04)

The Michigan District Judges Association indicated support for the bill. (1-20-04)

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.