

CLIENT MEMORANDUM

Legislation Effective in New York to Combat Paper Terrorism

November 19, 2013

AUTHORS

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On Wednesday, November 13, 2013, Governor Andrew Cuomo signed a bill¹ to alleviate the burden on New York State public officials and certain criminal defense attorneys² caused by illegitimate financing statements (“bogus filings”) filed under the New York Uniform Commercial Code (“NYUCC”) by government separatist group members, prison inmates, disgruntled litigants, criminal defendants and others looking to retaliate against public officials and criminal defense attorneys for doing their jobs. The effect of this law is to (i) amend Section 9-518 of the NYUCC to allow special proceedings to expunge or redact bogus filings and to enjoin filers of bogus filings from filing or amending financing statements in the future (effective as of November 13, 2013) and (ii) make it a felony to file a bogus filing against a public official or criminal defense attorney in retaliation for performance of his or her official duties/job responsibilities (effective November 1, 2014). It also directs the chief administrative judge to adopt rules to govern special proceedings, including rules permitting the court to empower a referee to hear and determine the matter to assure expeditious disposition of bogus filings. This law is important because, even though these bogus filings are not effective, victims can spend years battling their effects, which may include inability to advance employment status, obtain financing, purchase and sell property, and conduct other financial affairs.

¹ Bill Number A7552: An act to amend the civil practice law and rules, the judiciary law, the penal law and the uniform commercial code, in relation to wrongful financing statements filed under the Uniform Commercial Code.

² The bill covers criminal defense attorneys who represented the filer of bogus filings in another criminal proceeding.

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The need for this legislation can be traced to the July 1, 2001 amendments to Article 9 of the NYUCC that, among other things, encouraged an Internet-friendly UCC registry by ending the requirement for a signature on a UCC financing statement,³ making it easy for “domestic terrorists”⁴ to make bogus filings. The New York Department of State (“DOS”) does not have the authority to verify the accuracy or the validity of financing statements when they are filed, even if they appear suspicious. The DOS can only refuse to accept an initial financing statement for filing if (i) the record is not communicated by a method authorized by the DOS, (ii) information is missing (such as a description of the collateral or the name or address of the debtor or the secured party), (iii) the information is not legible, or (iv) the filing fee is not tendered.⁵ Options available to New York victims of these bogus filings prior to the enactment of this bill were limited to correction statements,⁶ termination statements and liability to the debtor for losses incurred by failure of the filers to comply with Article 9 of the NYUCC (criminal penalties were no longer an option because forgery was not necessary for bogus filings to be accepted for filing by the DOS).

Correction statements provide public notice of a dispute regarding the financing statement but do not invalidate the financing statement. Termination statements invalidate the financing statement but the financing statement remains of record for at least one year after the filing of the termination statement and can show up in a credit report. Section 9-625 of the NYUCC imposes liability for damages for losses incurred for not complying with Article 9 of the NYUCC and statutory damages in the amount of \$500. These remedies have proven ineffective because victims suffer harm from bogus filings even if such filings are terminated. Moreover, the civil penalties are not severe enough to discourage bogus filings.

There is no easy way to prevent bogus filings, even though they run afoul of Section 9-509(a) of the NYUCC, which requires a debtor to authorize the filing of a financing statement filed against him or her. Collective efforts by states to subvert bogus filings date back to 2004, when the National Association of Secretaries of State and the International Association of Commercial Administrators developed recommendations to help state filing offices promulgate a response to bogus filings. More than half of the states have now adopted non-uniform laws to address bogus filings. Generally speaking, there are four different approaches: (i) pre-filing administrative discretion, (ii) post-filing administrative relief, (iii)

³ Section 9-509(a)(i) of the NYUCC provides that the debtor must authorize the filing of a financing statement in an authenticated record, which includes authenticating or becoming bound as a debtor by a security agreement. The UCC form of financing statement does not have a place for the debtor's signature.

⁴ The Federal Bureau of Investigation designated the filing of bogus financing statements as a domestic terrorist movement and a threat to law enforcement. See *Federal Bureau of Investigation, Sovereign Citizens: A Growing Domestic Threat to Law Enforcement*, www.fbi.gov/stats-services/publications/law-enforcement-bulletin/september-2011/sovereign-citizens (September 2011).

⁵ See Section 9-516(b) of the NYUCC.

⁶ Section 9-518 of the NYUCC provides a nonjudicial means for a debtor to give notice that a UCC financing statement is inaccurate or wrongfully filed. The UCC-5 is the form for taking action under this section, and it is currently known as a “Correction Statement” and can be filed only by the debtor; however, after the 2010 amendments to Article 9 take effect in New York, it will be known as an “Information Statement” and will be able to be filed by either the secured party or the debtor.

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post-filing expedited judicial relief, and (iv) enhanced criminal/civil penalties. New York has selected a combination of post-filing expedited judicial relief and enhanced criminal and civil penalties.

The pre-filing administrative remedy approach gives the filing offices broader discretion in rejecting bogus filings. The benefit of this is that the victim never suffers the consequences of the bogus filing. The detriment is the added cost of covering additional staffing, training and time to flag bogus filings. At least 15 states currently have some type of statutory pre-filing remedy. The post-filing remedy approach gives the filing offices the authority to take corrective action by allowing for quick, inexpensive removal of bogus filings from the UCC records. Such approach may also provide for criminal and/or civil penalties, and does not require substantial increases to the budget. However, the victims of bogus filings still may be subjected to financial and reputational harm.

In conclusion, the quick removal of and criminal penalties for making bogus filings is a cost-effective way to combat paper terrorism. However, secured creditors need always to keep in mind that a financing statement does not tell searchers that the secured party of record has a security interest; rather, it merely gives notice that the secured party may have one. A searcher should always follow up on any filed records to determine the legal effectiveness of a financing statement, and a searcher should never assume that authority exists merely because a financing statement has been filed in the UCC records. A financing statement could have been filed without authorization, in error or with malice by someone with no claim to any rights in the listed collateral. While this law does not affect procedures or remedies that apply to typical corporate commercial finance transactions, it creates another protection for the veracity of the notice filing system under the NYUCC.

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