

Nebraska UCC Legislation May Create New Due Diligence Burden

On March 19, 2008, Nebraska Governor Heineman signed legislation that includes an amendment to the state's version of UCC Article 9. Tucked away at the end of LB 851 is an important change to UCC § 9-506(c) that will have a substantial impact on the UCC search and filing process. The amendment is in response to ongoing uncertainty about the sufficiency of individual debtor names. The new law will take effect three calendar months following adjournment of the legislative session, which is scheduled for mid-April.

Individual debtor names are of great concern to secured parties. In many states half of the indexed UCC records provide individual names. Individuals are often involved in substantial secured transactions as sole proprietors, personal guarantors, or when engaged in farming operations.

It is vital for the secured party to provide the correct name of an individual debtor. Under § 9-506(b), if the name is not correct, the financing statement is seriously misleading. There is an exception in § 9-506(c) where the financing statement is not seriously misleading if a search of the correct name, using the jurisdiction's standard search logic, would disclose the record.

Secured parties must correctly provide the individual debtor's name on the financing statement or risk being left with an unperfected security interest. Yet, Article 9 provides no standard that allows the secured party to determine the correct name of an individual with any certainty. The secured party can only exercise its best judgment and hope for the best.

The Nebraska legislation seeks to remedy the individual name problem, not by defining a clear standard for sufficiency of individual names, but by revising § 9-506(c) to read:

If a search of the records of the filing office under the debtor's correct name, *or, in the case of a debtor who is an individual, the debtor's correct last name*, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with section 9-503(a), the name provided does not make the financing statement seriously misleading.

The purpose of this language was to provide lenders with greater certainty that errors or omissions in an individual debtor's first and middle names would not make a financing statement seriously misleading.

The bill made it through the legislative process with little comment. The Nebraska Banker's Association was the chief proponent of the bill. The Nebraska Secretary of State took a neutral position on the legislation, while the Nebraska State Bar Association was silent on the matter.

Unfortunately, the Nebraska solution has a significant unintended consequence. It imposes a potentially expensive new burden on parties that must conduct due diligence. The Nebraska Secretary of State UCC search system allows searches exclusively by an individual's last name. Now any financing statement with an individual last name that matches the debtor's name must be reviewed as part of a sufficient search. That could be a huge number if the debtor has a common name. For example, a UCC search of the individual last name "Johnson" on the Nebraska Secretary of State's web site produces 2671 unique active records. Each must be reviewed as part of a diligent search.

Another result of the new legislation is to reduce the incentive for a filing party to get the individual name correct. The first and middle name fields become irrelevant because they have no effect on a search by last name. The first and middle names could include initials, nicknames or typos, with little risk to the secured party. All that matters is that a search on the correct last name would disclose the record. The lack of incentive for accuracy just adds to the due diligence burden for interested parties. As the law is written "Sparky" might be sufficient as a first name when the debtor's

actual name is "Robert."

The new version of § 9-506(c) places a costly burden on parties that need to conduct due diligence involving an individual debtor name. Lenders and legal counsel must prepare to modify their due diligence practices before the bill takes effect in July 2008. After that time, a thorough and sufficient UCC search must include every financing statement that matches the debtor's last name. Anything less increases the risk for a searching party. Obviously, this will require more time and expense to conduct UCC searches in Nebraska. Interested parties will have to balance the added costs of Nebraska due diligence with the potential risk of missing active financing statements filed under individual name variations.

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