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### The Fraudulent Filing Problem

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Final Paper

The Fraudulent Filing Problem

In the routine world of secured transactions, a creditor providing a loan or financing to a debtor<sup>1</sup> will file a financing statement to perfect a security interest in collateral against the loaned amount.<sup>2</sup> Under Article 9 of the Uniform Commercial Code (hereinafter referred to as "U.C.C."), a creditor must obtain the assent of the debtor and include information such as the debtor's name, secured party's name, and an indication of the collateral to submit a valid financing statement.<sup>3</sup> When multiple secured parties have perfected interests in the same debtor's property, financing statement filing dates are essential to determine which has priority to the collateral.<sup>4</sup> Additionally, financing statements play an important role for creditors examining the credit worthiness of prospective debtors as filing records are publically available documents searchable in the names of debtors identified on file.<sup>5</sup> The filing system established by the U.C.C.,

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<sup>1</sup> U.C.C. § 9-102 (a) (28) (A) (2013) ("Debtor" means: a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor").

<sup>2</sup> U.C.C. § 9-310 (a) (2013). ("[General rule: perfection by filing.] Except as otherwise provided in subsection (b) and Section 9-312(b), a financing statement must be filed to perfect all security interests and agricultural liens.")

<sup>3</sup> U.C.C. § 9-502 (a) (2013). ("[Sufficiency of financing statements.] Subject to subsection (b), a financing statement is sufficient only if it: (1) provides the name of the debtor; (2) provides the name of the secured party or a representative of the secured party; and (3) indicates the collateral covered by the financing statement.")

<sup>4</sup> See U.C.C. § 9-322 (a) (2013) ("[General priority rules.] Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules: (1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection. (2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien. (3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected."); see *also* U.C.C. § 9-317 (a) (2013) ("[Conflicting security interests and rights of lien creditors.] A security interest or agricultural lien is subordinate to the rights of: (1) a person entitled to priority under Section 9-322; and (2) except as otherwise provided in subsection (e), a person that becomes a lien creditor before the earlier of the time: (A) the security interest or agricultural lien is perfected; or (B) one of the conditions specified in Section 9-203(b)(3) is met and a financing statement covering the collateral is filed.")

<sup>5</sup> See U.C.C. § 9-503 cmt. 2 (2013) ("Debtor's name. The requirement that a financing statement provide the debtor's name is particularly important. Financing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor's name. Subsection (a) explains what the debtor's name is for purposes of a financing statement."); see *also*

however, is not well protected against parties seeking to abuse it by submitting fraudulent financing statements, having neither a basis in an actual debt nor the assent of the debtor. The purpose of this paper is to investigate the state of the fraudulent filing problem and its effect on the secured transactions system of the United States, examine the non-uniform approaches states take to deal with the problem, and specifically analyze Pennsylvania's method of resolving fraudulent filings.

Under the U.C.C., a state filing office<sup>6</sup> must accept a financing statement if it satisfies the formalities of listing identifying information regarding the debtor and secured party, and may only refuse to accept for a failure to provide such substantive information or for procedural errors including a failure to tender the applicable filing fee.<sup>7</sup> A filing office is not required to check whether an actual debt exists nor whether the debtor assented to the filing. The lack of such information at the filing office allows for the acceptance of fraudulent financing statements. When the validity of a filed financing statement is called into question by a debtor, the uniform suggested solution allows the debtor to file an correction statement<sup>8</sup> with that filing office,<sup>9</sup> and to seek statutory

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<https://www.corporations.state.pa.us/ucc/soskb/SearchStandardRA9.asp> (last visited December 1, 2013) (providing a searchable database by debtors name in Pennsylvania).

<sup>6</sup> See U.C.C. § 9-501 (2013). I surveyed the codifications of U.C.C. § 9-501 and the Secretary of State appears to be the standard filing office.

<sup>7</sup> U.C.C. § 9-520 (a) (2013) ("[Mandatory refusal to accept record.] A filing office shall refuse to accept a record for filing for a reason set forth in Section 9-516(b) and may refuse to accept a record for filing only for a reason set forth in Section 9-516(b)."); U.C.C. § 9-516 (b) (2013) ("[Refusal to accept record; filing does not occur.] Filing does not occur with respect to a record that a filing office refuses to accept because: (1) the record is not communicated by a method or medium of communication authorized by the filing office; (2) an amount equal to or greater than the applicable filing fee is not tendered; (3) the filing office is unable to index the record because: (A) in the case of an initial financing statement, the record does not provide a name for the debtor; . . . (C) in the case of an initial financing statement that provides the name of a debtor identified as an individual or an amendment that provides a name of a debtor identified as an individual which was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's surname; . . . (4) in the case of an initial financing statement or an amendment that adds a secured party of record, the record does not provide a name and mailing address for the secured party of record; (5) in the case of an initial financing statement or an amendment that provides a name of a debtor which was not previously provided in the financing statement to which the amendment relates, the record does not: (A) provide a mailing address for the debtor; (B) indicate whether the name provided as the name of the debtor is the name of an individual or an organization").

<sup>8</sup> In U.C.C. Revised Article 9 this term has been changed to "information statement". However, I will consistently use the term "correction statement" throughout this paper as it is commonly used in state statutes.

<sup>9</sup> U.C.C. § 9-518 (a), (b) (2013) ("Claim Concerning Inaccurate or Wrongfully Filed Record. (a) [Statement with respect to record indexed under person's name.] A person may file in the filing office an information statement with respect to a record indexed there under the person's name if the person believes that the record is inaccurate or was wrongfully filed. [Alternative A] (b) [Contents of statement under subsection

damages and actual damages if any against the filer.<sup>10</sup> The correction statement is merely filed alongside the financing statement and does not influence its effectiveness.<sup>11</sup>

A filed financing statement subsequently becomes part of a database searchable in the name of the listed debtors.<sup>12</sup> Taking advantage of the commercial industry's common reliance on the results of database searches for debtors' names, fraudulent filers intend to harm the financial standing and reputation of the unwitting parties listed as debtor to the fraudulent debt. In New York, one source of this problem has arisen from prisons, where inmates utilize the computerization and ease of the filing process, combined with the lack of screening at the filing office, to "harass, extort, blackmail and terrorize public officials in their personal capacities."<sup>13</sup> Because of the scope and reach of internet commerce, these "paper terrorists" can attack with relative stealth, sometimes evading capture altogether due to difficulties in tracing the source of such filings.<sup>14</sup> Preventative strategies to limit the ability of prisoners to engage in fraudulent filings have included prohibiting inmates from sending or receiving any "mail related to the UCC" as well as civil litigation.<sup>15</sup>

Such an inmate case is *Brown v. New York State Department of State and James Walker*, where a prisoner filed fraudulent financing statements against the

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(a).] An information statement under subsection (a) must: (1) identify the record to which it relates by the file number assigned to the initial financing statement to which the record relates; (2) indicate that it is an information statement; and (3) provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed.").

<sup>10</sup> U.C.C. § 9-625 (e) (2013) (" . . . the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, may recover \$500 in each case from a person that: . . . (3) files a record that the person is not entitled to file under Section 9-509(a)"); U.C.C. § 9-625 (b) (2013) (" . . . a person is liable for damages in the amount of any loss caused by a failure to comply with this article. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased cost of, alternative financing.")

<sup>11</sup> U.C.C. § 9-518 (e) (2013) ("[Record not affected by information statement.] The filing of an information statement does not affect the effectiveness of an initial financing statement or other filed record.").

<sup>12</sup> U.C.C. § 9-503 cmt. 2.

<sup>13</sup> Peter A. Crusco, Paper Terrorism And The Bogus UCC-1 Lien War, Empire State Prosecutor, 15 (2008). Crusco explains that the New York Department of State accepts more than 1500 filings daily. It is crucial that the filing office retain its ease of filing for legitimate commercial business to continue efficiently.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 16 (citing *Brown v. New York State Department of State and James Walker*, \_\_\_ Misc. 3d \_\_\_, Index No. 5323/2004 (Dollard, J., Sup. Ct. Qns. Co. 2005)).

presiding judge and trial prosecutor in the criminal case against him.<sup>16</sup> The victims commenced civil litigation seeking expungement of the filing, termination of the filing as null and void, enjoinder of the defendant from all future U.C.C. filings naming the victims as debtors, and statutory damages of \$500.<sup>17</sup> The lawsuit took nearly one year to decide, and the court held that the extent of remedies available under New York's replicative adoption of the U.C.C.'s suggested solution included the filing of a correction or termination statement, plus statutory damages.<sup>18</sup> Considering the circumstances of this case, even those who endeavored to represent criminal defendants did not feel safe from the threat of fraudulent filings. "As the legal community grew to learn about the filing scheme, even the defense bar grew concerned that it too would be targeted by unsatisfied clients with plenty of time to learn the scheme in jail."<sup>19</sup>

Outside of prison, others have employed fraudulent filing schemes, including the anti-government "sovereign citizen movement" that uses fraudulent filings as a method of retaliation against "injustices" these citizens deem to have been perpetrated against them by local, state, and federal government officials.<sup>20</sup> The drive behind this particular group utilizing fraudulent filings is the belief that an illegitimate government is in control of the United States; therefore, group members attempt to exploit the government's own U.C.C. filing system.<sup>21</sup> For example, county and state officials in Minnesota are afraid to charge and prosecute criminals who use fraudulent filing tactics such as "[t]he Ellerstons, who were charged with 47 counts of fraudulent filing and sentenced in June [2013] to 23 months in prison" after having filed more than \$250 billion in fraudulent liens and other filings against public officials involved in the foreclosure of the Ellerstons'

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<sup>16</sup> Crusco at 16.

<sup>17</sup> *Id.* at 17.

<sup>18</sup> *Id.* at 17-18 (indicating the \$500 statutory damages may have particular utility as a deterrent against prisoners because it is charged against the prisoner's commissary account); See N.Y. U.C.C. Law § 9-518 (McKinney 2012) ("(a) Correction statement. A person may file in the filing office a correction statement with respect to a record indexed there under the person's name if the person believes that the record is inaccurate or was wrongfully filed. (b) Sufficiency of correction statement. A correction statement must: . . . (3) provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed. (c) Record not affected by correction statement. The filing of a correction statement does not affect the effectiveness of an initial financing statement or other filed record") (amended 2013).

<sup>19</sup> *Crusco.* at 17.

<sup>20</sup> Erica Goode, A Movement Wields Paper As a Weapon, N.Y. Times, August 24, 2013, at A1.

<sup>21</sup> *Id.*

home.<sup>22</sup> The effects of fraudulent filings reach beyond their victims' credit ratings, and amplify outside financial and emotional stressors already experienced by the named debtors.<sup>23</sup> However, the filers themselves, in earnest, also may believe they are being victimized.<sup>24</sup> Nevertheless, a response defrauding the filing system may, depending on state law, be unlawful and in any case would be harmful to the innocent parties listed as debtors.

The National Association of Secretaries of State (hereinafter referred to as "NASS") recognizes that state filing systems are vulnerable to fraud and issues a report entitled "State Strategies to Subvert Fraudulent Uniform Commercial Code (UCC) Filings" (hereinafter referred to as "NASS Report") to provide the most comprehensive source of information regarding solutions to fraudulent filings for Secretaries of State across the United States.<sup>25</sup> Unfortunately, as the majority of state filing offices "must accept any lien that is filed without judging its validity,"<sup>26</sup> fraudulent filers are enabled by routine filing practices. Even though some filings may carry traits on their face that identify them as likely to be fraudulent,<sup>27</sup> a filing office operating with limited resources would have the burden of checking the validity of every financing statement to actually prevent any fraudulent filings. The U.C.C. presents a uniform suggested solution of filing a correction statement to remedy the fraudulent filing problem;<sup>28</sup> however, even the U.C.C. drafters recognize the inability of correction statements to act as "a satisfactory or complete solution to problems caused by misuse of the public records."<sup>29</sup> As a result, fraudulent financing statements lie undiscovered because their existence is not apparent until the named debtor is searched for in a filing database. Nonetheless, more

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<sup>22</sup> *Id.* at A11.

<sup>23</sup> *Id.* (noting that resolving the problems fraudulent filings cause may take countless hours).

<sup>24</sup> *Id.* (Mr. Ellerston "had no previous criminal record" and felt attacked by the banks attempting to foreclose on his home).

<sup>25</sup> See National Association of Secretaries of State, State Strategies to Subvert Fraudulent Uniform Commercial Code (UCC) Filings, (April 2013) ("NASS Report") (providing information about the variety of methods states have taken to attempt to solve problems caused by fraudulent filings).

<sup>26</sup> Goode at A11; see U.C.C. § 9-520.

<sup>27</sup> See NASS Report (recognizing a number of features as hallmarks of fraudulent filings including: tell-tale buzzwords like references to the Bible and the Constitution; signatures that often say "sovereign living soul"; stamps and thumbprints in red ink; or the words "accepted for value" placed on filing forms).

<sup>28</sup> See U.C.C. § 9-518.

<sup>29</sup> U.C.C. § 9-518 cmt. 3 (2013).

than half of states have codified this U.C.C. suggested solution, providing no further remedy for a debtor named on a fraudulent filing.<sup>30</sup>

The NASS explains that the states implementing some method of remedy to the fraudulent filing problem beyond the U.C.C. suggested solution employ a variety of devices. These fall into four categories: "pre-filing administrative discretion, post-filing administrative relief, post-filing expedited judicial relief, and enhanced criminal/civil penalties."<sup>31</sup> While some states choose to employ a single strategy and grant the body responsible for enforcement a broad scope of authority, others employ a combination of strategies, granting a narrower scope of authority to each enforcement body.<sup>32</sup> Taking into account potential costs and benefits of each approach, the NASS suggests that a

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<sup>30</sup> See NASS Report (noting a number of states have not adopted a method of resolving fraudulent filings beyond the U.C.C. §9-518 provisions); see e.g. N.Y. U.C.C. Law § 9-518 (amended 2013). As of the April 2013 update to the NASS Report, New York had not amended its codification of U.C.C. § 9-518; however, on November 13, 2013, the state legislature enacted an amendment to provide for post-filing judicial relief as follows: "(d) Special proceeding to redact or expunge a falsely filed or amended financing statement. (1) Provided he or she is an employee of the state or a political subdivision thereof, a person identified as a debtor in a financing statement filed pursuant to this subpart may bring a special proceeding against the named filer of such statement or any amendment thereof to invalidate the filing or amendment thereof where such statement was falsely filed or amended; except that an attorney who is not an employee of the state or a political subdivision thereof may also bring a special proceeding hereunder where he or she represents or has represented the respondent therein in a criminal court. . . . (2) The petition in a special proceeding hereunder shall plead that: (A) the financing statement filed or amended by the respondent pursuant to section 9—509 was falsely filed or amended to retaliate for: (i) the performance of the petitioner's official duties in his or her capacity as an employee of the state or a political subdivision thereof, or (ii) in the case of a special proceeding brought by an attorney who is not an employee of the state or a political subdivision thereof, to retaliate for the performance of the petitioner's duties in his or her capacity as an attorney for the respondent in a criminal court; and . . . (D) prompt redaction or invalidation of the financing statement is necessary to avert or mitigate prejudice to the petitioner. (3) If the court makes a written finding that the allegations in paragraph two of this subsection are established, the court shall order the expungement of such statement or its redaction in the public records in the office in which the financing statement is filed, as appropriate, and may grant any additional relief authorized by section 9—625. In such case, the court shall cause a copy of its order to be filed with the secretary of state or other appropriate filing office pursuant to this chapter. Upon a finding that the respondent has engaged in a repeated pattern of false filings as found under this subsection, the court also may enjoin the respondent from filing or amending any further financing statement pursuant to this article without leave of the court. If the respondent is incarcerated at the time the court issues an order containing such an injunction, the court shall cause the head of the correctional facility in which the respondent is incarcerated to receive a copy of such determination. The head of such a facility shall cause a copy of such order to be provided to the respondent. In any instances of the issuance of such an injunction where the respondent has defaulted, the court shall direct service of such injunction upon the respondent." 2013 Sess. Law News of N.Y. Ch. 490 (A. 8013) (McKinney 2013).

<sup>31</sup> NASS Report at 7.

<sup>32</sup> *Id.* at 8.

combination of strategies may result in the most effective solution to the fraudulent filing problem facing state filing systems.<sup>33</sup>

According to NASS data, at least fifteen states employ some form of pre-filing administrative discretion, statutorily granting a state filing office authority to reject financing statements that are likely to be fraudulent.<sup>34</sup> Among such statutes, the scope of authority granted to a filing office varies from a mere ability to reject a financing statement listing a secured party and debtor of the same name<sup>35</sup> to a general power to reject any financing statement that appears fraudulent.<sup>36</sup> Regardless of the scope, the purpose of instilling such authority in the filing office is to prevent fraudulent filings from becoming solidified in the public record, thereby maintaining the record's reliability.<sup>37</sup> The cost of implementing such rules, however, may be directly related to the scope of authority granted. As every state filing office is faced with the challenge of utilizing limited resources to deliver the most efficient result, undertaking a detailed fraud examination of every filing would likely overextend staff or require additional hiring and specialized training.<sup>38</sup> Ultimately, it will be the job of state legislators to determine the appropriate grant of such authority by balancing potential benefits against the resource cost and detriment to efficiency.

While the NASS recognizes pre-filing administrative discretion as the most commonly utilized method adopted by states to solve the fraudulent filing problem, post-filing administrative relief is another method employed by at least nine states.<sup>39</sup> An administrative post-filing remedy is a statutory grant of authority to the Secretary of State to remove a financing statement from the public record if it is believed to be fraudulent. Similar to pre-filing remedies, the scope of authority granted under post-filing

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<sup>33</sup> *Id.* at 11 (concluding that "[a] remedy that allows state filing offices to subvert a bogus filing and/or allows for its quick removal from the record, in conjunction with strong criminal and civil penalties, will likely be the most effective way for states to alleviate the burdens on bogus filing victims.").

<sup>34</sup> *Id.* at 8.

<sup>35</sup> See Idaho Code 28-9-516A (1) (b) (2012) ("(1) The filing officer shall not file an initial financing statement or financing statement amendment: . . . (b) When an individual debtor and an individual secured party would, as a result of the filing, appear to be the same individual on the financing statement).

<sup>36</sup> See Ala. Admin. Code r. 820-4-3.02 (3) (b) (2007) (" . . . the filing office shall refuse a UCC record if: . . . (b) The record appears fraudulent on its face).

<sup>37</sup> NASS Report at 8.

<sup>38</sup> *Id.* at 8-9.

<sup>39</sup> *Id.* at 9.



administrative relief varies from state to state.<sup>40</sup> Although post-filing relief benefits the efficiency of the filing system by not requiring the filing office to perform any pre-filing review, it is likely to impose a burden on the judicial system through potential appeals of administrative decisions. Furthermore, post-filing action cannot be taken until a fraudulent filing is revealed - often by causing harm to innocent listed debtors - making this remedy an ineffective method of preserving the integrity of state filing systems as a whole. Post filing expedited judicial relief works in a style similar to post-filing administrative relief. The unique feature of such judicial relief, however, is the speed of proceedings, which may reduce the time of resolution of a case from years to mere weeks.<sup>41</sup> Judicial relief, though, is the least popular approach among states, with only seven adopting this type of statute,<sup>42</sup> likely because state legislators are unwilling to impose such a direct burden on the state judiciary.

In a different vein of remedy, increased criminal and civil penalties are utilized as a deterrent, attempting to prevent fraudulent filings from occurring at all. However, sole use of this remedy will not provide adequate relief to victims when fraudulent filers such as members of the "sovereign citizen movement" act with wanton disregard for rules enforced by what they believe is an illegitimate government and are not deterred from filing. Still, statutes imposing increased penalties may be more likely to gain favor of legislators because they do not impose any burden on state offices and require minimal resources to enforce. Therefore, at least ten states make it criminally unlawful to fraudulently file a financing statement and at least fourteen states authorize civil penalties, "permitting victims to seek damages, court costs, attorney's fees, related expenses, and injunctions."<sup>43</sup> Variety in the severity of penalty provisions is also present among states, with some reaching the extreme of "mak[ing] it an outright felony to attempt to harass someone using a fraudulent financing statement."<sup>44</sup>

Pennsylvania is among those states that utilize a post-filing administrative relief approach, specifically providing for post-filing administrative hearings that may result in a correction statement filed by the Department of State as an addendum to the

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<sup>40</sup> *Id.*; compare W. Va. Code § 46-9-516a (2013), with N.C. Gen. Stat. § 29-518 (2013).

<sup>41</sup> NASS Report at 10.

<sup>42</sup> *Id.* at 9.

<sup>43</sup> *Id.* at 10.

<sup>44</sup> *Id.*; see e.g. Tex. Penal Code Ann. § 37.101 (2013).

fraudulent financing statement.<sup>45</sup> Even this statute recognizes the strain that would be placed on the filing office if it were to bear the full responsibility of curing the fraudulent filing problem, and recommends judicial procedures as an effective source for correcting the public record and imposing criminal penalties upon fraudulent filers.<sup>46</sup> When a party challenges a financing statement as fraudulent, the Department of State will file a correction statement "if the hearing officer finds that the financing statement was filed without any authority to do so, and it appears that the financing statement was filed with the intent to 'annoy, harass or harm' the debtor."<sup>47</sup> This correction statement will identify that "the Department of State found that the initial financing statement was fraudulently filed and that it may be ineffective" and must state "the reasons why the department found the initial financing statement to have been fraudulently filed."<sup>48</sup> Although the original financing statement remains on file, the presence of the correction statement creates a rebuttable presumption of its ineffectiveness.<sup>49</sup>

Drafters of this Pennsylvania statute note that the Department of State originally wanted to secure authority to remove fraudulent financing statements from the database.<sup>50</sup> That approach was avoided, however, to prevent debtors from "possibly fraudulently terminat[ing] legitimate financing statements."<sup>51</sup> Therefore, Pennsylvania adopted an option which allows a potentially valid financing statement to remain on record and places the burden of correction on the administrative hearing procedure. This burden has the possibility of flowing over to the judiciary given the availability of appeals from such administrative decisions.<sup>52</sup> But, because the drafters recognized that "many of these [fraudulent] filers do not believe that they are subject to the jurisdiction of

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<sup>45</sup> See 13 Pa.C.S. § 9518 (2013).

<sup>46</sup> 13 Pa.C.S. § 9518 cmt. 3 ("Resort to Other Law. This Article cannot provide a satisfactory or complete solution to problems caused by misuse of the public records. The problem of "bogus" filings is not limited to the UCC filing system but extends to the real-property records, as well. A summary judicial procedure for correcting the public record and criminal penalties for those who misuse the filing and recording systems are likely to be more effective and put less strain on the filing system than provisions authorizing or requiring action by filing and recording offices.").

<sup>47</sup> Juliet M. Moringiello, Revised Article 9, Liens from the Fringe, and Why Sometimes Signatures Don't Matter, 10 Widener J. Pub. L. 135 (2001) (quoting S.B. 330, 185th Gen. Assem., Reg. Sess. § 9518 (Pa. 2001)).

<sup>48</sup> *Id.*

<sup>49</sup> Moringiello.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 159.

<sup>52</sup> 2 Pa.C.S. § 702 (2013).

any courts other than their own common law courts, it is highly unlikely that they will file appeals," thereby mitigating the potential burden.<sup>53</sup>

Pennsylvania's approach to resolving fraudulent filings has resulted in 23 administrative adjudications since 2005 and 28 correction statements.<sup>54</sup> Of this total, few administrative adjudications have led to appeals.<sup>55</sup> Among these appealed cases, purported secured parties attempt to obtain the "authority" to file a financing statement by a common method. In each case, the fraudulent filer mailed an invoice or demand for payment to the purported debtor which provided that receipt or a failure to respond would be construed as a grant of consent for a financing statement to be filed against the listed amount.<sup>56</sup> The Commonwealth Court of Pennsylvania was consistently unimpressed by this argument and looked to the Pennsylvania statute for guidance,<sup>57</sup> properly holding in all circumstances that the debtor did not authorize the filing if a security agreement was not signed and executed by both the debtor and filing party.<sup>58</sup> While the filing of correction statements in these cases did not amend or affect the effectiveness of their related financing statements, each correction statement included a summary of the administrative and judicial findings of fraud, and created the rebuttable presumption that the initial financing statement is ineffective.<sup>59</sup>

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<sup>53</sup> Moringiello at 159.

<sup>54</sup> Data provided by Martha Brown, Assistant Counsel, Pennsylvania Department of State (the discrepancy between number of correction statements filed and number of administrative adjudications exists because the Court of Common Pleas has found U.C.C. filings fraudulent and ordered correction statements without administrative proceedings).

<sup>55</sup> See *Gruff v. Dept. of State*, 913 A.2d 1008 (Pa. Cmmw. 2006); see *Gruff v. Dept. of State*, 934 A.2d 769 (Pa. Cmmw. 2007); see *Minford v. Dept. of State*, 928 A.2d 356 (Pa. Cmmw. 2007); see *Spencer v. Dept. of State*, 932 A.2d 1026 (Pa. Cmmw. 2007).

<sup>56</sup> *Gruff*, 913 A.2d 1008; *Minford*, 928 A.2d 356; *Spencer*, 932 A.2d 1026.

<sup>57</sup> 13 Pa.C.S. § 9509 (2013).

<sup>58</sup> *Gruff*, 913 A.2d 1008; *Minford*, 928 A.2d 356; *Spencer*, 932 A.2d 1026.

<sup>59</sup> The correction statement filed in regard to the Pennsylvania case *Gruff v. Dept. of State* included the following basis for the belief that the original financing statement was fraudulently filed: "On November 9, 2005, the Secretary of the Commonwealth issued the adjudication and order in the matter of The Honorable Jeffrey A Beard, Petitioner v. John Anthony Gruff, Respondent (attached). As a result, this correction statement is filed by the Department of State under 13 Pa.C.S. § 9518(d). The Department has determined that the initial financing statement 2005040101408 was fraudulently filed. John Anthony Gruff had the right to appeal the decision to a court of competent jurisdiction, but no timely appeal of the determination was filed. Therefore, this correction statement creates the rebuttable presumption that the initial financing statement is ineffective. The Department's determination that the initial financing statement was fraudulently filed is based on the determination that no rational basis exists under 13 Pa.C.S § 9509 (relating to persons entitled to file a record) entitling John Anthony Gruff to file the initial financing statement and that John Anthony Gruff, an inmate in a Pennsylvania Department of Corrections

The cases brought on appeal in Pennsylvania appear to be representative of the circumstances in which fraudulent filings customarily occur throughout the United States. In *Gruff v. Department of State*, an inmate filed fraudulent financing statements against a number of parties involved in his incarceration, including: the judge presiding over his criminal proceeding; the prosecutor of his criminal case; the court clerk involved in the same criminal proceedings; and prison officials.<sup>60</sup> The circumstances under which the fraudulent filings were performed took particular advantage of the lack of pre-filing administrative discretion measures in Pennsylvania. The secrecy with which an inmate can file combined with Pennsylvania's post-filing administrative relief statutory scheme allowed the filings in the *Gruff* case to lay undiscovered for two years and seven months.<sup>61</sup> Because Gruff had been released from prison on parole before the fraudulent filings were discovered, proceedings were later commenced to rescind his parole following criminal charges based upon the fraudulent filings.<sup>62</sup>

Pennsylvania has also encountered fraudulent filers displaying traits that might be indicative of the "sovereign citizen movement". In *Minford v. Department of State*, Richard A. Minford, a homeowner, filed a fraudulent financing statement against an insurance agency inspection service after being denied insurance coverage for his home.<sup>63</sup> Minford included a "truth affidavit" along with the financing statement he submitted to the filing office in which he claimed "facts" that granted him supposed authority to file.<sup>64</sup> An administrative decision finding the initial financing statement fraudulent was subsequently entered in accordance with 13 Pa.C.S. § 9518(d); however, Minford claimed that this administrative process was a "deceptive scheme" and argued on appeal that the Secretary did not have jurisdiction to rule on the validity

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facility, filed the initial financing statement with intent to annoy, harass or harm the debtor, who is the Secretary of the Pennsylvania Department of Corrections."

<sup>60</sup> *Gruff*, 913 A.2d 1008 (concerning filings against the judge and prison officials); *Gruff*, 934 A.2d 769 (concerning filings against the criminal prosecutor and court clerk).

<sup>61</sup> Gruff's fraudulent filings occurred while he was incarcerated on or about March 30, 2005 and criminal charges were not filed against Gruff for these filings until October 9, 2007.

<sup>62</sup> *Gruff v. Pa. Bd. of Prob. & Parole*, 986 A.2d 953 (Pa. Cmmw. 2009).

<sup>63</sup> *Minford*, 928 A.2d at 358-359.

<sup>64</sup> *Id.* at 360. Minford's "truth affidavit" claimed that his authority to file a financing statement arose from a provision in an "invoice" that he sent to the inspection service, followed by the inspection service's failure to respond.

of the financing statement.<sup>65</sup> Ultimately, the Commonwealth Court concluded that the Department of State had acted pursuant to 13 Pa.C.S. § 9518(d) and "the Secretary, as head of the Department had authority to conduct a hearing to determine if the Financing Statement was indeed Fraudulently Filed."<sup>66</sup> While these cases allow for an examination of the factual circumstances in which fraudulent filings have arisen in Pennsylvania, the number of correction statements filed far exceeds the number of appealed administrative decisions<sup>67</sup> and some fraudulent financing statements may still lie undiscovered.

### Conclusion

A combination of pre-filing and post-filing remedies would likely be the most effective solution to the fraudulent filing problem for all states. Pre-filing measures are an important component because of their ability to prevent fraudulent filings from ever affecting the credit-worthiness of their intended targets. Although an evaluation of every financing statement for fraud would likely require excessive cost, a more efficient pre-filing screening system may be implemented by taking advantage of the existing record of financing statements searchable in the names of listed debtors. Periodic searches for parties most often targeted by fraudulent filers, such as state government officials, would allow the filing office to provide notice to debtors of suspect financing statements. Under such a pre-filing screening system, the filing office could both continue normal filing operations and preserve the reliability of the filing record. However, this pre-filing measure would only prevent filings targeting a limited class of victims; therefore, a post-filing administrative or expedited judicial remedy would have to be in place to ensure that other victims have a course of action to seek relief.

Those states that have not yet adopted any resolution to the fraudulent filing problem should consider the various strategies employed throughout the United States to determine an appropriate approach. As states face differing budgetary concerns, they must weight the costs of training and hiring filing office staff or burdening the state

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<sup>65</sup> *Id.* at 361-362; see *Spencer*, 932 A.2d 1026 (concerning a fraudulent financing statement appeal where the appellant similarly challenged the jurisdiction of the Secretary of State to no avail).

<sup>66</sup> *Minford*, 928 A.2d at 362.

<sup>67</sup> 28 correction statements have been filed with the Pennsylvania Department of State since 2005 and only the cases of Gruff, Minford, and Spencer have led to appeals in that time.

judiciary against the potential benefits of pre-filing or post-filing remedies respectively. States should also consider the common sources of fraudulent filings because increased civil penalties may be an effective deterrent against some filers, such as inmates who would suffer limited access to commissary accounts. Regardless of the state specific setting, it will ultimately be the goal of any resolution to the fraudulent filing problem to maintain the efficiency of the filing system as a whole and provide effective remedies for the innocent parties listed as debtors to fraudulent financing statements.