



MATTHEW DUNLAP
SECRETARY OF STATE

STATE OF MAINE

OFFICE
OF THE
SECRETARY OF STATE

Testimony of Hon. Matthew Dunlap, Maine Secretary of State

For the Senate Homeland Security and Governmental Affairs Committee Informational Hearing
of June 18, 2009 on *"Examining State Business Incorporation Practices: A Discussion of S.
569: the Incorporation Transparency and Law Enforcement Assistance Act"*

Dear Chairman Lieberman, Ranking Member Collins, and Members of the Committee, I am the Secretary of State for the State of Maine, and I have been involved with the Company Formation Task Force formed by the National Association of Secretaries of State (NASS) since February 2007.

I participated both directly and through my senior staff with the drafting and release of the body's report and recommendations, which were adopted by the full membership in July 2007 and reaffirmed in July 2008. I also opposed the first iteration of the bill, S. 2956: "The Incorporation Transparency and Law Enforcement Assistance Act." I supported a resolution in opposition to S. 2956; the resolution was unanimously approved by my peers and adopted by NASS in July 2008.

Today, I remain opposed to the enactment S.569 because of the additional record keeping requirements it will place on states and the uncertainty of the costs associated with implementing such broad changes.

I support the testimony of my esteemed colleague, Hon. Elaine Marshall, North Carolina Secretary of State, who appeared before you at the hearing. She made compelling arguments against S.569 and I want to reiterate some of those points with you as well and describe the impact here in Maine.

I underscore Secretary Marshall's point that the information sought under S.569 already resides with financial institutions, credit unions and with the IRS. If the information is already available from other sources, why is there a need to have the Secretary of State collect, store and deal with privacy issues surrounding this information?

As Secretary Marshall indicated in her testimony, NASS asked Senator Levin to hold off on introducing federal legislation until our association had an opportunity to convene a Task Force to review the issue and develop meaningful recommendations for federal and state consideration. In July 2007, members approved the NASS Company Formation Task Force Report and Recommendations, which includes the following:

- A ban of bearer shares and interests in bearer form, a practice that was for all intents and purposes prohibited by states' case law, but not clearly outlined in state statute.
- A requirement that entities file a periodic report that includes the name and address of a natural person in the U.S. who has responsibility for providing access to the list of owners of record for a business entity. That name would be a part of the public record and, therefore, available to law enforcement without a subpoena.

These basic recommendations have served as the basis for drafting the Uniform Law Enforcement Access to Entity Information Act, crafted by the Uniform Law Commission with significant input from the legal, law enforcement and filing office communities. You heard details about this draft language from Harry Haynsworth, but Senator Levin dismissed it out of hand since it did not provide shape to his definitional term of beneficial ownership. As Secretary Marshall and Mr. Haynsworth indicated, there is no clear definition in business entity law in the United States for this term; yet Senator Levin continues to push a definition that was crafted for financial transactions disclosure not disclosure under the business entities law.

In May 2008, Senator Levin expressed his dissatisfaction with the NASS approach and introduced the Incorporation Transparency and Law Enforcement Assistance Act (S.2956). He reintroduced this bill in March 2009 as S.569. NASS and a number of other prominent organizations are on record in opposition to this bill, including the Uniform Law Commissioners, the American Bar Association (ABA), and the National Conference of State Legislatures (NCSL).

As Secretary Marshall indicated in her testimony and it is important to emphasize again, during the years since this issue has been brought to the public forefront, the coalition of NASS, ABA, ULC, NCSL has been working together to find appropriate state legislative and administrative answers that would accomplish the following:

- Avoid the federalization of the company formation process, which has always been a state function. Federal legislation will bring federal rulemaking and regulatory authority into an area that has traditionally been the jurisdiction of states;
- Create a way for company ownership data to be held by private individuals designated by the entities, rather than the Secretary of State or other state agency;
- Require that law enforcement agencies use subpoenas to inspect the ownership records rather than mandating that the Secretaries of State or state governments collect, secure and provide them;
- Avoid an immense, unfunded mandate requiring states to fund the hardware, software and staffing to collect, update, preserve and make accessible this ownership data. There would also be a substantial cost for public education efforts regarding the complete change to filing requirements;
- Prevent the office of the Secretary of State from becoming a law enforcement agency if compelled to regularly cross-check the entity ownership data against the Office of Foreign Asset Control's Specially Designated Nationals (SDN) List and report any suspicious matches.

Overall, the NASS recommendations strike an appropriate balance by supporting the goals of law enforcement without unnecessarily restructuring state governments into Federal branch agencies or negatively impacting the business community.

For even the most technologically advanced states, maintaining ownership information in a database will require the development and design of a new system. It will also require the states to conduct extensive, comprehensive and costly public education campaigns to ensure compliance.

Additionally, the NASS approach does not overburden small businesses, many of which are struggling economically right now. In crafting its recommendations, one of the major goals of the NASS Company Formation Task Force was to avoid any increased financial or filing burdens on small businesses, particularly “mom and pop” or family-owned businesses. It is also important that any changes in law remain simple and straightforward so as not to result in unintentional non-compliance.

Unlike S.569, the NASS Company Formation Task Force recommendations also support the protection of privacy for investors and family members and would not make their personal business matters a part of the public record. While S.569 does leave it up to each state as to how it would handle the public nature of the additional information that must be collected, the creation of a public and confidential filings information system is likely to be a nightmare for state filing offices to handle, since this type of confidential filing is not typical of a business entity filing office at the state level. Significant training of internal staff on the functioning and liability of access to this sensitive information will create a totally different level of responsibility for staff; many of my staffers will be reluctant, with good reason, to have any access to this information.

The issues Secretary Marshall and I raise regarding S.569 are not solely issues for my colleagues and me, but they are also issues for the small business community, venture capitalists, and other business-related entities. I strongly urge the Committee to seek out input from this segment of the business community to hear the impact that it will have on the backbone of our economy – small businesses.

In Maine, S.569 would be a significant burden, and we are a state recognized for innovation with online technology. Unlike Secretary Marshall, I have a 2 person technology staff to make changes to our existing system. S.569 will likely require a significant change in our system hardware and software configurations. Maine currently has 70,000 active corporations and limited liability companies within our databases, and all filings are examined before filing. While Maine is not a legal review state, our staff does review filings for completeness of the required statutory information. Maine does not permit online filing of formation documents, but does accept Annual Reports online.

As Secretary Marshall testified, to assess the real costs to the states under S.569 is almost impossible. A great disconnect exists between what the bill states and what we think it will mean in order to be effective. The unknown, but expected, requirement for this bill to be meaningful is the application to existing business entities. If proposed Sec.2009.(a)(1)(B) requires all existing entities to provide beneficial ownership information on an annual basis (not just those businesses created after the effective date), then entirely new processing and educational programs will have to be crafted. Everyone will need to provide citizenship or status information. Screening by

physical addresses will be inadequate. Responsibility is placed on formation agents, but the bill is silent as to the responsibility for those entities created without a formation agent. An educational undertaking to all new entities, approximately 4,000 – 5,000 per year in Maine, is one of significant cost. If all 70,000 entities of record must be informed, the cost grows greatly.

The huge volume of materials S.569 will generate over just a few years needs to be considered. On its face, Annual Report numbers will not increase, but Annual Reports are public records in Maine. If they contain confidential ownership information in order to keep current, redaction will need to occur or separate filing systems will need to be maintained, possibly increasing the image load exponentially. Maine is currently using hardware that is near or at the end of its lifespan. I am concerned that to put more pressure on existing hardware with the volume of new or expanded filings will cause catastrophic issues. In Maine, we have had to reduce our budgets so substantially over the last 4 years that we are struggling to meet our ongoing expenses. Going to the Maine Legislature to ask for money above and beyond normal operating expenses to fund federally mandated programs will be an exercise of profound exasperation. Given the narrowing band of available public resources, Maine simply does not have available the estimated \$1.1 million necessary to make upgrades to meet the requirements of S.569.

I concur with Secretary Marshall's assertion regarding the impact of S.569 on nonprofit corporations - general confusion will be the norm as nonprofits seldom have "owners" of any definition. Who are the "beneficial owners" of incorporated VFW organizations, American Legion organizations, Granges, churches, Lions Clubs International, Elk Lodges et cetera.? In Maine, these types of fraternal and social organization make up a large percentage of our nonprofit corporations. I would invite, but do not expect, any Federal assistance in answering the almost 13,000 telephone calls that my office will get on this issue from nonprofit corporations alone.

Secretaries of State around the country are very concerned that the term "beneficial ownership" is not well-established in American jurisprudence and that it will fall upon us to interpret what that means. It is also of concern that the law would apply to formation agents but does not specify who would be responsible in the case that a formation agent is not used. Filing offices have no desire to be the default keeper and verifier of the identity of non-United States citizen beneficial owners. The definition of formation agent itself is of concern since formation does not occur until my office accepts and files it; am I, the Secretary of State, then by definition a formation agent?

I share Secretary Marshall's concern regarding the possible verification of ownership information falling to our offices; which then leads to states comparing ownership names against OFAC's SDN list. The verification and comparison to this list would be a nightmare of biblical proportions. Starting on July 1st, I will have 5 less staffers in my office due to budget reductions. Any verification and checking would require me to double my staff; not reduce it.

Because I am also the state's chief Motor Vehicle official, I am also responsible for issuing state driver licenses and identity credentials. Using a combination of AAMVA naming protocols and existing names on the SDN list, finding matches on the SDN list through even a normal business proceeding—which would occur if an agent presents a driver's license as identity—would be problematic. Assuming their name was more than 15 characters long and hyphens were removed, if it were entered against the SDN list, it would not generate a match, even if the individual were listed on the OFAC SDN list. Naming protocols for the list demand an exact match. Bear in mind

that this assumes that no fraud has occurred in procuring any original document. The terrorists of September 11th, 2001 were able to obtain state credentials using Federally-issued travel documents, which were obtained in several cases through fraud. I would invite an amendment to this bill that would obligate the Federal government to uphold its end of the bargain on national security.


If you sense resistance and frustration from Secretary Marshall and me, you are correct. Clearly, I am not an advocate of Maine companies being used for money laundering or other illicit purposes. But we all feel these efforts are going to be of limited effectiveness compared to other possible avenues of recourse described in my testimony. Do you really think that the bad guys will think twice about providing fraudulent information at the time of formation? Ironically, this bill will not stop criminals, but will deter legitimate businesses from forming. Rather than creating entities that would be held to new filing requirements by S.569, entrepreneurs will create entities like sole proprietorships which don't file with our office. But by creating these types of entities, the businesses sacrifice the liability shield and tax benefits afforded to corporations and limited liability companies. What is the impact of reduced entity filings? Undoubtedly it would result in a major loss of revenue for states. In Maine, we generate revenue in excess of \$10 million annually for the Maine General Fund.

S. 569 represents a cultural change – not just for the filing offices who view their function as simply ministerial, but a cultural change for everyone engaged in business of most types in the United States. As Secretary Marshall points out, ground zero for the fallout from these cultural changes will be each state's filing office, and we are gravely concerned. Viewing the financial and human asset commitment contrasted with the efficacy of the proposal, it is hard to find significant added value and meaningfulness.

In closing, I too, as Secretary Marshall indicated, am very wary of any federal law that burdens states and legitimate businesses yet provides lawbreakers with the ability to evade it. The obvious argument is that the extremely small number of entities that are registered to do business that may be engaged in money laundering, terrorist financing and tax evasions are probably not going to file accurate or truthful information to state government. The bill can only serve to severely impact the vast majority of legitimate, law abiding businesses trying to stay afloat in turbulent economic times.

Thank you for allowing me to provide my thoughts on this very difficult matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Matthew Dunlap", with a stylized, flowing script.

Matthew Dunlap
Secretary of State
State of Maine