Approved 4-30-92
Date

MINUTES OF THE HOUSE COMMITTEE ON JUDICIARY.

The meeting was called to order by Rep. John Solbach at
Chairperson

1:15 ~~a.m.~~/p.m. on April 8, 1992 in room 313-S of the Capitol.

All members were present except:

Representatives Everhart, Garner, Gomez, Gregory, & Hamilton who were excused.

Committee staff present:

Jill Wolters, Revisor of Statutes
Judy Goeden, Committee Secretary

Conferees appearing before the committee:

Jim Clark, Assn. of County & District Attorneys
David Lord, Kansas Securities Commissioner's Office
Kathy Taylor, Kansas Bankers Association

The chairman called the meeting to order.

Hearing on SB 628, repealing the certified public accountant's client communciation privilege, was opened.

Jim Clark, Association of County and District Attorneys, testified in favor of SB 628. (Attachment #1)

David Lord, Kansas Securities Commissioner's Office, testified in favor of SB 628. (Attachment #2) He said accountants do not feel there is a need for this bill, however they are not opposed to the bill.

Hearing on SB 628 was closed.

Rep. Smith moved to report SB 628 favorably for passage. Rep. Carmody seconded the motion.

Rep. Hochhauser made a substitute motion to amend SB 415 into SB 628. Rep. Pauls seconded the motion. Motion carried.

Rep. Smith moved to report SB 628 as amended favorably for passage. Rep. Douville seconded the motion. Motion carried.

Hearing on SB 622, UCC, negotiable instruments lost, destroyed or stolen checks, was opened.

Kathy Taylor, Kansas Bankers Association, testified in favor of SB 622. She submitted proposed amendments for committee consideration. (Attachment #3)

It was suggested that Barclay Clark's "Kansas Comments" be included by the Revisor if appropriate as an aide to practitioners and judges as the Revisor finds should be included to clarify, provide background, rationale and intent.

Rep. O'Neal moved to adopt the amendments submitted by the Kansas Bankers Association. Rep. Rock seconded the motion. Motion carried.

Rep. Carmody moved to report SB 622 as amended favorably for passage. Rep. O'Neal seconded the motion. Motion carried.

Meeting adjourned at 2:00 P.M.

GUEST LIST

COMMITTEE: House Judiciary DATE: 4-8-92

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Kathy Taylor	Topeka	KS Bankers Assn
Chuck Stones	"	"
Jim Clark	Topeka	KCDAA
David Lord	Topeka	KS Securities Commission
SUSAN SOMERS	Topeka	KSCPA
John C. Frieden	topeka	" "
T.C. ANDERSON	TOPEKA	KSCPA
RUSS FREY	TopeKA	Ks Vet Med Assoc

Kansas County & District Attorneys Association

827 S. Topeka Blvd., 2nd Floor • Topeka, Kansas 66612
(913) 357-6351 • FAX (913) 357-6352
EXECUTIVE DIRECTOR, JAMES W. CLARK, CAE • CLE ADMINISTRATOR, DIANA C. STAFFORD

Testimony in Support of

SENATE BILL NO. 628

Presented to the House Judiciary Committee

The Kansas County and District Attorneys Association requested SB 628, and appears in its support. Our Association requested a similar bill several years ago, after an investigation by the Shawnee County District Attorney's office was hampered by the broad protection of records and communications with certified public accountants. The privilege given to communications with CPA's is greater than that given priests, attorneys or spouses. While this may be a subconscious reflection on the relative importance given to such communications, it is simply too broad for the current climate of white collar crime. Our previous effort met with no success, and we were given the old axiom "If it ain't broke, don't fix it." Well, it appears that while things may not be entirely broke, there at least needs to be some preventive maintenance performed.

A compromise proposal has been agreed upon by the Securities Commissioner and the Society of Certified Public Accountants. While we have some concerns over the fact that CPA's have a much more extensive privilege, we defer to the compromise agreement. It does allow prosecutors greater latitude in investigations of white collar crime.

HJC
4-8-92
#1
1 of 3

60-426. Lawyer-client privilege. (a) *General rule.* Subject to K.S.A. 60-437, and except as otherwise provided by subsection (b) of this section communications found by the judge to have been between lawyer and his or her client in the course of that relationship and in professional confidence, are privileged, and a client has a privilege (1) if he or she is the witness to refuse to disclose any such communication, and (2) to prevent his or her lawyer from disclosing it, and (3) to prevent any other witness from disclosing such communication if it came to the knowledge of such witness (i) in the course of its transmittal between the client and the lawyer, or (ii) in a manner not reasonably to be anticipated by the client, or (iii) as a result of a breach of the lawyer-client relationship. The privilege may be claimed by the client in person or by his or her lawyer, or if an incapacitated person, by either his or her guardian or conservator, or if deceased, by his or her personal representative.

(b) *Exceptions.* Such privileges shall not extend (1) to a communication if the judge finds that sufficient evidence, aside from the communication, has been introduced to warrant a finding that the legal service was sought or obtained in order to enable or aid the commission or planning of a crime or a tort, or (2) to a communication relevant to an issue between parties all of whom claim through the client, regardless of whether the respective claims are by testate or intestate succession or by *inter vivos* transaction, or (3) to a communication relevant to an issue of breach of duty by the lawyer to his or her client, or by the client to his or her lawyer, or (4) to a communication relevant to an issue concerning an attested document of which the lawyer is an attesting witness, or (5) to a communication relevant to a matter of common interest between two or more clients if made by any of them to a lawyer whom they have retained in common when offered in an action between any of such clients.

(c) *Definitions.* As used in this section (1) "client" means a person or corporation or other association that, directly or through an authorized representative, consults a lawyer or lawyer's representative for the purpose of retaining the lawyer or securing legal service or advice from the lawyer in his or her professional capacity; and includes an incapacitated person who, or whose guardian on behalf of the incapacitated person so consults the lawyer or the lawyer's representative in behalf of the incapacitated person; (2) "communication" includes advice given by the lawyer in the course of representing the client and includes disclosures of the client to a representative, associate or employee of the lawyer incidental to the professional relationship; (3) "lawyer" means a person authorized, or reasonably believed by the client to be authorized to practice law in any state or nation the law of which recognizes a privilege against disclosure of confidential communications between client and lawyer.

History: L. 1963, ch. 303, 60-426; L. 1965, ch. 354, § 7; Jan. 1, 1966.

60-428. Marital privilege, confidential communications. (a) *General rule.* Subject to K.S.A. 60-437 and except as otherwise provided in subsections (b) and (c) of this section, a spouse who transmitted to the other the information which constitutes the communication, has a privilege during the marital relationship which he or she may claim whether or not a party to the action, to refuse to disclose and to prevent the other from disclosing communications found by the judge to have been had or made in confidence between them while husband and wife. The other spouse or either his or her guardian or conservator may claim the privilege on behalf of the spouse having the privilege.

(b) *Exceptions.* Neither spouse may claim such privilege (1) in an action by one spouse against the other spouse, or (2) in an action for damages for the alienation of the affections of the other, or for criminal conversation with the other, or (3) in a criminal action in which one of them is charged with a crime against the person or property of the other or of a child of either, or a crime against the person or property of a third person committed in the course of committing a crime against the other, or bigamy or adultery, or desertion of the other or of a child of either, or (4) in a criminal action in which the accused offers evidence of a communication between him or her and his or her spouse, or (5) if the judge finds that sufficient evidence, aside from the communication, has been introduced to warrant a finding that the communication was made, in whole or in part, to enable or aid anyone to commit or to plan to commit a crime or a tort.

(c) *Termination.* A spouse who would otherwise have a privilege under this section has no such privilege if the judge finds that such spouse while the holder of the privilege testified or caused another to testify in any action to any communication between the spouses upon the same subject matter.

History: L. 1963, ch. 303, 60-428; L. 1965, ch. 354, § 9; Jan. 1, 1966.

HJC 4-8-92 #1 203

60-429 Penitential communication privilege. (a) *Definitions.* As used in this section, (1) the term "duly ordained minister of religion" means a person who has been ordained, in accordance with the ceremonial ritual, or discipline of a church, religious sect, or organization established on the basis of a community of faith and belief, doctrines and practices of a religious character, to preach and to teach the doctrines of such church, sect, or organization and to administer the rites and ceremonies thereof in public worship, and who as his or her regular and customary vocation preaches and teaches the principles of religion and administers the ordinances of public worship as embodied in the creed or principles of such church, sect, or organization; (2) the term "regular minister of religion" means one who as his or her customary vocation preaches and teaches the principles of religion of a church, a religious sect, or organization of which he or she is a member, without having been formally ordained as a minister of religion, and who is recognized by such church, sect, or organization as a regular minister; (3) the term "regular or duly ordained minister of religion" does not include a person who irregularly or incidentally preaches and teaches the principles of religion of a church, religious sect, or organization and does not include any person who may have been duly ordained a minister in accordance with the ceremonial, rite, or discipline of a church, religious sect or organization, but who does not regularly, as a vocation, teach and preach the principles of religion and administer the ordinances of public worship as embodied in the creed or principles of his or her church, sect, or organization; (4) "penitent" means a person who recognizes the existence and the authority of God and who seeks or receives from a regular or duly ordained minister of religion advice or assistance in determining or discharging his or her moral obligations, or in obtaining God's mercy or forgiveness for past culpable conduct; (5) "penitential communication" means any communication between a penitent and a regular or duly ordained minister of religion which the penitent intends shall be kept secret and confidential and which pertains to advice or assistance in determining or discharging the penitent's moral obligations, or to obtaining God's mercy or forgiveness for past culpable conduct.

(b) *Privilege.* A person, whether or not a party, has a privilege to refuse to disclose, and to prevent a witness from disclosing a communication if he or she claims the privilege and the judge finds that (1) the communication was a penitential communication and (2) the witness is the penitent or the minister, and (3) the claimant is the penitent, or the minister making the claim on behalf of an absent penitent.

History: L. 1963, ch. 303, 60-429; Jan. 1, 1964.

HJC
4-8-92
#1
383

STATE OF KANSAS

OFFICE OF THE SECURITIES COMMISSIONER
Second Floor
618 South Kansas Avenue
Topeka, Kansas 66603-3804
(913) 296-3307

Joan Finney
Governor

James W. Parrish
Securities Commissioner

TESTIMONY IN SUPPORT OF
SENATE BILL NO. 628 AS AMENDED

The Office of the Kansas Securities Commissioner is requesting a modification of present K.S.A. 1-401. This statute is known as the accountant-client privilege for the state of Kansas.

As the statute is presently written it is an extremely broad privilege. The Attorney General has given an opinion regarding this statute in Opinion No. 88-70. This was in response to an inquiry by Representative Snowbarger. In this opinion it is stated ..."the statutorily-created privilege is absolute, subject only to the limitations imposed by the statute itself." The present exceptions are only situations when the communication is material to the defense of an action against the CPA and where it is material to a peer review against the accountant.

An example of the problems caused by this broad privilege is demonstrated during recent KPERS investigations by our agency. During this investigation the facts developed such that we needed to examine the financial records of a securities debtor of KPERS. The accountant had these records in his possession. The accountant was willing to provide the records to us for review, however, he felt compelled to raise the privilege. At this point we examined the language of the present statute creating the accountant-client privilege and agreed with the accountant that such records were not available to us even through the use of a subpoena.

Such a restriction severely hampers a competent investigation to determine whether or not action is appropriate for this agency to properly enforce the Securities Act.

It was discussed that a search warrant could have been issued to acquired the records we needed. However, a search warrant should only be sought when criminal action is contemplated. Many times we may be looking merely at administrative remedies. In addition, the issuance of a

HJC
4-8-92
#2
1062

search warrant is much more intrusive than response to a subpoena.

I have reviewed the statutes of all 50 states and determined that there are 26 states that do not provide for any accountant-client privilege. This includes such states as California, New York, Nebraska, Oklahoma, Delaware and Ohio. The remaining 24 states can be divided into three groups as to the manner in which the statutes are drafted. Fifteen provide some type of exemption to the general privilege. Most of these exemptions include criminal and bankruptcy cases or situations where a subpoena has been issued. Six states have statutes similar to Kansas which provide exemptions only when the accountant is involved. Two states do not appear to provide any exception to the privilege.

In an effort to retain a general privilege for the accountant-client relationship and yet provide access to vital records needed by the state to properly perform its regulatory and law enforcement functions, we propose a modification of the existing statute. We suggest the language presented today.

Unless there is some modification, any person or company anticipating investigation need only place his or its records in the custody of their accountant and such records become shielded from examination by any enforcement agency and from being subject to subpoena and use at trial.

Surely the legislature does not desire this result. It is a recognized principle for the creation of any privilege that the benefits of the privilege must out weigh the injury that would inure to the effective administration of justice. It is our position that as the statute presently exists, the public injury to effective administration of justice far out weighs any benefit to the accountant's relationship with his client.

HJC
4-8-92
#2

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

April 7, 1992

TO: Members of the House Committee on Judiciary

RE: **SB 622**

There is attached to this testimony, a copy of two suggested amendments to the Uniform Commercial Code, Articles 3 & 9 which have been offered by Mr. Barkley Clark, Shook, Hardy and Bacon, Kansas City. I will attempt to summarize the events which have led to the proposed changes in the UCC.

As you know, Article 9 of the Uniform Commercial Code deals with taking a security interest in personal property to secure payment of a loan. Contained within the UCC are the rules as to "perfection" of that security interest so that the lender can be certain that should the borrower default on the loan, the lender will have a first priority lien on the property that he or she took as collateral.

The UCC also specifically defines what types of property are within the "scope" of Article 9 (see KSA 84-9-104). If an item is not within the "scope" of Article 9, the rules of perfection found there do not apply and one must look elsewhere to determine which rules to use.

Certificates of Deposits (CD's) have long been considered as being within the scope of Article 9 of the UCC as they are under the category of "instrument". They are specifically included in the definition of "negotiable instrument" under KSA 84-9-104(2)(c). In order to be an "instrument", a writing must be a negotiable instrument, transferable by delivery (with any necessary endorsement or assignment) as part of the ordinary course of business.

Bank CD's, like other types of deposit accounts, are subject to rules regarding reserve requirements. That is, banks are required by federal regulation (Reg. D) to hold reserves on deposit accounts with the Federal Reserve Bank, in an amount that they determine. The amounts depend on the type of account held - whether it is a time deposit (egs. CD, savings accounts), or a transaction account (eg. checking account).

Previously under Reg. D, if a deposit was a CD, the bank would have to differentiate between those that were personal and non-personal as there were no reserves required for personal CD's, but banks were required to reserve 3% of all non-personal CD's. Because the Federal Reserve feared that many banks would try to circumvent the reserve requirements by having a customer take out a personal CD (no reserves) and then transfer that to a corporation,the Fed required that the CD contain language that made it nontransferable or that limited the transferability in order to be treated as a personal CD. The Fed has removed this distinction and now requires 0% reserves against both personal and nonpersonal CD's.

HJC
4-8-92
#3
105

Office of Executive Vice President • 1500 Merchants National Building
Eighth and Jackson • Topeka, Kansas 66612 • (913) 232-3444
FAX (913) 232-3484

The problem that has occurred is that there are some recent Kansas court decisions that have looked at the nontransferable language on the CD and have decided that such language takes the CD out of the scope of Article 9 of the UCC, since in order to be an "instrument", the writing must be able to be transferred by delivery plus an endorsement.

Now, if CD's are not instruments under the UCC, one looks to other law to determine how to take a security interest in this type of property. The problem is that the law is very scarce and unclear (since CD's have always been thought to be UCC personal property). As a consequence, banks are now finding they are reluctant to finance a loan when the borrower wants to give a CD as collateral - a loan that was once the best loan a banker could make - because the bank cannot be certain that it is first in the priority line with regard to that collateral.

As Barkely Clark states in his comments, these amendments are really "technical" since the nontransferable language is there only because of the reserve requirements of Reg. D. It was never intended that these instruments could not be pledged as security on a loan and thus these amendments make it clear that the requirements of Reg. D do not affect the rules of the UCC.

Although not a very brief summary, I do hope this gives a succinct chronology of the events leading to the proposed amendments.

Kathleen A. Taylor
Associate General Counsel

HJC
2-8-92
Att #3
SB 622

Amend K.S.A. 84-3-110(d) to read as follows:

(d) If an instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, pledged, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, pledged, discharged, or enforced only by all of them. If an instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively. For purposes of this subsection, the term "instrument" includes a writing that would otherwise qualify as a certificate of deposit but for the fact that the writing contains a limitation on transfer.

Amend K.S.A. 84-9-105(1)(i) to read as follows:

(i) "Instrument" means a negotiable instrument (defined in K.S.A. 84-3-104 and amendments thereto), a certificated security (defined in K.S.A. 84-8-102 and amendments thereto), a writing that would otherwise qualify as a certificate of deposit (defined in K.S.A. 84-3-104(j) and amendments thereto) but for the fact that the writing contains a limitation on transfer, or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.

HJC
4-8-92
#3
3085

LAW OFFICES
SHOOK, HARDY & BACON

FAX (816) 421-5547
W.U.T. TELEX 426291 SHB KSC
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

ONE KANSAS CITY PLACE
1200 MAIN STREET
KANSAS CITY, MISSOURI 64105
(816) 474-6550

OTHER OFFICES:
40 CORPORATE WOODS
OVERLAND PARK, KANSAS
19 BUCKINGHAM GATE
LONDON, ENGLAND

March 24, 1992

VIA FAX - 913/232-3484

Ms. Kathy Taylor
KANSAS BANKERS ASSOCIATION
1500 Merchants National Building
Eighth and Jackson
Topeka, Kansas 66612

Re: UCC Amendments

Dear Kathy:

In line with our phone conversation this morning and the materials you sent to me, we have taken a crack at solving the problem posed by the Proctor and Bank IV cases by suggesting the UCC amendments set forth on the separate sheet of paper. The amendment to Article 3 of the UCC is intended to reverse the Proctor case by making it clear that a CD continues to be covered by § 3-110(d) even though it is non-transferable on its face in an effort to comply with Regulation D. Under this proposal, either payee of a non-transferable CD made payable to "A or B" would be able to pledge the CD without the signature of the alternative payee. The CD would be covered by this limited provision in Article 3, even though it is not be an "instrument" for Article 3 purposes in general.

The second suggested amendment is, in our view, even more important. Under the Bank IV case, non-transferable certificates of deposit are outside the scope of Article 9, so that no one knows for sure how a security interest in them is perfected. In particular, retaining possession may not be adequate. To correct this problem, we have suggested language amending UCC § 9-105(1)(i) to bring non-transferable certificates of deposit within the general scope of Article 9 as "instruments." Based on this change, a security interest in them could be perfected only by retention of possession.

In light of the Bank IV case, a trustee in bankruptcy could currently argue that a non-transferable CD is an Article 9 "general intangible" requiring the filing of a UCC-1, even where the CD is pledged to the issuing bank. Obviously, no Kansas banks are filing UCC-1s to cover these situations; therefore, the exposure

HJC 4-8-92 #2 4085

SHOOK, HARDY & BACON

to Kansas banks is substantial. This problem is corrected by bringing these non-transferable CDs within the scope of Article 9 and clarifying that they are perfected by taking possession of them as "instruments."

As we discussed on the phone, these changes are really in the nature of "technical amendments," in the sense that Kansas banks today issue non-transferable CDs only because of the reserve requirements of Regulation D, with no intent that these instruments not be pledged as security. In our view, these proposed amendments are not inconsistent with the Federal Reserve Board's policies under Regulation D; they simply make sure that the non-transferability feature required by Reg. D does not adversely affect other commercial law rules under the UCC.

I agree with your conclusion that these amendments should be incorporated into Senate Bill #622, with the caveat that the title be amended to reflect the new subject. The Revisor's office needs to draft the new title so that it is broad enough to pick all the UCC amendments under a single generic heading.

After you have had an opportunity to review the proposed language, please give me a call and we can plot our strategy from there.

Sincerely,

Barkley

Barkley Clark

BC:ved
Enclosure

10533517

HJC 4-8-92 Att #3 5825