[LB114 LB116 LB136 LB189]

The Committee on Banking, Commerce and Insurance met at 1:30 p.m. on Tuesday, February 6, 2007, in Room 1507 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB114, LB189, LB136, and LB116. Senators present: Rich Pahls, Chairperson; Chris Langemeier, Vice Chairperson; Tom Carlson; Mark Christensen; Tim Gay; Tom Hansen; Dave Pankonin; and Pete Pirsch. Senators absent: None. []

SENATOR PAHLS: Welcome to the Banking, Commerce and Insurance Committee hearing. My name is Rich Pahls. I am from Omaha and I represent District 31. I am honored to be your Chair. The committee will take up bills in the order posted. I will just run through them right now, LB114, LB189, LB136, and LB116. This is your opportunity to express your position on the proposed legislation before us today. I am asking you to take a look at some of our procedures. It would make things run much more efficiently if you would number one, turn off your cell phone, use the on-deck chair, put your sheet in the testifiers box up here. After the introduction we will have the proponents, opponents, and neutral testifiers. As usual we will try to keep equal time to all sides of the issue. We are asking you to begin your testimony by spelling your first and last names for the record. If you have written material we need at least ten copies. If you do not have ten copies if you wave your hand one of our pages will go and get the ten copies for you if you do not have it. Looks like we are all pretty well prepared today. I will introduce all the people who are involved with this committee. The committee counsel is Bill Marienau. Committee clerk is Jan Foster. I will have the senators introduce themselves starting... []

SENATOR CARLSON: Tom Carlson, District 38. []

SENATOR PIRSCH: Pete Pirsch, District 4. []

SENATOR LANGEMEIER: Chris Langemeier, District 23. []

SENATOR PANKONIN: Dave Pankonin, District 2. []

SENATOR GAY: Tim Gay, District 14. []

SENATOR HANSEN: Tom Hansen, District 42, home of Asa Lincoln's great grandchildren. []

SENATOR PAHLS: That is good because we expect economic development to come out of this group and, Senator, I am depending on you to help us out with that on a regular basis now. You started a pattern. We also have two pages who help us keep this meeting moving, Kristine Kubik is from Prague, Nebraska, and Cora Micek from

Hastings, Nebraska. We are ready to start on LB114. I am going to close my introduction by turning it over to our capable counsel, Bill Marienau. [LB114]

BILL MARIENAU: (Exhibit 1) Mr. Chairman and members of the committee, for the record my name is Bill Marienau, B-i-l-l M-a-r-i-e-n-a-u. I serve as legal counsel to this committee and I appear at the request of Chairman Pahls who is the introducer of this bill, LB114. To cover LB114 quickly I would begin by saying that this bill contains what are actually fine tuning adjustments and tweaks to Nebraska's Uniform Trust Code. Now, what is the Uniform Trust Code? The Uniform Trust Code comes to the states by way of the Uniform Law Commissioners. It was finalized in the year 2000 by the Uniform Law Commissioners. Later on we are going to have at least one Uniform Law Commissioner, if the reinforcements are arriving to talk about this bill, if not others behind it, and to explain the work of the Uniform Law Commissioner so I won't go over that in any detail. The Uniform Trust Code is actually the first form of a national codification of trust law for America. Not national in the sense that there would be one body of statute for the entire country, but a recommended body of statute for each of the states to enact if they choose to govern the area of trusts. Before the Uniform Trust Code came along a great deal of trust law had to be found in various places, either in old cases or in treatises such as the restatement of the law of trusts. The Uniform Law Commissioners stepped in, filled that gap, and came up with the Uniform Trust Code. Nebraska began working on a version of it beginning in 2001, and by the interim of 2002 a study group or task force had met and had gone through the trust code in tremendous detail and developed a report. I have an example of it here with me. I will just use this as a visual aid not as an exhibit so we don't overburden the hearing record. But the task force or working group went through every section of the Uniform Trust Code. There are 110 sections. That working group did a tremendous amount of work. In the 2003 session the trust code was enacted by the Legislature, that was LB130, I believe. The bill became operative in 2005, and since that time there have been a few fine tuning adjustments that the Uniform Law Commissioners have come up with. They recommend those to the states, and that is what you have here in this bill. This bill was actually introduced last year by Senator Mines and due to the crush of business towards the end of the short session, it didn't make it either on it's own or within some other package. So this bill in either as LB114 or as it's predecessor has been around now for a year. And if you want to glance at the, or when you have an opportunity, the introducer statement, there is a description of each of the sections. But let me hasten to point out that in these descriptions in the introducer statement there are quotes from the updated official comments from the Uniform Law Commissioners that for the most part these provisions are not substantive changes. But they are clarifications and they are updates, like is section 1 the purpose of the amendment is to make the language consistent not to change the substance. Those are the words from the Uniform Law Commissioners. In section 2 no substantive change is intended, again that is a quote. Section 3 restructures and clarifies, and on and on through the other sections. One could go through the sections in their substance if you wanted to, but again, I would say

the bill doesn't change these sections, it clarifies their provisions, it restructures their provisions for clarity. Before I forget I would like to offer as an exhibit a letter to the committee from Professor John Gradwohl at the University of Nebraska College of Law. John wanted to be here today. He has been part of the Uniform Trust Code project from the start. He was a member of the interim study, working group and he just wanted to offer that letter to indicate his support. I could go on but I know you don't want me to, so if you have any questions I would move to those. [LB114]

SENATOR PAHLS: Do I see any questions for Bill? As usual, Bill, thank you. [LB114]

BILL MARIENAU: Thank you. [LB114]

SENATOR PAHLS: I see we have some proponents. Good afternoon. [LB114]

LARRY RUTH: Chairman Pahls, members of the committee, my name is Larry Ruth, R-u-t-h, and I am one of Nebraska's commissioners on the National Conference of Commissioners on Uniform State Laws. The other commissioners are Retired Chief Justice Krivosha, Judge Arlen Beam who is on the eighth circuit court of appeals federal bench, myself, Harvey Perlman, and Joanne Pepperl, and one final one Amy Longo. I am only here to introduce the next speaker. John McCabe is with the national conference, he is from Chicago. We intend to give a little bit of background on the national conference in Harvey Perlman's testimony on LB136 so I will put off anymore until then. But this is the organization that did work within the last couple of weeks on the child custody case that was in front of the body in which you worked on very rapidly. So without further ado I want to introduce John McCabe and they will give you a little more information on the national conference in two bills. [LB114]

SENATOR PAHLS: Senator Gay. [LB114]

SENATOR GAY: Real quickly, but just for educational purposes, that is quite a list, but how do you get on that committee? [LB114]

LARRY RUTH: Okay. It is variously done in different states, but in Nebraska the Revisor of Statutes Joanne Pepperl, is automatically on it and then the rest are appointed by the Governor. And, typically once you are appointed it has been customary in the past, you continue to be appointed because you gain some seniority in that and also as you gain seniority you have a senior position then another one can start, and so Nebraska gets good representation on that body. Every state has representatives to this organization and it is funded by the states. [LB114]

SENATOR GAY: Thank you. [LB114]

SENATOR PAHLS: Is it a commissioner or judge? [LB114]

LARRY RUTH: Well, in this particular case it is Larry. How does that sound. Okay. Thank you. [LB114]

SENATOR PAHLS: Okay. Thank you, Larry. Any more proponents? [LB114]

JOHN McCABE: My name is John McCabe. I am legislative director for the National Conference of Commissioners on Uniform State Laws, a name which I am sure five minutes from now you will not remember in toto, and we will be talking about the conference, I think, more in conjunction of LB136 and I would defer to Harvey Perlman's testimony which has been prepared for that purpose. As to (LB)114 you have heard from Bill Marienau, to the effect, that this is to adopt some subsequent amendments to the Uniform Trust Code that is subsequent to the time that Nebraska adopted them. They are clarifying amendments. They deal with issues of creditor's rights in trusts, which this kind of issue, it can be kind of critical, but the whole point of these amendments is to make it clearer where the barrier is with respect to beneficiaries' creditors, with respect to getting to the corpus of the trusts, and most trusts these days, and indeed under the trust code, are what we call spendthrift trusts, which means that if there are discretionary distributions, that it is the discretion of the trustee when a distributions may be made to beneficiaries, the beneficiaries' creditors are not entitled to any part of the corpus of the trust. That is to protect the settlor's interests which are to maintain the corpus of the trust. But if there are distributions from the trust and when they are made to the beneficiaries, then of course beneficiaries' creditors can claim them like any income source that a beneficiary has. This is always been critical to make determinations as to when exactly a creditor has rights and how exactly, more exactly to determine those, and these amendments essentially serve that purpose. Other than that I would be happy to answer questions if you have any, and we have at least a couple of more uniform act related bills coming I know. [LB114]

SENATOR PAHLS: I see no questions...oh, Senator Langemeier. [LB114]

SENATOR LANGEMEIER: Chairman Pahls. Thank you for coming to Nebraska to testify, and you just brought up a point there that we do have four bills all on uniform trust today. In your position have you had the opportunity to review all four of those? [LB114]

JOHN McCABE: I think, now, you said four. [LB114]

SENATOR LANGEMEIER: Three, excuse me. [LB114]

JOHN McCABE: I am aware of two plus the uniform prudent management institution, (LB)136, which is a different bill. Is there another, because I know two plus that one that are here? And yes, I will be prepared to talk on all of those. [LB114]

SENATOR LANGEMEIER: Okay. That was going to be my question if you were going to talk on all three. Thank you. [LB114]

SENATOR PAHLS: Senator Pirsch. [LB114]

SENATOR PIRSCH: In terms of background or overview, how many states have adopted Nebraska Uniform... [LB114]

JOHN McCABE: The trust code? [LB114]

SENATOR PIRSCH: Yeah. [LB114]

JOHN McCABE: About 19 at this point. It is an ongoing project with the conference. We anticipate we will pick up two or three more this year. The trust code itself is a very large project. Bill pointed to you the study report here in Nebraska. Nebraska was one of the first states to get into the process of looking at the trust code. I think that is to some degree because Nebraska is a uniform probate code state. So you had the predecessor uniform probate code uniform law that has established what the probate law of Nebraska is, and to some degree the trust law of Nebraska preceding the trust code, and you have very strong bar group here with interests in this and interests in keeping the law up with regard to states and trusts. And so that is how the trust code got in rather quickly in Nebraska, more quickly than other states. But this is an ongoing project with us and we anticipate over the years that we will convert most of the rest of the country to the Uniform Trust Code. [LB114]

SENATOR PIRSCH: And I assume when they are adopted by other states they are adopted with some variations to certain degrees or are they largely wholesale? [LB114]

JOHN McCABE: Well, you know, I will say to that that my organization is firmly in support of uniformity of law on these issues for a variety of reasons, economic and social reasons. But we also recognize that uniformity is something of a platonic ideal to which my organization is dedicated. But we do take amendments to very large codes like this. One of the problems with trust in the state law is that you have to accommodate existing conditions in given states in ways that you would not do, say, in the commercial law where we are much more uniform with the uniform commercial code. So yes, there are variations from state to state. Some of what you see in (LB)114 is to respond to variations that occurred in some states on just this spendthrift issue. [LB114]

SENATOR PIRSCH: Okay. Very good. Thank you. [LB114]

SENATOR PAHLS: I see no more questions, thank you. [LB114]

JOHN McCABE: Thank you. [LB114]

SENATOR PAHLS: More proponents? [LB114]

TOM FITCHETT: Mr. Chairman, my name is Tom Fitchett, T-o-m F-i-t-c-h-e-t-t. I am an attorney in private practice in Lincoln. I have been a member of the study committee since its inception in 2001. I think our first meeting was in December of 2001. In connection with the proposal for LB114 I have reviewed them, they are good provisions. I think it is great that Nebraska can follow along and be a part of the Uniform Trust Code as these amendments come down through the national commission. The one that deals with spendthrift provisions at the end is a very good provision. There has been some lack of clarity there and this improves it. It also takes care of discretionary...well, dealing with the spendthrift provision it says that if you have a mandatory provision for distribution in a trust that a creditor can get at that, but mandatory wasn't defined very well. That occurs in this proposal which is a good thing to have happen. So I am here to support the legislation and have had a chance to look at it, the Uniform Trust Code, over the last few years. It is a good piece of legislation in my opinion. [LB114]

SENATOR PAHLS: Do I see any questions? Seeing none, thank you, appreciate it. [LB114]

ROBERT J. HALLSTROM: Chairman Pahls, members of the committee, my name is Robert J. Hallstrom. I appear before you today as a registered lobbyist for the Nebraska Bankers Association in support of LB114. The amendments are technical, not substantive in nature. They improve the Uniform Trust Code. We have been supportive in the past of adopting and revising the Uniform Trust Code to update it and we just want to express our support again today for the changes embodied in (LB)114. [LB114]

SENATOR PAHLS: Any questions for Bob? Seeing none, thank you. [LB114]

ROBERT J. HALLSTROM: Thank you, Senator. [LB114]

SENATOR PAHLS: Any more proponents? Opponents? People in the neutral? That closes the hearing on LB114. [LB114]

SENATOR PAHLS: We will now open on LB189. Senator Mines, I think we are ready. [LB189]

SENATOR MINES: Chairman Pahls, thank you. Good afternoon, members of the committee. For the record my name is Mick Mines, M-i-n-e-s. I represent Legislative District 18, and today I am the primary introducer for LB189. This, as drafted, would amend provisions of the Nebraska Uniform Trust Code under (section) 30-3867(e) and

that relates to the trustee's duty to inform and report to qualified beneficiaries, and the trustee's duty to administer a trust solely in an interest of the beneficiaries. With regard to revisions to the trustee's duty to inform and report, I understand that Mr. Hallstrom will be bringing an amendment that will strike some of the changes, so in the interest of time let me bypass that. With respect to revisions to the trustee's duty to administer a trust solely in the interest of the beneficiaries, LB189 would expand the transactions under the UTC which are not presumed to be affected by a conflict between the personal and fiduciary interests of the trustee, to include the placing of securities transactions by a trustee through a securities broker, that is part of the same company as the trustee. Additionally, whether it is owned by the trustee or is affiliated with the trustee. Provisions of section 30-3867(c)(4) currently provide that transactions involving the investment of management of trust property are presumed to be affected by a conflict between the personal and fiduciary interests. If entered into by a trustee with a corporation, or other person, or enterprise in which the trustee or person who owns a significant interest in the trustee has an interest that might affect the trustee's best judgment. An exemption to this presumption is provided under Nebraska Revised Statute (section) 30-3867(e) which expressly provides that an investment by a trustee and securities of an investment company, or an investment trust to which the trustee or its affiliate provides services in a capacity other than the trustee is not presumed to be affected by a conflict between the personal and fiduciary interests if the investment complies with the prudent investor rule. And that is laid out in sections 30-3883 to 30-3889. The trustee is further required to at least annually notify the persons entitled to receive a copy of the trustee's annual report of the rate and method by which the trustee's compensation has been determined. LB189 would expand the provisions of Nebraska Revised Statute (section) 30-3867(e) to provide that the placing of securities transactions by a trustee through a securities broker that is part of the same company as the trustee, is owned by the trustee, or is affiliated with the trustee is not presumed to be affected by a conflict between the personal and fiduciary interests of a trustee if the transaction and any investment made pursuant to the transaction, again, complies with the prudent investor rule. LB189 would allow trust beneficiaries to benefit from transactions conducted between a trustee and a company that is affiliate with the trustee which provide an economic benefit to the trust and it's beneficiaries. Trust beneficiaries would continue to be protected by the existing requirements under Nebraska Revised Statute (section) 30-3867(e) that such transactions and any investment made pursuant thereto comply with the prudent investor rule. As I mentioned before there is an amendment by Mr. Hallstrom that will address some concerns. I think you also have members of the UTC task force and they will have some input as well. Thank you very much for the consideration, Mr. Chair and members, and that will conclude my remarks for LB189. Thanks. [LB189]

SENATOR PAHLS: Senator Langemeier. [LB189]

SENATOR LANGEMEIER: Chairman Pahls, thank you. Senator Mines, thank you for

your introduction, and I have to admit that this subject has a tendency to put me to sleep. And I am going to ask you this question and it may not be for you to answer. You may move it on to Hallstrom or somebody behind you. Give me an example of how a trust is going to be different if with this? [LB189]

SENATOR MINES: I am going to defer to Mr. Hallstrom. However, a trustee right now cannot benefit from a fiduciary relationship, let's say. So a trustee, under this article, would simply say that if the transaction is conducted under the prudent investor act it protects the trustee, and says you can use your own firm, you can use some other firm, and you may, in fact, receive some benefit as long as you maintain the prudent investor. [LB189]

SENATOR LANGEMEIER: And that benefit may be pay or is that a trip to the Bahamas for buying enough over here? I mean what do you mean by benefit? [LB189]

SENATOR MINES: It could be, and again, I will defer to Mr. Hallstrom, but let's just say that you are using your bank and you are using your affiliated stock brokerage to transact business, and there are transaction fees. So that would be a benefit, too, and you would have fiduciary interest in that organization. That is the way I understand it. Now there may be a lot more to the story, but I will let Mr. Hallstrom. [LB189]

SENATOR LANGEMEIER: Thank you. I am just trying to grasp onto something in reality... [LB189]

SENATOR MINES: I understand. [LB189]

SENATOR LANGEMEIER: ...other than a lot of technical stuff. Thank you. [LB189]

SENATOR MINES: Thank you. [LB189]

SENATOR PAHLS: Senator Gay. [LB189]

SENATOR GAY: I have got a question, and this one, too, if you want to pass it on. But the way I am understanding this trust company running a trust, but if a person has a trust and they are running if for the family and the mom or whoever is in a home, let's say, it says here on compensation you have got to annually disclose the compensation. So annually you have to disclose the compensation. If they were using a broker or financial advisor you have got to annually disclose the compensation to the trustee. The trustee could be the individual who is placing the trades, annually you would have to do that. So this just doesn't apply to all trust companies. [LB189]

SENATOR MINES: That is correct. [LB189]

SENATOR GAY: Any trustee individually. [LB189]

SENATOR MINES: Yes, that is the way I understand it. [LB189]

SENATOR GAY: Thank you. [LB189]

SENATOR PAHLS: Thank you, Senator. [LB189]

SENATOR MINES: Thank you, and I am in another meeting so I will waive closing. [LB189]

SENATOR PAHLS: Thank you again, appreciate it. [LB189]

SENATOR MINES: Thank you. [LB189]

SENATOR PAHLS: We just had you claim bankruptcy because we made you a senator. [LB189]

ROBERT J. HALLSTROM: (Exhibits 1-3) Thank you, Senator. I have had some interesting discussions on bankruptcy this session. Chairman Pahls, members of the Banking, Commerce and Insurance Committee, my name is Robert J. Hallstrom. I appear before you today as registered lobbyist for the Nebraska Bankers Association in support of LB189. H-a-l-l-s-t-r-o-m. Senator Mines has indicated that one significant portion of the bill is designed to go away due to some discussions that we have had with the working group, or the study group, or study committee with the Uniform Trust Code, particularly working with Professor Gradwohl, and that has to do with the duty to inform and report to qualified beneficiaries. I am passing around not only the proposed amendments, which I will describe in more detail in just a few minutes, but also a letter from Professor Gradwohl that basically indicates that with the amendments that we have proposed that on behalf of the task force study committee that they are supportive of LB189. In that letter Professor Gradwohl has bestowed upon me the status of the Banking Industry Liaison to the Nebraska legislative study committee on the Uniform Trust Code. At times the word liaison became the guy who gets rolled over if he happens to disagree with the study group, but for the most part I do seriously want to commend that task force over the years for having placed a labor of love and virtually thousands, I think, of man-hours in putting together the Uniform Trust Code, reviewing case decisions and statutory law to ensure that Nebraska's trust code was brought up to speed and in the best shape possible. Basically the amendments that I have presented will eliminate any provisions of the bill as originally introduced relating to the duty to inform and report to qualified beneficiaries. What that leaves us with is the duty of loyalty, section 802 of the Uniform Trust Code. Perhaps again going down that walk down memory lane to give the committee a little bit of a historical background as Mr. Marienau did on LB114, this particularly relating to the duty of loyalty. Back in the early

nineties there were issues where banks, particularly larger banks, were starting to create what are referred to as proprietary mutual funds, funds within the bank that are sponsored by the financial institution itself. The Office of the Comptroller of (the) Currency came out at that time, and, again, this preceded the adoption of the Uniform Trust Code, but there are still fiduciary obligations of a trustee even before the Uniform Trust Code relating to the prudent investor rule to the duty to carry out the trust in the best interest of the beneficiaries and so forth that applied. And the Office of the Comptroller of the Currency, in looking at issues relating to national banks, at that time, and equally applicable to state-chartered banks, indicated that if you have a trust department in a bank and that same bank has a proprietary mutual fund, that even though the duty of loyalty continues to exist and you are governed by the principles of the prudent investor rule and the best interests of the beneficiaries, that state law would have to be enacted to, in essence, recognize that notwithstanding those presumptions, if you will, and the duty of loyalty, that the state law would recognize the ability to act as both trustee and as investment advisor to a proprietary mutual fund and receive compensation for either or both of those transactions without violating any duty of loyalty. Nebraska, in 1993, adopted that very type of statute. We adopted it along with, I think, every other state in the nation at that time, and there is, as Senator Gay points out, a disclosure of regarding the rate and method of compensation when you are acting both as trustee and investment advisor for the proprietary mutual fund. When the Uniform Trust Code was adopted and took effect, I think, in 2005, those provisions were in fact a portion of the recommended model act or Uniform Trust Code. So Nebraska, again, readopted effectively within the Uniform Trust Code virtually identical provisions to those that we had adopted originally in 1993. What has occurred since that time a number of states, I think four of them that I have referenced in my testimony, have adopted some additional provisions that clarify that in addition to the proprietary mutual fund activities that a bank may also work in the area of placing security transactions with an affiliate of the bank or the trust and receive compensation similarly to what they are authorized to do under the proprietary mutual fund. Those four states, I think New Hampshire, Missouri, Wyoming, and Alabama, have all adopted not only the placement of securities transactions but even gone broader than that. We are simply here today to seek the authority under state law for the placement of securities transactions. In essence, I think I have got an example, this clarifies that under state law currently there is a real concern and a problem for the trustee getting involved even if they can place a securities transaction that happens to be in the best interest of their beneficiaries. So in other words, if I have the decision to choose between making an election to place a securities transaction that has a $10 fee through my securities brokerage affiliate and looking outside to where I would reasonably place that transaction with Edward Jones or somebody completely unrelated is a $20 fee. Fairly simple example, but it highlights the fact that I certainly could do better by way of the beneficiaries in placing that transaction through my affiliated brokerage firm. In many cases it is not just the difference between $10 and $20, but sometimes that fee may even be waived or divided between the trust commission and the commission that you get from the securities

brokerage firm. So all in all the practice is to simply clarify in state law that we can act in the dual capacity. The guiding principle, and even clarified more so by the amendments that I have passed out, and I will talk to those right now. The first one is, Senator Mines referred to the fact that the bill as originally introduced clearly recognized the duty to comply with the prudent investor rule in doing either the proprietary mutual fund activities or the proposed securities transactions. What has been added to that at the request of the study committee for the Uniform Trust Code is that it must also clearly be in the best interest of the beneficiaries. We had absolutely no problem putting those provisions in as proposed under the amendment. The other clarification is that the compensation must be reasonable, and that will apply equally to either the proprietary mutual fund compensation or to the placement of securities compensation that you may have in dealing with an affiliate of the bank or the bank trust department. So that in a nutshell is where we go with the green copy of the bill plus the amendments that we have proposed for consideration by the committee, and we would encourage the committee to advance the bill with those amendments. Be happy to address any questions. [LB189]

SENATOR PAHLS: Senator Gay. [LB189]

SENATOR GAY: So you used a purchase example, but a managed account where they are waiving all the fees would still be covered under this. So a reasonable amount of, let's say you are just charging a monthly fee or an annual fee and you waive all expenses, this would encompass that as well. [LB189]

ROBERT J. HALLSTROM: I think it would encompass that. That would fall under... [LB189]

SENATOR GAY: As long as it is reasonable, I guess, that could be argued at any point. [LB189]

ROBERT J. HALLSTROM: Yes, Senator, and the other issue, Senator, I think with regard, and I will just address your question and maybe some concerns about what is the impact or the disclosure requirements for an individual trustee. The issue to keep in mind is that where the disclosures apply under this bill is only if you are dealing with an affiliated proprietary mutual fund or an affiliated securities brokerage. So obviously the prospect of an individual trustee being in that situation where they have an affiliated securities brokerage firm is probably not going to be applicable. So it should not be a hardship on an individual trustee because it should not apply. [LB189]

SENATOR GAY: Okay. Thanks for clarifying that. [LB189]

ROBERT J. HALLSTROM: You bet. [LB189]

SENATOR PAHLS: Senator Pirsch. [LB189]

SENATOR PIRSCH: So this broadening, if you will, of the duty that has already occurred in four states, is that correct? [LB189]

ROBERT J. HALLSTROM: That is correct. [LB189]

SENATOR PIRSCH: Okay. When was that first adopted in the beginning of those states? [LB189]

ROBERT J. HALLSTROM: The states have adopted them at different times. Nebraska was towards the cutting edge. They weren't the first state, but they were up at the top. I would suspect that those provisions, there is a couple that I think have only been in effect for a couple of years. Missouri is one of the states that we have generally looked to and I think that the study committee has been very sensitive to what Missouri has done because a gentleman named Professor English is kind of the Godfather of the trust code, if you will, at least from my understanding, and Missouri is one of the states that has broadened the duty of loyalty exception to include securities transactions as well as the proprietary mutual fund. [LB189]

SENATOR PIRSCH: Okay. No ill effects reported? [LB189]

ROBERT J. HALLSTROM: Not aware of any problems. There has not been, I think a number of other states quite frankly, Senator, are going to look at expanding this. The Uniform Trust Code has come on rather slowly, but it is picking up steam and I think everybody was looking initially to get the Uniform Trust Code in its pristine shape, and then are looking at issues after they get it adopted to enhance it in this fashion. [LB189]

SENATOR PIRSCH: Okay. Thank you. [LB189]

SENATOR PAHLS: Senator Langemeier. [LB189]

SENATOR LANGEMEIER: Chairman Pahls, thank you. Bob, you talked a little bit about buying it through your affiliated $10 or going out into the other markets and buying it at $30. Would they be buying the same product? [LB189]

ROBERT J. HALLSTROM: Yes, it would be. A decision, Senator, within, and that is where the prudent investor rule comes in that they would be guided by the principle that they are supposed to make prudent investments in determining what bond or security to purchase. So it is going to be yes in any individual case. I am going to be making a decision based upon the prudent investor rule to invest in security X. The question is am I going to invest in security X through the affiliated brokerage firm or an outside firm, and the issues of the services that are provided, that bear cost of the commission that

might be incurred at affiliated versus unaffiliated are the things then that go into the decision making in terms of that back end protection which is the best interest of the beneficiaries of the trust. [LB189]

SENATOR LANGEMEIER: Thank you. [LB189]

SENATOR PAHLS: Senator Pankonin. [LB189]

SENATOR PANKONIN: Thanks, Chairman Pahls. Bob, I want to make sure that answer you just gave is probably true for buying individual securities, but let's take First National Bank trust department, they have their own funds as well, and to go back to Senator Langemeier's question there may be a difference in the cost and the fund may have the same goal or in the prospectus have the same type of orientation, but it might not be the same grouping of individual stocks. So I think just to... [LB189]

ROBERT J. HALLSTROM: Yeah. Exactly, Senator, if you are looking at a mutual fund that would definitely be the case. They may have similar investment objectives, rate of return and so forth. But they will inherently be slightly different. [LB189]

SENATOR PANKONIN: So to answer his question, not exactly. [LB189]

ROBERT J. HALLSTROM: Yeah. Not in every case. Thank you, Senator. [LB189]

SENATOR PAHLS: Don't see any more questions, thank you, Bob. Appreciate it. [LB189]

ROBERT J. HALLSTROM: Thank you. [LB189]

SENATOR PAHLS: Proponents? [LB189]

JOHN McCABE: Mr. Chairman, again, my name is John McCabe. I am legislative director for the conference. I really wanted to say with respect to LB189 and particularly the amendments that the discussion of these amendments went through my office partly...I have a counsel who essentially does the trust code. Michelle Clayton, she and John Gradwohl and the trust group here in Nebraska were engaged in discussing the proposed amendments. I think Bob's articulation of why they are there is correct. The proposed amendments simply make if very, very clear that you may do certain things with respect to affiliates, that is buy products of affiliates, use products of affiliates, but you are not absolved from basic fiduciary obligations. You are not absolved from basic fiduciary obligations relating to conflict of interest, duty of loyalty in other words, and you are not released or relieved of the duty to be cost conscious, which is part of the prudent investor obligation which are also articulated fiduciary obligations with regard to trust. So with those amendments everybody I think has agreed that it would be fine to

adopt this in Nebraska, and I would be happy to answer questions. [LB189]

SENATOR PAHLS: Senator Langemeier. [LB189]

SENATOR LANGEMEIER: Chairman Pahls. Thank you, again, for your testimony, and I look forward to the third bill here. What is the benefit to the beneficiaries of the trust to have them be able to do this, have this second option out there to purchase? What is the true benefit? [LB189]

JOHN McCABE: The answer is that fundamentally we are not really dealing with what is to the benefit of the beneficiaries. We now have a very broad financial institutional structure, if you will, where banks act as fiduciaries. They have large trust departments where they also have in-house mutual funds, where they also have affiliates that are brokerages or have varying affiliations with brokerages where they may place trades in terms of the total profits of the institutions. And I think that from the git-go with the trust code it has always been understood that that is all right so long as fiduciary obligations are maintained. In other words, they are not required not to use their own affiliates, but they are required to pay attention to conflict of interest in the event that they do that, and to make sure that conflict of interest does not enrich the corporate trustee or the institution more than it helps the beneficiaries. And so what we are doing here is, I think, articulating more clearly those rules, and with the additional amendments we make it much more clear that the institution in terms of using these things, using its own affiliates is not absolved from basic fiduciary obligations. That is in the best interest of the beneficiaries, and we quite clearly want that stated and that is why the amendments are in here. There is nothing wrong with using affiliates if it is cost effective, if the returns are appropriate, and as long as the institution is not benefiting more than the beneficiaries are. That is basically what it is all about. [LB189]

SENATOR LANGEMEIER: Thank you. [LB189]

SENATOR PAHLS: Senator Pankonin. [LB189]

SENATOR PANKONIN: Thanks, Chairman Pahls. Sir, we are very thankful that you came all the way from Chicago to testify. What you just talked about, and I agree that the amendment does help in that, but what we are talking about is a very fine line because a trust is developed to protect people that maybe don't have the ability to invest on their own whether it is a widow or children or whatever the circumstances, and when you say that the duty is the best interest of the beneficiaries that is what obviously trusts are about. But for them to measure, if someone says here is our in-house fund and here is the outside opportunities, I mean, to a person that is why you have a trust because you are trying to...I just think it is inherently very tricky to follow. [LB189]

JOHN McCABE: That is why we call them fiduciaries and make them live up to certain,

and they are not totally precise standards that I am sure you are aware. But they have obligations and those obligations have to be met in order to avoid liability for breach of fiduciary obligations. [LB189]

SENATOR PANKONIN: So my question is do you think under this bill and these amendments that is improved? [LB189]

JOHN McCABE: Yes. I do believe so, and that is clearly the objective of the amendments. I mean we didn't produce the original bill, but the amendments are part of a negotiation to make sure that the proposed amendment from the Bankers Association does meet the standards very clearly. [LB189]

SENATOR PANKONIN: Thank you. [LB189]

SENATOR PAHLS: Senator Pirsch. [LB189]

SENATOR PIRSCH: I guess trying to wrap my arms around this a little bit more. Currently Nebraska Revised Statutes (section) 30-3867(c)(4) provides the baseline rule is that there is presumed conflict, correct? And then there is an exception encapsulated in (section) 30-3867(e) and could you comment? What is the state...it is the difference between the two that if you put that in practical real terms then...right now with the exception, how far can you take it, and then with the enactment of this proposed bill how would that effect? [LB189]

JOHN McCABE: Well, I guess for me that is a little hard I guess, and perhaps we ought to bring Bob up here and let him articulate what the differences would be better because he is more familiar with the actual operations of banks and similar institutions. Again, it is not necessarily bad for an institution to use its own in-house facilities, so long as it is cost effective to do so, and that is the underscored issue here. It is really a question underlying a double dipping question that underlies all this, and yeah, you can double dip if in fact in terms of your basic obligations, the risk return analyses you have done and the returns that you expect, you can be allowed to use affiliates. But you have to be doing that in the context of doing exactly that, what a prudent investor does. Do the risk return analysis, do the diversification analysis, and take into account all of the factors that you must take into account when you are managing a trust, including who the beneficiaries are, what is their situation, are they totally reliant on the trust for income, is there other income. I mean all of these things go into individual decisions with respect to trusts in their investment, and it is not a good thing to absolutely prohibit use of affiliates but it is a very good thing to clarify that when you do use affiliates that you have some rules that apply that generally guide as fiduciary obligations the actions of the institution and the trustee. I know it is not simple. Not simple at all. [LB189]

SENATOR PAHLS: Senator Carlson. [LB189]

SENATOR CARLSON: Senator Pahls. Sir, in this you're helping clarify it for me with Senator Pirsch's question, but decision you used the term cost effective and then it also needs to be performance effective, but that fits in with the prudent investor rules, one has got to be weighed against the other. [LB189]

JOHN McCABE: Right. Performance effective under this act, and really the Prudent Investor Act precedes the trust code, and actually is incorporated in the trust code when the trust code is adopted. But Nebraska, like most states, had the Prudent Investor Act well before the trust code. The Prudent Investor Act governs generally the fiduciary obligations of a trustee, and it lays out a set of standards that guide trustees in the performance of their fiduciary obligations, and one of the things that they have to take into account is cost clearly. It doesn't mean that you can't buy say a hedge fund, which is expensive automatically. But if you are going to buy hedge fund, for example, and spend the money, pay them hedge fund fees you better be sure that your risk return analysis is sufficient enough that it is worth the risk to try to get the expected return. So cost effectiveness is an issue of the whole pattern of prudent investment, and again, every trust has to be treated differently with respect to all of the objectives that the trustee has. But being cost effective is one of the obligations under the Prudent Investor Act. [LB189]

SENATOR PAHLS: Senator Gay. [LB189]

SENATOR GAY: Would you agree there are many other protections for the beneficiary outside of this act as you had mentioned? You look at a lot of different factors. This doesn't fix everything but there are other ways that people are looking out for the beneficiaries' interest. To me this just allows for an opportunity with the changing opportunities that are out in the financial services. It kind of just changes the landscape to fit more what is going on today. But beneficiaries, would you agree, are covered in many other ways than this that a advisor or a fiduciary would have to look out for? [LB189]

JOHN McCABE: Well, your basic fiduciary obligations are within the law of trust, either the common law of trusts or the statute, and the trust code is an effort to create a sort of baseline set of fiduciary rules that govern all aspects of trust and trust management. There was some, not part of this bill, but the notification requirements for beneficiaries under the trust code are another aspect of this. The notification requirements are there to make sure the beneficiaries have information about what is happening with the trust. Again, the trustee must communicate with the beneficiaries. Again, another set of obligations for the trustee that is part of the total trust obligation. But what you basically have here is the statute and now includes the Prudent Investor Act which has the specific rules with regard to investment, also with regard to delegation of authority. In other words, if you are a trustee and you don't have the sophistication, may you

delegate to an investment advisor or other like agent to do an investment for? The answer is yes, you can do that as you do it prudently under the rules of the act. So you have a whole lot of rules in the trust code that govern the management of trust for the benefit of the beneficiaries and that is always the underlying rule with one exception which is revocable trusts where actually the obligation actually flow to the settlor who has the power to revoke the trust and remove the trustee. So as long as the settlor has that power, we essentially flow the obligations to the settlor. But in all other circumstances it always flows to the beneficiary, and yeah, there are a lot of rules that apply. We didn't abolish the common law either where the common law is not articulated specifically in the trust code, it is not abolished. But that is the core of law. It has a huge long history. When we did the code originally, as a trust code, its fundamental objective was to codify, not to do major change in trust law. It is very like the Uniform Commercial Code in that respect. When we did the Uniform Commercial Code years ago, and as we are continuing to do it, much of that is codification of common law principles that were always around, sometimes not as well articulated as they ought to be but were around and the trust code is in that same mode. If you are doing trusts in a state like Nebraska, now the first place you look to see what rules guide you both as a drafter of trusts, that is lawyers who draft and administer these things, and for trustees, the first place you are going to look other than the trust instrument itself is the statute. And then if that doesn't answer your questions you are probably going to look to the common law and other sources. But that is how the whole process tends to work. [LB189]

SENATOR PAHLS: Senator Langemeier. [LB189]

SENATOR LANGEMEIER: Thank you, Chairman Pahls. With the trustee having this new option to invest with an affiliate, would that not give the affiliate agency a competitive advantage over an agency group, and I am not sure I am using the right terminology there, over someone that doesn't have an affiliation with a division of trust individuals? [LB189]

JOHN McCABE: The answer is I don't know. I mean that is not one that I can really answer very well. That is not a real issue with regard to the obligations to a beneficiary because you are obliged to give the beneficiary the most cost effective results. Because you give those to the beneficiary doesn't mean you have an obligation to say other organizations or other people who compete in the trade. It is not really an issue of competition here. In the trust code what we are dealing with solely is the fiduciary obligations that flow to the beneficiaries. If there are anti-competitive problems, well, those have to be dealt with in terms of law to avoid basically anti-competitive practices. The trust code doesn't answer that. It is not meant to answer that and deal with that. [LB189]

SENATOR LANGEMEIER: Right. I guess I was looking at it as is, and I am aware that the trust code does not answer that. But inadvertently might that not happen on the

outside, just something that may happen? [LB189]

JOHN McCABE: You should ask the experts about that I think. [LB189]

SENATOR LANGEMEIER: Thank you. [LB189]

SENATOR PIRSCH: Just a quick question here, just so many things in my mind. So currently the way things are set up in (section) 30-3867(c)(4) with the exception can you use, if you are the trustee right now, can you use an affiliate with the beneficiary as long as it meets the prudent investor rule? [LB189]

JOHN McCABE: Yeah, I think so. [LB189]

SENATOR PIRSCH: So that is currently the law of the land as exists now. [LB189]

JOHN McCABE: Again, I look at this as more a clarification, not a real change in the law. [LB189]

SENATOR PIRSCH: I see. That is what I was kind of getting at. [LB189]

JOHN McCABE: This is meant to make sure, which is why the bankers are bringing it, make sure that nobody raises that question automatically when you use an affiliate. But no, I think the prudent investor rule does not preclude use of affiliate agents. Again, so long as you meet the fundamental fiduciary obligations. [LB189]

SENATOR PIRSCH: So is it fair to say the purpose of this law is just to reduce, to clear and express writing that which you believe to be the current law of the land right now in Nebraska? [LB189]

JOHN McCABE: Um-hum, and you also have to remember here that almost all the rules in the trust code, including the prudent investor rules, are almost all default rules. So you always look at the document itself, the trust instrument itself to determine what really applies. It is only when the trust instrument itself does not govern then you start looking at the statute in the other law, and it is quite possible within a trust instrument to do specifications about where you are going to put things. I mean any settlor who agrees to that would be bound because a trust agreement is an agreement, it is a contract. [LB189]

SENATOR PIRSCH: Okay. Within the statement of intent the author writes LB189 would expand the provisions, so I guess that is where I kind of got hung up on is, you are saying this is clarifying as opposed to expanding. [LB189]

JOHN McCABE: Yeah, I think it is more clarification than expansion. As far as I know

there is nothing in the trust code nor in the Prudent Investor Act before it that says you can't use an affiliate. You are just precluded from using an affiliate, you cannot. [LB189]

SENATOR PIRSCH: Okay. [LB189]

JOHN McCABE: But you better be careful when you are doing it, and that is still the case, you better be careful when you are doing it. [LB189]

SENATOR PAHLS: Seeing no more questions, thank you. [LB189]

JOHN McCABE: Sure. Happy to... [LB189]

SENATOR PAHLS: Additional proponents. [LB189]

TOM FITCHETT: Tom Fitchett, as previously a member of the study committee that has worked on the legislation. I believe that this is a clarification of the existing legislation. The existing legislation says that it is not a conflict if you are working with an affiliated company as long as you comply with the prudent investor rule. This adds to it and that that action is in the best interest of the beneficiary. So it is in addition to that. The present statute says that you can be compensated for doing so as long as the fee...the trustee may be compensated by the investing company coming back to the trustee as long as the services are paid for out of fees charged to the trust, and you get into circular stuff. Well, the fee charged to the trust, okay, the trust paid the affiliate and the affiliate now pays the trustee. That language didn't help a lot, so that is disappearing in the act. The proposal says that the fee must be reasonable, and I think that is a good change to make, and the notification provision was there previously. So there really isn't a lot of change. It is adding some things, at least in my opinion, to the statute to make it a little stronger than it was, and getting rid of the problem of this tracing of funds that might have been required under the existing statute. I think it is a good piece of legislation. [LB189]

SENATOR PAHLS: Senator. [LB189]

SENATOR LANGEMEIER: Chairman Pahls, thank you. We have heard a lot today about the prudent investor rule and that this is good because we always had a prudent investor rule to cover any other little loops. Can you tell me how the prudent investor rule is enforced? [LB189]

TOM FITCHETT: It would be enforced by beneficiaries. If they felt that their trustee was not complying with the obligations of the prudent investor rule, then they have a cause of action against the trustee. [LB189]

SENATOR LANGEMEIER: And that would be a court case? [LB189]

TOM FITCHETT: Yes, it would be. [LB189]

SENATOR LANGEMEIER: Okay. Thank you. [LB189]

SENATOR PAHLS: Seeing no more questions, thank you. Any more proponents? Opponents? People in the neutral? That closes this session on LB189. Senator Mines had waived closing. [LB189]

SENATOR FLOOD: (Exhibit 1) Good to see you, Mr. Chairman, members of the banking committee. Good afternoon. My name is Mike Flood, F-l-o-o-d, and I represent the 19th Legislative District which includes all of Madison County. I'm here this afternoon to introduce LB136 which is a bill to adopt the Nebraska Uniform Prudent Management of Institutional Funds Act. This act updates and would replace Nebraska's Uniform Management of Institutional Funds Act which the Legislature adopted in 1996. This first uniform law, known as UMIFA, was drafted almost 35 years ago and portions of it are now out of date. The National Conference of Commissioners on Uniform State Laws has drafted a uniform act, UPMIFA, to modernize the original law and that is what you have before you today. With that, I will turn it over to the real experts on the subject, Larry Ruth and Mr. John McCabe, who joins us from Chicago to talk about LB136. I want to thank you for your consideration and would be happy to answer any questions that you have. [LB136]

SENATOR PAHLS: Do we have any questions for the Speaker? [LB136]

SENATOR FLOOD: Thank you, Mr. Chairman. May I be excused? [LB136]

SENATOR PAHLS: Yes, and thank you. [LB136]

SENATOR FLOOD: And I would also ask to waive my closing. [LB136]

SENATOR PAHLS: So done. Proponents. [LB136]

LARRY RUTH: (Exhibit 2) Senator Pahls and members of the committee, my name is Larry Ruth, R-u-t-h. I appear today supporting LB136. And I'm giving to you right now testimony that Harvey Perlman would give if he were present. He's down harvesting, hopefully, alumni funds from Arizona I think for the University of Nebraska. So I think he probably is given a pass. I don't want to read his testimony. I know you don't want me to, but I want to review it with you. He remarks that he thinks that LB136 would be important for the advance...an important advancement for the University of Nebraska Foundation as well as other nonprofit foundations and their beneficiaries. And he launches into a bit of an explanation of how uniform laws are adopted and how they're considered by this organization that we belong to. I might just mention that if you looked

at your statute books right now there are about 55 or 60 uniform laws that are sprinkled throughout, everything from the land area, real estate area to child abduction area. Now that's the most recent act you just passed. And probably the biggest one that you may know about is the Uniform Commercial Code. There is a whole volume of law on your desks or somewhere that is just Uniform Commercial Code, and that is probably the major work product of this organization which addresses the commercial transactions across the states and has now for about 30 or 40 years. This organization began back in the 1880s so it's a very long, old organization; and it was set up to respond to the need for uniformity of certain laws as it related to the states. The states were beginning to have differences in the commercial area and other areas. And there is kind of a press for more federal legislation to get uniformity. And the response to that from the states was to come up with this organization to have uniform laws but yet keep them then within the jurisdiction of the state legislatures. So in a very important respect these uniform laws are to protect the sovereignty of the states and to maintain your interest, for example, in the trust law rather than having a federal law on this. In this particular case, what we're looking at today is the Uniform Prudent Management of Institutional Funds Act. And once again, rather than having a federal law on this we have a uniform law that's adopted. Each state can tweak it a little bit. It can change a lot easier than it would be if you were having to change it at the federal level each time there was a need that had to be met. Harvey talks about the fact that we have members on the commission, as I mentioned earlier, and then he talked a little bit about the drafting sessions. And I don't want to go into that, but I just want to relate to you that UPMIFA, the bill you have in front of you, is a very recent proposed uniform law that was adopted by the national organization. And it builds on the previous one that was a uniform law and which is currently our law in the state of Nebraska. Harvey also mentions about the advantages to the state from uniform law and I won't go into those, but just to relate to you once again the crown jewel, so to speak, is the Uniform Commercial Code which covers every commercial transaction that we do it seems like, which lawyers who have gone to law school spend whole courses on, and which is very important to our economic development in the state because it means that the corporations who do business in one state can come to Nebraska and realize they're dealing with laws which are similar, if not completely uniform, with other state laws. Do you have any questions? [LB136]

SENATOR PAHLS: Any...Senator Langemeier. [LB136]

SENATOR LANGEMEIER: Thank you, Chairman Pahls. I wasn't going to ask one, but I'm going to anyway. In the handout we were given, no other states have adopted this piece of legislation at this point. [LB136]

LARRY RUTH: I'll let John McCabe talk to that, but that might be the case. [LB136]

SENATOR LANGEMEIER: There's nine states that are looking at it under this, including

Nebraska, but if we adopt this we would be the first one. So companies that wanted to deal with Nebraska would have the opportunity to deal with one oddball out of the group at this point. Correct? [LB136]

LARRY RUTH: Well, they all have to start somewhere. And this is probably one of the least controversial ones because it builds on the previous law which many, many states have adopted. And it also uses the prudent investor theory which we have already adopted in several instances here in the state. [LB136]

SENATOR LANGEMEIER: Thank you. [LB136]

LARRY RUTH: So I think we're building on good foundation. [LB136]

SENATOR PAHLS: Senator Pirsch. [LB136]

SENATOR PIRSCH: Just a...and I take it's with respects to the letter from Harvey Perlman, is that something you've gone over in this bill? [LB136]

LARRY RUTH: Yes. [LB136]

SENATOR PIRSCH: It says that this would be an important advance for the University of Nebraska Foundation. Could you just briefly comment how that would... [LB136]

LARRY RUTH: I don't know. [LB136]

SENATOR PIRSCH: Okay. [LB136]

LARRY RUTH: In other words, he's talking about his foundation. Maybe there's someone here from the University of Nebraska Foundation. I know that there's a representative here from the independent colleges, and they oftentimes have independent college foundations. [LB136]

SENATOR PIRSCH: Sure, I just thought... [LB136]

LARRY RUTH: Yes. [LB136]

SENATOR PIRSCH: Thank you. [LB136]

SENATOR PAHLS: Yes, Senator Gay. [LB136]

SENATOR GAY: Larry, and I know this is Mr. Perlman's testimony here and so I'll give you some leeway or maybe you can move this on, but on item 3 it supports the system because if you have the uniform laws it preempts some congressional efforts to stick

their nose in states' business and that's why we do these things a lot of times. But do you have any cases that maybe could help us with where they're looking at doing that or... [LB136]

LARRY RUTH: Actually, John McCabe can probably answer that but I do know... [LB136]

SENATOR GAY: Yeah, and you don't... [LB136]

LARRY RUTH: ...no, but there have been several instances, UIFA (phonetic), for example, I think, uniform information act that we adopted or UETA rather, Uniform Electronic Transaction Act, and some of the others, we were actually given the task or the suggestion that if we would adopt uniform law in the area that we would probably avoid having the Congress having to do it, and then you would have it being able to be tailored by each state. [LB136]

SENATOR GAY: So this protects our state's rights to work out our own solutions without federal intervention basically. [LB136]

LARRY RUTH: Right. I'm a little reluctant to say state rights, although I said that because it has that pejorative meaning of a bygone year. But in actuality, it does protect the federal system. That means that you do have things that are done at the federal level, the Congress, but there's a wealth of opportunity for the state legislatures to work in, and as you have the federal government getting into areas, it reduces...it diminishes yours. So I think that's one of the reasons we do this. [LB136]

SENATOR GAY: Thank you. [LB136]

LARRY RUTH: Um-hum, thank you. I'd like to introduce John McCabe. [LB136]

SENATOR PAHLS: Yeah, okay, thank you. Welcome back. [LB136]

JOHN McCABE: My name is John McCabe from Chicago, the National Conference of Commissioners on Uniform State Laws. We're going from the fat into the fat here because we've already had discussion about prudent investor rules and we're going to look at the prudent investor rule in the context of this act because that's what this act is all about except in a different context than trusts. You know, what we're really talking about and it's what we were talking about in trusts, too, but in this act we're talking about really about money, about investment of money for specific purposes, in this case charitable purposes and money that is generally donated to charitable institutions to be invested to provide income and appreciation for charitable purposes. And so on the other side it also deals with the expenditure of that money. And prudent rules for governing the expenditure of the money that charitable institutions achieve or obtain

basically through prudent investment. It replaces an earlier act, and you've heard that, the Uniform Management of Institutional Funds Act, which Nebraska has, along with 48 other states. The Management of Institutional Funds Act was historically, I think, the first prudent investment act, the first articulation of prudent investment rules I believe in American law actually. It preceded ERISA I believe to be the case, ERISA being the federal law that governs pension funds in which these principles are also included. UMIFA, when it came out in the seventies, very quickly passed through the legislatures of the United States. By the time we got to 1980, I think we had virtually the 48 adoptions that we currently have. Over time we began to work on prudent investment more as a notion, as an idea, more particularly. And that's where the Uniform Prudent Investor Act comes in. It was brought out to provide investment rules for trusts that are characteristically prudent investor rules. And if you look at the official commentary to the Uniform Prudent Investor Act, you will see that it refers back to UMIFA as its ancestor. Now so what you get here is a broadening of rules that govern investment, that start in the charitable world with UMIFA, that have been instituted in the world of private trusts and to the degree that charitable trusts are governed by prudent investor rules under the trust law, also those kinds of charitable trusts. And now we're coming back, not to redo the revolution that occurred in the seventies with regard to UMIFA, but essentially to bring UMIFA up to date with respect to the things we've learned by doing the uniform Prudent Investor Act. There actually is another act out there which has not been adopted in very many places dealing with public employee retirement systems that also has these same prudent investor rules in them. And I guess the best way to do this is simply look at the bill and just point you to the right sections here. I'm looking now for section 3 because I think you number precisely with the...the bill precise...yeah, here we go, section 3 which in my copy is page 3 and it says here, "Subject to the intent of a donor expressed in a gift instrument." Much like what I stated about trust law, we always look to the trust instrument first and the statutory law secondarily so what this suggests these are default rules. So if a donor is making a substantial donation to a charitable institution and wants to put conditions upon the assets in the way the assets are invested, the donor has that privilege. And the donor...whatever the donor wants it's the donor's money, whatever the donor wants prevails, even if there's a conflict with this act so that we have here default rules. And this is just exactly the way it's done in trust law. We have here articulation of a duty of loyalty here, an idea of duty of loyalty. But we're in a different fiduciary relationship situation here than we are in trust law. A trustee clearly has fiduciary obligations to the beneficiaries of a trust. But when you're dealing with a charitable institution that is holding money primarily on its own account coming from private donors, you don't really have that beneficiary relationship to which you can point for the fiduciary obligations. So the fiduciary obligation in this case is more a consistency with the donor that as some of this flows back to the donor and meeting the donor's intent, and implied intent with some of these rules, and also making sure that the beneficial purpose for which the money has been donated is also honored in the management of the money. So you have a duty of loyalty, but it says a duty of loyalty imposed by other law. Now most charitable institutions are organized under other law,

basically not-for-profit corporation acts, for example, where you have fiduciary obligations already articulated. You also have if you do charitable trusts in this state that are pure charitable trusts, you again fall under the modified fiduciary obligation of a trustee under those rules. So we don't try to establish under this act the precise duty of loyalty issues, but we rely on other law to provide for the duty of loyalty, we make it clear that you have to abide by the duty of loyalty as it comes under other law. You have an obligation of good faith clearly articulated here. That good faith is usually discussed in these terms as honesty in fact. That's what we think of as good faith in the law, and the care an ordinarily prudent person in a like position would exercise under similar circumstances. So we have a fairly high standard of care. Ordinary care is a high standard of care. It is higher than gross negligence. It is higher than reckless misconduct. It means that the institution has to be on its toes with regard to handling that money. It can't be negligent. And then we get into the articulation of the kinds of things and really 3(b) is that, the kinds of things that you must take into account when you are considering the investment, what the investment...what investments you're going to use in order to make that money for the charitable purposes. And you have, for example, right up front "may incur only costs that are appropriate." It allows pooling. You may pool funds. You may put more than one endowment together for investment purposes, which means you can go to a mutual fund, buy mutual funds for that purpose, I mean whatever constitutes pooling. But you go down to (e) there on page 8, again you have the advertence to whatever the donor says, but what do you have to look to? You have to look to general economic conditions, the possible effects of inflation or deflation, tax consequences, the role that each investment of course or course of action plays within the overall investment portfolio of the fund, the expected total return from income and the appreciation of investments, other resources of the institution, the needs of the institution, and the fund to make distributions and to preserve capital and so on. You have an affirmative obligation under section 3 to diversify assets unless for some reason, and that would mainly be the donor's choice, you can't diversify because diversification, diversification, diversification are the three rules of modern portfolio theory. It really devolves down to that. And then with the diversification rule, you essentially get the authority to invest in any kind of asset that after considering all these things is appropriate and prudent for the particular money. And that basically, this section is basically the articulation of what prudent investment means. It is derived from and comes almost without much change, essential change, from the Prudent Investor Act that applies to trustees, is analogous to what is in federal law under ERISA. We have a whole spectrum of prudent investor requirements out there and this is as concise an articulation of those as you will find in any law, but in this case for charitable institutions and institutional funds. Okay. The second part of this, the second big part of this is expenditure of funds. UMIFA, the Management of Institutional Funds Act, refers to appreciation, expenditure of appreciation. Now historically when you go back into the 1970s, there was very little law, indeed almost no law, that applied to charitable institutions in dealing with their money. It was thought from the point of view of accounting principles that probably the only thing you could do safely was to use

income for program purposes. And it was thought at the time that trust rules, which were very restrictive in that time, might migrate over into the institutional funds arena. And that was considered not to be an appropriate transfer. This is a beginning, again, before we thought about in the trust world prudent investment. So we have under UMIFA the right, the ability under prudent rules not so articulated here, not as well articulated here as they are here and as precise as they are here, the ability to invest in any kind of investment, including those that would provide for appreciation. And so on the expenditure side, what the rule says in UMIFA is that an institution, a charitable institution may spend appreciation. It may include appreciation as part of the...segmented as part of the asset availability for program purposes. And that was considered to be a great advance in the 1970s, and indeed was a great advance in the 1970s and articulated rules out there that nobody was sure would ever be applied. And up to this time they've been successfully applied and there's, I think, a large body of opinion that that was probably the most significant thing we did with UMIFA at the time. Now one of the things that developed out of that was this idea that, well, how do we...and some of this is really accounting stuff in a way, but how do we articulate how much of appreciation and income should we spend in any given year? And what came out of that is this concept of total return expenditure; that is, we will look at both income and appreciation in a given year and we will make a determination as to what percentage of that is a sufficient amount to spend for program purposes that would be a prudent amount. And the way the rules have developed over time for this, and actually this is now also migrating into the trust world, there you'll sometimes hear in the trust world this idea of a unitrust and it's really the very same concept. So what most institutions do is to look at their portfolio, look at their expectations for appreciation and income, and they will set a rule that says a fixed percentage of total return and they will usually use a three-year rolling average to make the determination of what you take your percentage of so that we don't do it just on...if we get a year where the stock market goes crazy, you know, 3 percent of that might be better than 3 percent of the next year when the stock market crashes. So we're going to average that out, and they'll usually use a rolling average of at least three years in order to average out the total return amount. And they will set a rule that a given percentage, usually somewhere between 3 and 5 percent, but 5 percent is generally very high, considered very high, will apply and that's what we will have for program expenditures. So we look at the total return, not just the income, not just the appreciation, but the combination of the two and we will consider that as the amount that we can prudently, and I keep emphasizing this word prudently, spend for the program purposes of the charitable institution. And that's essentially the rule that you will find here, I have to find my numbers here, I think it's section 4, okay. So let's find the page, and I think we start at section 5 (sic--page 5). Now what we have here is a prudent expenditure rule. To some degree it mirrors the prudent investor rule, that is what you do for investment also you have to take into account when you're making expenditure. And under (section) 4, you have a number of factors, the seven factors, that you have to think about when you're setting your percentages and dealing with what the prudent investment rule ought to be. And we go

here, I'm looking at page 6, "the duration and preservation of the endowment fund; the purposes of the institution and the endowment fund;" again, "general economic conditions; the possible effects of inflation or deflation;" all of these things you must muster in terms of setting what your total expenditure rule is going to be, total return expenditure rule is going to be. So what we've done is sophisticate the notion of expenditure, not just to deal with appreciation, but to deal with the whole notion of total return, which is what everybody is doing these days. That's the practice. And then setting limits on what you may do in order to make those limits prudent and in line with all of the things you must take into account for preserving capital, but also for providing for program. There is something in UMIFA that is not in this act and it has been probably the one thing that has made charitable institutions pay more attention to this than any other. And there is a rule in UMIFA called the historic dollar value rule, and it's in the appreciation section in UMIFA, and I don't have the cite to your current law. But the notion is that you can never spend an endowment fund below its historic dollar value. So that if in...the idea is if in 2007 I give a million dollars current value to a charity as an endowment that at any time in the future it may never be spent down below a million dollars. That rule with the total expenditure concept is considerably obsolete and not very effective. And so you don't find historic dollar value, but what you find is you must very carefully determine what your expectations are for return, and then you must allocate that return which is prudent under the very much more articulated rules under section 4. Those are your basic...that's basically what we're doing here--money, try to make it safer to make money because prudent investment is about getting better return and to do it safely. And on the other side to make expenditure decisions that don't recklessly spend down the corpus of the endowment or the institutional fund, and at the same time provide for adequate resources for programs, which is what charitable organizations are all about. There are other things in here. There's a delegation rule. It's an articulation of the delegation rule that is pretty much like the old UMIFA delegation rule which means that if you're an institution holding institutional funds, you may hire investment advisors and people to invest for you so long as you do it prudently. There also in here are rules relating to release of restrictions on funds and articulation of change of purpose which lawyers call cy-pres, c-y-p-r-e-s. We continue to use Latin where it's totally unnecessary, but we do it--and that have a more modernized and updated rules with regard to going to court, basically, to eliminate restrictions that should no longer be there because they impair the effectiveness of the funds that exist. And sometimes when purposes change, it's necessary to go to court to change the purpose so long as it's consistent with the donor's intent. We always have the rule of the donor's intent. Those are all here in this act. There is one thing that is significantly different. If you have an old fund under this act that's a very small fund, and the rule is, and I think you've got in here the exact provisions from the uniform act, yes, on page 9. If a fund is less than $25,000 in value, we're talking very small money here, and more than 20 years old and you need to release a restriction in order to make it more effective or to use it, essentially you may do so upon notification to the Attorney General. In other words, you don't have to go to court first. You can...you notify the Attorney General. You

can release the restriction, and that puts the burden on the Attorney General to challenge you if the Attorney General believes that a court ought to do this. That's basically what this act...those are the principles of this act. You are already under UMIFA here. This is a progressive progression kind of change, does not throw out the baby with the bath water. It continues what we did with UMIFA. The reason we don't have any adoptions is that we did this in 2006 and this is the first set of legislative sessions. I now have ten states with bills. I also have it in the state of Pennsylvania in the joint...in what is a kind of R&D thing in Pennsylvania which is called the joint state government commission. And I expect to see before the end of the year, before this set of legislative sessions ends, because we're still waiting for a lot of reports from the states, about 20 bills. This is going to be very popular. It's going to go very quickly and it's going to be adopted in a lot of states. Answer questions if I can. [LB136]

SENATOR LANGEMEIER: Thank you. Are there any questions? [LB136]

SENATOR GAY: I've got a question. [LB136]

SENATOR LANGEMEIER: Senator Gay. [LB136]

SENATOR GAY: In section 6 where you just talked about the charitable purpose changes or the donor's intent changes, even though the university, let's say or anybody, could go to the Attorney General, let's don't use the university, somebody goes to the Attorney General and says, you know, this is no longer effective to use the donor's wishes that were made 35 years ago. We would like to use it for program B instead of program A. They can go to the Attorney General... [LB136]

JOHN McCABE: Only for the small ones, though, the really tiny... [LB136]

SENATOR GAY: Under $25,000 or less? [LB136]

JOHN McCABE: Yeah. [LB136]

SENATOR GAY: Okay. So and then I guess the question is $25,000, where did that come from, $25,000, because that in the charitable giving world is probably not a lot... [LB136]

JOHN McCABE: The amount in the official text in the uniform act is bracketed, which means that any state could consider any amount it wants to. The uniform act proposes a principle and we put a very low amount in there. And you will hear, and I've heard from some folks out there in the charitable world, that think it maybe ought to be $100,000, it ought to be $200,000. This is really small funds even something under a half million dollars might be considered, in context, a small fund. And so we may see some changes in those numbers, but we put the $25,000 number in there to be very

conservative. And this bill repeats that and it is a very conservative approach. [LB136]

SENATOR GAY: So that could be changed is what you're saying, by any state. [LB136]

JOHN McCABE: Oh, yeah, yeah, yeah. If there's a desire to raise that figure, you know, I would admonish the Legislature to be careful about how far you raise it. But I think there are rational...there would be reasons on a rational basis to consider larger amounts of money. But again, $25,000 is what is in our bracketed act and that's where we put it at this point and that's where the bill puts it at this point. [LB136]

SENATOR LANGEMEIER: Thank you. Any other questions? Senator Carlson. [LB136]

SENATOR CARLSON: Is there...with no other states having adopted it yet, is there any risk to being the first? [LB136]

JOHN McCABE: Actually, I think you probably won't, well, you're unicameral so that's a great advantage. But we have bills moving actually rather rapidly in a couple of states. Idaho, for example, has moved the bill from Senate to House. And I think South Dakota has got it out of the Senate as well. So, you know, if you are not first, you are clearly going to be within the first ten. But I don't think...it is probably not likely that you would actually be the first at this point. [LB136]

SENATOR LANGEMEIER: Thank you. Any other questions? Seeing none, thank you for your explanation and your testimony. [LB136]

JOHN McCABE: Happy to do that. [LB136]

SENATOR LANGEMEIER: Next proponent for LB136. Good afternoon. Welcome to the committee. [LB136]

THOMAS O'NEILL: (Exhibit 3) Thank you, Senator Langemeier. Members of the Banking, Commerce and Insurance Committee, I'm Tip O'Neill, that's O-'-N-e-i-l-l. I'm the president and representative of the Association of Independent Colleges and Universities of Nebraska. I represent 14 independently controlled, nonprofit, private colleges located here in the state. I thank the legal counsel for the committee and Larry and Harvey Perlman for involving us in this process at an early stage. And I would like to say that the legislation has been reviewed by the personnel at the respective campuses that I represent. Again, this is not as major a change in this as it was back in 1996 when we last visited the Uniform Management of Institutional Funds Act. They're fine with it. I just wanted to clarify one thing regarding Senator Gay's question earlier and that is that $25,000 limitation is based on...that's the amount you can apply to the Attorney General and get the changes waived. Otherwise, you have to go to court and courts do that kind of as a matter of course. They do it regularly. There are times when

it just becomes impractical to carry out the donor's intent. For example, in a college or university situation, perhaps the major doesn't exist anymore for which the fund was established. Perhaps there was something illegal now, you know, limiting a scholarship, for example, to a member of a particular race or creed may not be constitutional anymore. So this happens with regularity. It's just that if it's $25,000 or lower, as this bill would indicate, you could go to the Attorney General and do it and not have to file a court action. So anyway, the most important provision that we see in here is section 7 of the bill on page 9, and that's basically saying that you determine whether or not the trustees were acting in a prudent manner based on the facts and the circumstances as they existed at the time the decision was made and not in hindsight. And that's the important thing. Most of the people who are on the boards at Nebraska private colleges and universities are really private citizens. They have no particular expertise in any particular investment activity, but they're there because they love the institution and they love what it represents. And you know, they do what they think is best at the time. And so we think that is an appropriate standard, and we certainly support it. Be happy to answer any questions. [LB136]

SENATOR LANGEMEIER: Thank you. Are there questions? Senator Gay. [LB136]

SENATOR GAY: I wasn't sure if I missed...how much in all these foundations, I assume, that are working on? [LB136]

THOMAS O'NEILL: They all have endowments. [LB136]

SENATOR GAY: And you say fiscal impact on the state, $1.42 billion. That's just of all the colleges? [LB136]

THOMAS O'NEILL: That's the economic impact of the... [LB136]

SENATOR GAY: So what amount of dollars are in these types of things for... [LB136]

THOMAS O'NEILL: It ranges significantly. I think Creighton probably has the largest endowment in the independent sector. It's about $360 million. That ranges from $360 million at Creighton to probably less than $2 million at some of the institutions I represent so. [LB136]

SENATOR GAY: Are most doing this? [LB136]

THOMAS O'NEILL: Right, right, but they all have some endowment. [LB136]

SENATOR LANGEMEIER: Any other questions? Seeing none, Mr. O'Neill... [LB136]

THOMAS O'NEILL: Thank you, Senator. [LB136]

SENATOR LANGEMEIER: ...thank you for your testimony. Welcome. [LB136]

KEITH MILES: (Exhibit 4) Good afternoon. Thank you, sir. My name is Keith Miles, M-i-l-e-s. I am the vice president and general counsel for the University of Nebraska Foundation, and I am here to speak in support of LB136. And I will try to limit my oral testimony and make that fairly concise. You've already heard in good detail the mechanics of how LB136 works, UPMIFA. And I just want to highlight a couple of points that I think will be very beneficial for not only our organization, but other charities here in the state and for our donors as well, the first of which would be the issue of what is prudent spending for endowment funds. As you heard Mr. McCabe say, the 1972 UMIFA used a concept of historic dollar value kind of setting that as the baseline. What I like to define that as is, essentially, the cost basis. It's what the donors put into the fund, and if there are any additional gifts in future years to that endowment, that would raise the cost basis. But essentially under UMIFA there were issues if you tried to spend down below that and there really weren't any clear definitions in UMIFA as what happened if you did drop below that. There are a number of interpretations that if the principal value dropped below that historic dollar value that you could spend traditional income which would be interest and dividends but no more. And this has created a quandary for charities if you've adopted a level spending policy, as has been discussed earlier. For example, our spending policy right now for endowments is 4.5 percent of a rolling twenty quarter average. And that allows you to essentially kind of even out the fluctuations in rise and fall of markets. But if your fund did drop below that historic dollar value, you were unable to spend to continue with that, so you may drop from a 4.5 percent payout in one year down to 1 or 1.5 or whatever your actual interest and dividends would be in the following year. And I think that has caused some charities to probably invest more heavily in assets that do generate current interest and dividends so they could weather that kind of a storm. And that may be fine in the short term, but I think in the long term that would not be considered prudent because with a perpetual endowment the objective is to maintain and beat the race with inflation so that your principal value will continue to grow and exceed adjustments for inflation each year to continue to be able to fund your charitable objectives. And again, as you've heard, UPMIFA now replaces that historic dollar value concept with a prudent standard, requires the charity to focus on the donor's intents and the specific purposes in the endowment to determine what would be a prudent investment and spending philosophy. I think that the charity does not have free rein under this to go out and invest in how they want and spend how they want. Obviously again it is still a prudent standard and we would be investing on behalf of our donors and on behalf of our institution to generate income to fund the programs, but also again to grow and maintain the purchasing power of the principal. And again as has been previously pointed out, anything in a fund agreement or other sort of contract with the donor would govern in investments. And that's always what we advise is that we have a specific written agreement with that donor so it is clear as to what their objectives are as to how we're

investing and what we're investing for and what we're trying to achieve. And then secondly, the other purpose that has been touched on already is the release of restrictions on old funds if the purpose no longer exists or can't be reasonably carried out. Under UPMIFA now with the small funds, whether it be $25,000 or another level that you might choose, it does allow us to more efficiently go in and change that use. The Attorney General is still involved and would still have the right to disagree to any proposed change, so they're going to protect the public in making sure that we are still following a charitable intent with the use of the funds. And in our philosophy, we're always trying to maintain whatever the donor's original intent was as nearly as possible. For example, if they are supporting a particular major that no longer exists, we're going to look to what's the nearest major to that or the nearest program that would still follow what the donor's interests were. Again notwithstanding UPMIFA, the best course of action for charities is to have a separate agreement with a donor that would govern how the fund is to be used and how it's to be invested and would also deal with what might happen if the purpose no longer exists, may name an alternate purpose or may name a process by which you can come up with an alternate purpose. And I think in concert with both of these and with UPMIFA and with separate gift agreements that charities may have with their donor it will provide us with a good management tool for investment and for expenditure of endowment funds. And I think ultimately it's going to result in more charitable dollars for communities and for charitable purposes within the state. And I would urge your support of the bill. I'd be happy to answer any questions. [LB136]

SENATOR LANGEMEIER: Thank you, Mr. Miles. Are there questions? Seeing none, they're going to let you off the hook easy. Thank you for your testimony. [LB136]

KEITH MILES: Thank you. [LB136]

SENATOR LANGEMEIER: Next proponent. Opponent. Neutral testimony. Introducer waived his closing so that concludes the hearing on LB136. Thank you. The committee is going to take a little break here until Senator Pahls can come back and introduce LB116 so we're going to stand at ease for a few minutes until he returns. [LB136]

SENATOR LANGEMEIER: Just for the record, LB116, Senator Pahls changed provisions relating to the priority of purchase money security interests. Due to the fact that he is testifying in another committee, he is going to waive his introduction and we will give him some more time for closing if he needs it. We are going to go to the first proponent. [LB116]

ROBERT J. HALLSTROM: (Exhibit 1) Senator Langemeier, members of the committee, my name is Robert J. Hallstrom, H-a-l-l-s-t-r-o-m. I appear before you today as registered lobbyist for the Nebraska Bankers Association in support of LB116. I certainly appreciate the fortitude and the patience of the committee. We have had some technical bills in nature and complicated issues. I do want to note for the record that Sally

Gordon, Sergeant of Arms, indicated that even if the room cleared out for this hearing she would stay to the bitter end. She also cautioned me not to read too much into that because her job obligates her to stay here until the hearings are closed. So with that, I would appreciate the committee's support for LB116. LB116 has to do with a technical issue under the Uniform Commercial Code. We talk about purchase money security interest in livestock. There have been purchase money security interest provisions in the Uniform Commercial Code for many years regarding inventory and other assets. More recently when the revised Article 9 was adopted in early 2001, I believe, we had a new provision similar to that that applies for purchase money security interest in inventory that applies equally to a PMSI in livestock. Essentially what we have when we are talking about a purchase money security interest, perhaps an example would do best for the committee's understanding. When I as a borrower go into my local lender to borrow funds for my farming operation, that lender may take what is called a blanket security interest in all of my assets now loaned hereafter acquire. That is a financing statement is filed to take security interest in those farm products and other assets associated with the farming operation. The law also recognizes that that may have been filed first in time so it would generally have a super priority. But if somebody comes in after the fact and provides specific funding to acquire a specific asset, whether it be livestock or any other item of personal property, that a purchase money security interest in that asset can be taken if it is perfected and if notice is provided, in the case of livestock, at the time that the debtor takes possession. So we have two traditional criteria, perfect it by filing and provide notice to any prior perfected security interest holders. That notice has traditionally been viewed as important because it lets that prior perfected security interest holder know that there are assets out there of its borrower that somebody else may have first dibs on. We fast forward to the reason for the specific bill here LB116. There has been a recent case out of Texas, what I refer to as the Lubbock Feeders case that I referred to in my testimony, that involved a factual situation something like this, an individual who had an existing lending relationship with the local financial institution. The local financial institution having that blanket security interest that I referred to earlier, went to a sale barn, bought a pen of livestock which was financed by a feedlot to which the cattle were to be shipped and fattened out and ultimately sent to slaughter. In that case it is the traditional notion of that feedlot having provided the actual funds to purchase the pen of livestock was going to be in a position, if they did everything they needed to, to have that super-priority that comes in in the form of a PMSI in livestock. In this case the debtor purchased the cattle, directed the cattle to be taken by truck or transported in some fashion to the feedlot where they were then fed out and ultimately slaughtered. Under those circumstances the feedlot who had provided the funding perfected its security interest, but never provided any mechanism of notice to the prior perfected security interest holder. When the loan went sour and there was an issue of competing priorities between the prior perfected security interest and the feedlot that held the claimed PMSI in livestock, the court ruled on what we think is a technicality that the debtor never took actually physical possession of the cattle under those circumstances and therefore the notion of requiring notice could be

dispensed with on behalf of the feedlot. We think that is an inappropriate result. We think it is form over substance. Clearly in that case the borrower or the debtor took at a minimum constructive possession or had a third party agent or bailee take control and possession of the cattle on the debtor's behalf, and we think that the results should have been different. To avoid the possibility of that type of result coming about in litigation in Nebraska, we have proposed the changes under LB116. Simply put they would provide for a clearer definition of possession and the possession would include not only the actual physical possession by the debtor him or herself, but also possession by a third party on behalf of or at the direction of the debtor, including but not limited to possession by a bailee or an agent of the bailee. I think it brings into play what we would traditionally view as perhaps constructive possession, a third party exercises a level of control or dominion, or the debtor him or herself exercises a level of control and dominion that is sufficient to allow reasonable minds to determine that the debtor, in fact, does have possession of the cattle, and that the triggering of the notification requirement for a PMSI in livestock should be set in or kicked in. For those reasons we would ask the committee to support LB116. I do have a copy of the Lubbock Feeders case for those that are interested in maybe taking a closer look at what occurs. I do indicate in my testimony on pages 3 and 4 that there actually is some indication in the comments to a different section as to how possession should be defined. It is undefined under the code, but comment 3 to Uniform Commercial Code section 9-313 talks about in determining whether a particular person has possession the principles of agency apply. We think that clearly should be the case in this context that a third party serving as an express or even an implied agent of the debtor should be sufficient to deem the debtor to be in possession of the livestock under similar types of circumstances. With that, I would be happy to address any questions of the committee. [LB116]

SENATOR LANGEMEIER: I have one, Mr. Hallstrom. How was Lubbock Feeders, and I think I know the answer but I am going to ask anyway, how is Lubbock Feeders to find out about the prior perfected interest? Is that part of that web site that we heard from the Secretary of State? [LB116]

ROBERT J. HALLSTROM: Basically, Senator, there is a very smooth system that we have in Nebraska on the Internet that can be checked easily. The one thing I might add, too, is that sometimes you might think, well, is this a hardship to provide the notification. Number one, they can check the Internet. So it is easily retrievable to determine who has the prior perfected security interest. The other issue in all these types of cases that I think is fundamental and consistent throughout is that these are not things that just happen on the spur of the moment. If a feedlot is going to be financing a particular borrower who has an ongoing or existing relationship with the local bank, but from time to time when they purchase these cattle, say at the sale barn, they have arrangements. The agreements are already in hand. They have been signed by the debtor. They are kind of an open agreement that says in the event I purchased the cattle here I will sign the documentation necessary for that particular transaction. But that feedlot in this case

should know full well dealing with the debtor in advance whether or not that debtor has a lender with a blanket financing statement, and if so the giving of notice and the discovery of that security interest, (a) should be easy and, (b) can even be bypassed if they contact the lender in advance to seek a subordination agreement or something of that nature. So we don't think that there is a hardship on those that might be seeking PMSI, and, in fact, it stays within the keeping of the traditional PMSI in livestock which is to provide notice to the prior perfected security interests so they are not mislead to their detriment down the road. I might add everyone I hope is familiar, unfortunately, with the George Young scenario. George Young in that situation I don't think was hesitant about not only buying and selling cattle multiple times, but also financing them. That is one of the areas where this type of PMSI notification wouldn't have resolved that problem completely, but it certainly would be in keeping with letting that prior perfected security interest holder know that there is at least one lender out there that has taken an interest in cattle that they might otherwise be asked to finance. [LB116]

SENATOR LANGEMEIER: And then one more for me and then we are going see what others. The notification, we have heard a little bit about that in the last couple days, whether it is written, Internet, oral, how does that notification currently read in law? How do you have to notify? [LB116]

ROBERT J. HALLSTROM: I don't have the statute in front of me, but I think it has to written notification. There is not a certified mail return receipt/required under there, but it has to be written notification, Senator. [LB116]

SENATOR LANGEMEIER: Okay. Other questions? Senator Carlson. [LB116]

SENATOR CARLSON: Senator Langemeier. Bob, so that you know I have gotten a call and I am supposed to ask you a question and I am even supposed to tell you who the call was from. [LB116]

ROBERT J. HALLSTROM: Okay. [LB116]

SENATOR CARLSON: So Bob Dahlgren, Bank of Bertrand in West Nelson Cattle Feeder. [LB116]

ROBERT J. HALLSTROM: Yes. [LB116]

SENATOR CARLSON: In the example that you used, whose responsibility was it to notify? [LB116]

ROBERT J. HALLSTROM: The responsibility in that original case had the court upheld the traditional notice requirement, would have been the requirement of the party seeking the purchase money security interest or the feedlot itself. [LB116]

SENATOR CARLSON: So not the buyer? [LB116]

ROBERT J. HALLSTROM: No. The traditional notion, Senator, whether it is a PMSI in inventory, livestock or any other type you don't have a notification for noninventory or livestock. But in those two cases the traditional notion of the law is if I as a potential secured party, in this case the feedlot in Lubbock Feeders, want to jump ahead of the bank that has filed prior in time that would normally have the prior perfected security interest, I am obligated to give them notice to let them know that I am giving the funds for the purchase of these assets and I will be in first position after I notify you. That is just the law as it has been since the Uniform Commercial Code came in. [LB116]

SENATOR CARLSON: Okay. A second question then, it is Wes Nelson's feedlot and he buys cattle, and he calls me to see if I want these cattle. He is financing with Bank of Bertrand, and so I tell him, yes, and I give him a check based on the financing with my bank. Does this proposed legislation enter in there? He has already bought the cattle. He asked me if I want them and I say, yes. The cattle have already been bought. How can I notify? [LB116]

ROBERT J. HALLSTROM: Well, I might have to sit down with you and pencil that out, Senator, but the issue is that if the debtor comes into possession of the cattle then the notification is required if, in fact, you are financing that purchase. Under those circumstances there might be an issue as to whether or not it is even eligible for purchase money security interest status or treatment because if you bought the cattle and are not providing the financing and buying them to the specific ultimate borrower, you bought those in advance of even thinking about creating a purchase money security interest, and that is one of the issues that was at hand in Lubbock Feeders is whether or not the cattle were bought before the desire to enter into a financing arrangement was even in existence. So there may be some technicalities as to whether or not that type of facts setting would even qualify for PMSI status because you bought them and then you go looking for a buyer/borrower. And so your PMSI status may not even be accorded to that particular transaction. Okay. Thank you, Senator. [LB116]

SENATOR CARLSON: Okay. Thank you. [LB116]

SENATOR LANGEMEIER: Senator Hansen. [LB116]

SENATOR HANSEN: Thank you, Senator Langemeier. Bob, I have got a couple of questions on the Lubbock case, First National Bank versus Lubbock Feeders, I am not sure this is a technicality. I think that that is probably more common and the reason I say that is that John Cox is a cattle courier. John Cox borrows money in case he gets stuck with some cattle. He didn't get stuck with these cattle. He bought them. He never took possession. The cattle went directly from the sale barn to the feedlot. He never had

possession of them. If he had bought the cattle, not had a home for them, still had to take them to Lubbock Feeders in his name, he would have then had possession of those cattle. He never had possession of those cattle because he had a buyer in mind. If he didn't have a buyer in mind, he would have got stuck with them therefore he would have been the debtor. And I think that is more common than uncommon in cattle trading, and I don't know who regulates cattle trade. I am sure it is somewhere in the UCC code, I think, but I am not sure anybody does or anybody understands it or how they do those things. But they usually go to the sale barn and the number of cattle they buy they never have the loan big enough for that. [LB116]

ROBERT J. HALLSTROM: Right, and that is why the paperwork is already in place to provide that financing for it, I would assume. [LB116]

SENATOR HANSEN: I would like to look into a little more before we advance this anyway. Sure like to look into some of the Nebraska cattle trading practices rather than...because I don't think that is a technicality. I think that is more general practice than a technicality in that Texas case. [LB116]

ROBERT J. HALLSTROM: Well, and the issue, Senator, is the Texas case probably is broader than that in terms of you may have equal application that if a individual buys the cattle as well and has made prearrangements for it to go to the feedlot pursuant to the purchase money security interest, I think you would have potentially, and that would be the adverse impact, the same application for a nontrader that would have just said well, gosh, I never took possession because I got the winning bid, the gavel dropped on my bid, I now have the cattle. But as long as I can keep an arm's length distance and say, well, I just told them to put them on the truck and head them down there, I think that type of an analysis works equally well in both the cattle trader and the individual purchaser scenario to where they can put their hands up and say, well, I never did take possession of them when they have to get from point a to b at somebody's instruction. And so that is where the issue comes in. [LB116]

SENATOR HANSEN: I think it would be the instruction of the feedlot because they called Mr. Cox, said buy so many cattle at such a weight, put them on my trucks and bring them to the feedlot. [LB116]

ROBERT J. HALLSTROM: I won't take exception because I am going to guess that you know a lot more about the cattle trading business than I do, Senator. But the issue that I would raise is whether or not who is really the borrower in that case then that the feedlot is financing if they have got the buyer for the cattle on the other end? And so I think we can look into those situations. I just hate to hold up the bill if we have got some interest in moving it along and taking care of the interest that we have. [LB116]

SENATOR LANGEMEIER: Senator Carlson. [LB116]

SENATOR CARLSON: Senator Langemeier. Bob, this is a pretty elementary question but help me understand it. You are the lender and I am the borrower and you have got a blanket security interests in me, explain what that means? [LB116]

ROBERT J. HALLSTROM: Okay. If I am, in general, financing your farming operation, I may take security interests in real estate, I may take security interest in your personal property assets, your farm machinery, equipment, livestock, and so forth. I take a security agreement. You sign a note. I take a security agreement. You sign a financing statement and that is filed in a blanket financing statement in the basis notion as something that will apply to allow me to be perfected as to all assets now owned or hereafter acquired. So we have the ability through sales of assets to have an interest in the proceeds as they come in and the bank may or may not require you to apply proceeds from the sale of collateral that is secured towards your loan. They may leave some of it for personal expenses, things of this nature, and as you acquire subsequent, sell one pen of livestock, buy another one, that financing statement automatically attaches to perfect the security interest in those after acquired assets. It is called a blanket because it is generally thought to cover everything that you pledge for collateral, and that is why they are first in time, they are first in priority, and the only exception to this is the purchase money security interest that if somebody comes in after the fact in good faith and actually provides the funding to buy a new asset, they ought to have the ability to leap ahead of you and be first because they provided the actual funding for that specific asset. And the code generally says also that you ought to give notice to that blanket lender because they need to know if the borrower comes in, and it may generally be involved with a potentially fraudulent scenario, but if the borrower comes in and says I just bought this pen of livestock, can you advance me some more money on it, the banker may do that not having been notified that somebody else has already paid for it once. So that scenario could arise. [LB116]

SENATOR CARLSON: Okay. One other thing to clarify then under blanket security, and for whatever purpose and it might be for buying livestock, but in the meantime if I go sell a load of corn and not notify you I am in violation. [LB116]

ROBERT J. HALLSTROM: You may be. There has been a lot of court cases as to how far and wide your security agreement covers that depending upon whether or not there might be an implied waiver from some cases way back. But generally speaking, yes, you could very well be in violation because the proceeds from that sale should come to the lender and you may have arrangements as to whether or not you apply all that to the loan or use it for some other purpose. But, yes, that would generally be the case. [LB116]

SENATOR CARLSON: Okay. [LB116]

SENATOR LANGEMEIER: Senator Pankonin. [LB116]

SENATOR PANKONIN: Thank you, Senator Langemeier. Bob, would it be fair to say that these cases have always come up when there is a problem? In the wheels of commerce, whether it is what Senator Hansen was talking about, oftentimes these things aren't necessarily used all the time. You know, you have done business with this person for a long time and there is that trust and whatever, but when things go wrong is when these cases come up. And so the question is who brought this up? Obviously there is the Texas case, but was it the Nebraska Bankers or was it specific cattle people that do cattle lending or what prompted this? [LB116]

ROBERT J. HALLSTROM: No, we had some lawyers that practice in this area on behalf of banks that are quite actively engaged in the Uniform Commercial Code. On a nationwide basis we have got a field of attorneys that communicate, not a chat room per se, but they communicate with other lawyers in other states that are very interested in the Uniform Commercial Code, and when this case was handed down, those lawyers, including some from Nebraska, said gosh, this isn't right, it shouldn't be the way that the system applies because it cast doubt on the purchase money security interest financing arm. So it more came from the lawyers that represent banks saying there ought to be a fix to this, the traditional notion of giving notice when you are going to leapfrog somebody and take that PMSI in livestock should be maintained, the integrity of it should be maintained. And Senator Hansen and I may disagree as to whether it is a technicality or not. But basically that was the issue that it certainly seemed that under those circumstances the person took some form of possession that should have been sufficient to trigger the normal notion of notice that is required. [LB116]

SENATOR PANKONIN: Do you think other states, Bob, are going to be looking at this as well? [LB116]

ROBERT J. HALLSTROM: I tell you, Senator, we are kind of in the lead here. We had since it was brought to our attention last November I was at a meeting of my counterparts that the American Bankers Association put on every year. I commented and provided background materials on this. I have had, specifically in Iowa, and a couple of other of my counterparts who have said we are really interested in this, if you are already taking the lead on it we probably won't do anything this session, but we are interested in what happens and we may very well want to follow suit because of the ramifications of the Lubbock Feeders case. [LB116]

SENATOR LANGEMEIER: Thank you. Senator Hansen. [LB116]

SENATOR HANSEN: Thank you, Senator Langemeier. Just one comment about the difference between the John Cox case and George Young case. George Young intentionally defrauded many, and it sounds like Mr. Cox just got caught and... [LB116]

ROBERT J. HALLSTROM: Yeah, and Senator, I certainly don't want to mislead the committee in terms of talking about the fraudulent activity. I think the potential for fraudulent activity or my reference to that was intended to highlight the fact that that is where the failure to give notice can cause problems to the prior perfected security interest holder because if you have as a matter of course less notices coming back form the PMSI, if you happen to find yourself in a George Young situation that notice may have helped you in some small part avoid trying to finance those cattle twice because you knew at least the lenders, who were all working in good faith with their borrowers, had notified each other and communicated to each other that, in fact, somebody already claims a security interest in that particular pen of livestock. [LB116]

SENATOR LANGEMEIER: One more question. [LB116]

BILL MARIENAU: Bob, explain to me how does the feedlot get a PMSI if it never gave notice? [LB116]

ROBERT J. HALLSTROM: The issue, Mr. Marienau, is that if you look at the provisions of UCC 9-324 there are four criteria in that and the two that you generally focus on are, one, you must perfect your security interest, which is generally the filing requirement, and secondly, when the debtor takes possession you must give notice to any prior perfected security interest holders. And based on the Lubbock Feeders case they determined that under those circumstances even though from our perspective some third party, whether it was the feedlot, whether it was the transport driver of the truck that took the livestock to the feedlot, somebody was acting at the direction and under the instructions of that debtor who is borrowing and is a subject of the PMSI, and that debtor being in possession should have triggered the notice requirement. [LB116]

BILL MARIENAU: The feedlot trumped the bank. [LB116]

ROBERT J. HALLSTROM: Yes. [LB116]

BILL MARIENAU: But they have never given notice to the bank. [LB116]

ROBERT J. HALLSTROM: Yeah, and in this case the court essentially said we are going to dispense with the usual requirement to give notice because we are going to treat the debtor in those circumstances as never having taken actual physical possession of the cattle. [LB116]

BILL MARIENAU: Because the debtor was Mr. Cox then, in between. [LB116]

ROBERT J. HALLSTROM: Yes. [LB116]

BILL MARIENAU: Okay. Thank you. [LB116]

SENATOR LANGEMEIER: Thank you. Any other questions? Senator Carlson. [LB116]

SENATOR CARLSON: Senator Langemeier. Bob, I will ask you two more brief questions then I am done. [LB116]

ROBERT J. HALLSTROM: Fair enough. [LB116]

SENATOR CARLSON: In your opinion does this bill benefit the larger city banks over the small town banks? That is question one, and secondly, why do you think a small town bank would be against this? [LB116]

ROBERT J. HALLSTROM: I don't think it particularly benefits any size of bank over another. It is the issue that any bank wherever located can find itself in the traditional position of having taken a prior perfected security interest that constitutes what I have referred to as a blanket financing statement. So whether you are a small bank dealing with the Palmyra livestock auction barn just outside of Lincoln here or out in western Nebraska or whether it is an Omaha lender or a Lincoln lender, a larger financial institution, I don't think that probably has any bearing on who benefits or who is subject to adverse treatment pursuant to either the Lubbock Feeders case or through our solution that we have proposed under LB116. I don't particularly see any reason that there would be a small town bank that wouldn't support this issue. The thing to keep in mind, Senator, and in so many of these UCC issues and to the extent that bankers can be viewed as coming to issues with a pure heart, we have lenders on both sides of this issue. What we are looking at is that we may have lender for the feedlot in the Lubbock Feeders case and we may have a lender for the producer that sold them. So it is not about winners and losers in terms of the propositions that we support in trying to resolve what we see as a troublesome issue. It is our interest in having certain rules that come into play and give the lending community, irrespective of which side of that equation or that fence you are on, the certainty of knowing what rules are applicable to any particular situation. And again the uncertainty of this is what is possession. It is undefined under the Uniform Commercial Code, but it sure seems to me that there was a level of exercise and dominion and control constructive possession, if you will, that existed at any number of positions in the Lubbock Feeders case that should have been sufficient to trigger the notification requirements. Now what I will pledge to do with you, Senator, in light of you being nice enough at the request to alert me to who the two people that were that asked the question, we have had other issues that are completely unrelated to this issue having to do with feedlot insolvencies and the transfer of title provisions under the Uniform Commercial Code that you probably don't want to hear about it today because we have gone on exhaustively. But I would be happy to sit down with you and give you some clarification as to what I think probably more of their concern is and I think it is pretty much unrelated to this issue, although I don't want to

discount what their interest might be. [LB116]

SENATOR CARLSON: Thank you. [LB116]

SENATOR LANGEMEIER: Thank you. Any other questions? Seeing none, you are off the hook. [LB116]

ROBERT J. HALLSTROM: Thank you. [LB116]

SENATOR LANGEMEIER: Just for the record, committee counsel's name is Bill Marienau, not Marino. Are there any other proponents? Any opponents? Any neutral testimony? And Senator Pahls, we didn't let you do an introduction. Would you like to do a closing? Senator Pahls waives closing and thank you and that concludes the hearing on LB116. [LB116]

Disposition of Bills:

LB114 - Advanced to General File.
LB116 - Advanced to General File.
LB136 - Advanced to General File.
LB189 - Advanced to General File, as amended.

Chairperson

Committee Clerk