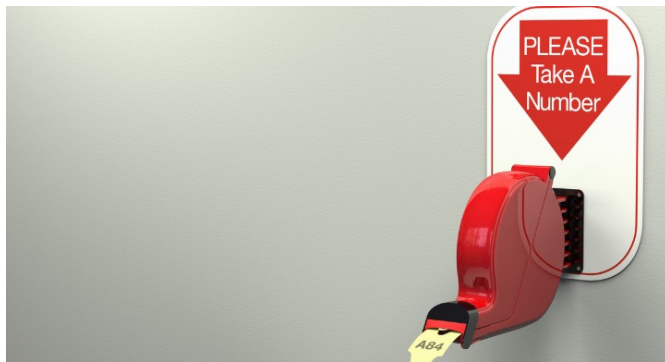


Getting and Keeping Your Place in Line: Two Reminders if You Take Personal Property as Security for a Debt

Written By **Norman J. Leonard** (njl@wardandsmith.com) and **Lance P. Martin** (lpm@wardandsmith.com)

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As all creditors know, you must file a financing statement under the Uniform Commercial Code ("UCC"), called a "UCC-1," with the North Carolina Secretary of State to perfect a security interest in personal property (and with the county Register of Deeds if the property might become a real estate fixture). The UCC-1 puts the world on notice of your security interest and establishes your place in line with respect to rights in the collateral. But you must prepare and maintain your financing statement properly to protect your interests from inflexible court scrutiny. Errors

that seem inconsequential or easily correctible can be fatal to your claim.

Getting in Line: Use the Debtor's True and Complete "Legal" Name - and Nothing Else

You can go to a lot of trouble to document your credit file properly and hurry to file your UCC-1, yet fail to perfect your security interest because you did not use the debtor's proper legal name on your UCC-1. Under Revised Article 9 of the UCC, it is *extremely* important that you use the debtor's full and correct "legal" name when preparing the UCC-1. If the precise "legal" name is not used, the filing office may reject the UCC-1 or, worse, the UCC-1 will be ineffective to perfect your security interest and establish priority.

A Debtor that is a Legal Entity

Section 9-503 of the UCC provides that your UCC-1 will sufficiently identify your debtor that is a "*registered organization*" (that is, a corporation, limited partnership, or limited liability company) if your debtor's name on your UCC-1 matches your debtor's name shown on the public record in the state in which it was originally organized. For example, the name on a corporation's corporate charter filed in the office of the Secretary of State or the State Corporation Commission would be the proper one.

If your debtor is an unincorporated sole proprietorship or partnership, then your UCC-1 should use the individual or organizational name of your debtor if it has a name, or the names of the partners, members, associates, or other persons comprising your debtor if it does not have a name. There also are specific rules applicable to trusts and decedent's estates. Always consult an attorney if there is any doubt about your debtor's full and correct legal name. Believe it or not, it is not uncommon to find that even your debtor may be confused about its legal status or name ("Co." is different from "Company" and "Inc." is different from "Incorporated"), and horror stories abound involving incorrect name designations.

If your UCC-1 does not use your debtor's "full" legal name, it will be ineffective. In one illustrative case, a corporation's full "legal" name was "Tyringham Holdings, Inc." The creditor's UCC-1 identified it as "Tyringham Holdings." A bankruptcy judge in Virginia held that the UCC-1 was ineffective because it did not state the debtor's full and complete "legal" name. "Inc." was considered an essential part of the corporation's name.

What happens if your debtor has both a "legal" name and a trade name? Use the "legal" name and *only* the legal name. In a bankruptcy case in Texas, the debtor's name was "Jim Ross Tires, Inc." The UCC-1 identified the debtor as "Jim Ross Tires, Inc. dba HTC Tires & Automotive Centers." The court ruled that the UCC-1 should have contained the debtor's full and complete "legal" name and nothing else. The inclusion of the words "dba HTC Tires & Automotive Centers" rendered the UCC-1 ineffective. Since that case was decided, other courts have reached similar conclusions when presented with similar facts.

Therefore, use your debtor's full and complete legal name on your UCC-1, and nothing more, or risk having a court tell you that the debt you thought was secured is, in fact, unsecured.

A Debtor Who is a Person

If your debtor is a person, then the rules for your UCC-1 have just changed as of July 1, 2013. Until July 1, Section 9-503 of the UCC required that your UCC-1 state the debtor's "individual name" to be effective. Since people may go by a name different from the one on their birth certificate, there are instances where a person's correct "individual name" is less than certain. "John Earl Doe" may, from time to time, use the name "John Doe," "John E. Doe," "Johnny Doe," or "J. E. Doe." The new Section 9-503, effective July 1, 2013, attempts to remove the uncertainty and provide a hard and fast rule.

As of July 1, 2013, Section 9-503 provides that if the debtor has an unexpired driver's license or special identification card issued by the State of North Carolina, then your UCC-1 will sufficiently identify that debtor *only* if the name on it matches the debtor's name exactly as it appears on the most recently-issued version of the debtor's driver's license or state-issued identification card. You should make a copy of the driver's license or identification card and keep it in your files in case issues arise.

Since people may, and often do, change names because of marriage, necessity, or simply whim, and have new licenses or identification cards issued to them, the terms of your Security Agreements should require your individual debtors to notify you if they change the name used on their driver's license or identification card and provide you with a copy of the new license or identification card. In the event of a name change, you will have a grace period of only four months in which to amend your previously-filed UCC-1 before it may become "seriously misleading" and, consequently, ineffective to maintain your status as a perfected secured creditor.

Staying in Line: Perfection is Easily Destroyed Forever

Once you perfect your lien, a certain amount of vigilance is required to maintain perfection. You can allow your UCC-1 to lapse or you can terminate it. Most creditors know that a UCC-1 lapses after five years, so they have systems in place to remind them to renew their UCC-1s by filing a continuation statement in the six-month period before the lapse date. You should also have such a system.

But what happens if you allow your UCC-1 to lapse or you terminate it by accident? Sections 9-513 and 9-515 of the UCC provide that once lapsed by passage of time without renewal or terminated by the filing of a termination statement, the financing statement which has lapsed or to which the termination relates ceases to be effective. The notion that an accidental *lapse* might be irreversible seems logical, and that is, in fact, what the case law bears out. But is there a safety valve available in the case of accidental *termination*?

Unfortunately, there is none.

A North Carolina bank recently found out the hard way that you cannot resurrect a mistakenly terminated UCC-1 by filing a correction statement. A bank employee responsible for filing termination statements mistakenly terminated a UCC-1 because the bank's computer system did not alert the employee to the fact that the UCC-1 that secured a particular loan that had been paid in full also secured another unpaid loan and should not have been terminated. After discovering the error, the bank filed a UCC-5 correction statement, thinking that would correct the public record and put the world back on notice of the bank's lien.

Unfortunately, correction statements are not for use by creditors and do not legally change the effectiveness of the existing record. Correction statements are solely for the use of debtors to supplement the record with "their side of the story" when they believe a UCC-1 contains inaccuracies or was wrongfully filed. In the North Carolina case, when other creditors ultimately forced the debtor into an involuntary Chapter 7 bankruptcy, the bankruptcy court held that the bank was unperfected, resulting in a potential loss of nearly \$5 million.

In the event of accidental termination or lapse, you should immediately file a new UCC-1. It's your only option. Although you will be put at the back of the line of secured creditors, if there is one, you will at least be a perfected secured creditor again with rights superior to any subsequent creditors.

Conclusion

Like many aspects of the UCC, the rules governing perfection of security interests under Article 9 are specific and exacting. The details matter and, if you don't follow the rules, good faith intentions and fundamental fairness will not save you. And don't expect mercy from your fellow creditors or the bankruptcy court. There is no alternative to doing it right the first time.

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