

# MARKS & WEINBERG, P.C.

## DISPATCHES FROM THE TRENCHES

### A LITTLE SOMETHING SOLE PROPRIETORSHIPS

This issue of Dispatches from the Trenches discusses sole proprietorships or d/b/a's.

#### What is a Sole Proprietorship

A sole proprietorship is the simplest form of business organization because it really is not an organization at all. A sole proprietorship is simply an individual person doing business in his or her own name or in a trade name. One common way of describing a sole proprietorship in legal documents is: John Doe d/b/a Doe's Lasers.

The term "d/b/a" means "doing business as." Many states require that the individual register the business name as a "fictitious name" or "tradenam". Failure to maintain such a filing does not, however, in any way affect the legality or enforceability of leases entered into by the individual in his or her business name.

No documentation is required to create a sole proprietorship; a sole proprietorship merely means doing business under his or her business name. There is only one owner of a sole proprietorship. One key aspect of this type of "organization" is that the sole proprietor is fully liable for all business debts, including the business lease. This should be fairly obvious as the individual is merely signing the papers using his or her business name. A proper signature block for execution by a sole proprietorship is:

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John Doe  
d/b/a Doe's Lasers

In fact, whether "Doe's Lasers" appears any way in the lease documentation is of little legal importance. The obligated party is Mr. Doe, and his bank account, personal or business, and other assets would generally be available to satisfy any indebtedness to the lessor.

## **Increased Risks with Sole Proprietorships**

There is some increased risk associated with having a lessee that is a sole proprietorship (i.e. merely an individual) as opposed to an organized entity. A few of those risks are outlined below.

### *Location of Debtor*

The first risk stems from the fact that the UCC provisions under Revised Article 9 which govern where a secured party must file (or where a lessor under a true lease files its precautionary filing designed to protect it in the event the lease is determined by a court to be a lease intended as security or a loan). These filing rules are based upon the "location of the debtor." If the debtor is an organized entity, it is "located" in the state in which it is created. For example, a Delaware limited liability company is "located" in Delaware and filings must therefore be made in Delaware. It is easy to order a "certificate of existence" or obtain other proof on-line of where a registered entity was created. This rule is therefore very clear and the risk of filing in the wrong place is lessened.

However, individual debtors are "located" at their "principal residence." This rule is less clear, especially for wealthier individuals. It is important to understand that the "location" of a sole proprietorship is the principal residence of the individual doing business as a sole proprietorship. It is not the principal place of its business, which is the location for unregistered business entities such as general partnerships. However, in the event a sole proprietor lives in a different state than the state where he operates his business (yes, I've crossed state lines to purchase liquor before), it is safest to file in both states.

### *Name of Debtor*

A financing statement is not effective to offer the secured party protection if it does not properly identify the debtor by name. The name to be used for corporations, limited liability companies and other formal business entities created by filings with state agencies such as the Secretary of State are generally clear and can be verified online with the applicable state agency or otherwise in an independent manner.

The name to be used for individuals is more difficult to obtain accurately. Even driver's licenses or social security cards can obtain outdated information due to a marriage or other name changes by an individual. So what form should a secured party use: driver's license, state-issued identification card, birth certificate, passport, social security card, military identification card? The list is long.

This difficulty has resulted in a flurry of states passing or threatening to pass non-uniform "safe harbor" provisions specifying that certain sources of an individual's name will be accepted as providing the true name for UCC filing purposes. While this sounds like good news for filers, it is bad news for searchers.

The Joint Review Committee for Uniform Commercial Code Article 9 is aware of the problem and has been working on a uniform solution. Nonetheless, this "name issue" is a

classic example of how rules relating to individuals can often be more difficult to formulate and apply than rules applicable to business entities.

### *Movement of Debtor*

Another risk relates to the fact that the debtor may change location. If the debtor changes its location to that of a different state, a secured party must file a new financing statement in the new location within four (4) months or it will lose its priority status against other creditors of the debtor or certain purchasers of the collateral.

Generally speaking, an organized entity does not "change its location" from one state to another. For example, if your lessee were an Alabama corporation, it cannot "move" to Florida. It could create a Florida corporation with the same (or different) name and transfer the assets to that Florida entity. Alternatively, it could merge the Alabama corporation into the Florida (a transaction viewed by Article 9 as a transfer). However, this is not viewed as a "movement" under Revised Article 9 and the above quoted four-month rule does not apply.

On the other hand, individuals can "move" by changing their principal residence. Even worse, no filings are required in any public record to reflect any such movement.

As a side note, some states have enacted legislation allowing for companies formed in one state to convert to an entity formed in another state. Sometimes, even the type of company can be "converted" in this manner. For example, a non-Delaware limited liability company can now be converted into a Delaware corporation. The writer is not aware of any case law directly analyzing whether such conversions constitute a "movement" governed by the 4 month rule. Prudent secured parties should comply with the 4 month rule for now.

### *Transfers of Collateral*

If an original debtor transfers the collateral to a new debtor that is "located" in another state, a secured party must file a new financing statement against the new debtor in the state where the new debtor is located within one (1) year or it will lose its priority status against other creditors of the new debtor or certain purchasers of the collateral.

Both individuals and registered entities can transfer collateral. As mentioned earlier, a merger type event is viewed as a transfer of collateral. For example, if your lessee were a Delaware corporation and decided it wanted to be an Alabama corporation, it would merely create the Alabama corporation (the new debtor) and merge into or otherwise transfer the collateral to the new debtor. In many cases, this sort of occurrence requires that the original debtor file some paper work in Delaware (such as "articles of merger") and, if a lessor searches the records annually for its riskier customers or pays for a monitoring service to catch such changes, it may receive notice of the transfer in time to make the new filings.

If an individual debtor decides to "incorporate," this will also result in the individual being viewed as "transferring" certain of its assets to the newly incorporated entity. Unlike with merger situations, lessors are less likely to discover the incorporation since no filings are made against the "original debtor" (the individual) in this case and the new

entity could be incorporated in any state and under any name, thereby making searching practically impossible.

More importantly, individuals are, as a practical matter: (1) much more likely to incorporate as their business increases than they are to sell assets to another company and (2) much less likely to realize that incorporating without a lessor's prior written consent is a violation of the Lease.

Kenneth P. Weinberg is a founding partner of Marks & Weinberg, PC. He and co-founder, Barry Marks, have significant experience in dealing with virtually every type of equipment and facility lease financing, have participated in leasing financings for more than a billion dollars of equipment and are recognized throughout the industry. Weinberg has written *Dispatches from the Trenches* since 2002, routinely writes articles in a variety of equipment leasing and financing journals, and has participated in numerous seminars on equipment leasing issues. If you would like more cases or articles on leasing, or have any questions or comments about this column or other leasing issues, please visit [www.leaselawyer.com](http://www.leaselawyer.com) or contact Weinberg at 205-251-8307.



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