MARKS & WEINBERG, P.C.

SOLE PROPRIETORSHIPS – SOMETHING TO THINK ABOUT

What is a Sole Proprietorship

A s*ole 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. There is no general legal requirement as to what the business name of the sole proprietorship might be, but the preferred way to refer to a sole proprietorship on the documents:

John Doe d/b/a Doeӧs Lasers

The term "d/b/a" means "doing business as.ö Many states require that the individual register the business name as a "fictitious name" or "tradename". 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 Doeôs 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.

<u>Increased Risks with Sole Proprietorships</u>

There is some increased risk associated with having a lessee that is an individual as opposed to an organized entity. Those risks are outlined below.

<u>Risk 1- Location of Debtor</u>

The first risk stems from the fact that the UCC provisions under Revised Article 9 which govern where a secured party must file 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 "principle residence." This rule is less clear, especially for wealthier individuals.

Risk 2- Movement of Debtor

The second 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.

An organized entity cannot "change its location" from one state to another. For example, if your lessee were a Delaware corporation, it cannot "move" to Alabama. It could create an Alabama corporation with the same (or different) name and transfer the assets to that Alabama entity. 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 change their principle residence. Even worse, no filings are required in any public record to reflect any such movement.

Risk 3- 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 merger 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, 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 would not be able 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 lessorôs prior written consent is a violation of the Lease.