

...

Seriously Misleading,
Standard Search Logic,
Noise Words,
Name Changes & Avoidance:

...

The Importance of Correctly
Identifying the Debtor in
Compliance with Article 9 of
the Uniform Commercial Code

...

By Kristin Alford, NCS Education & Marketing Specialist

Seriously Misleading, Standard Search Logic, Noise Words, Name Changes & Avoidance: The Importance of Correctly Identifying the Debtor in Compliance with Article 9 of the Uniform Commercial Code

The proper spelling of a debtor’s name on a UCC Financing Statement is a fervently litigated issue. The UCC Article 9 registry system is designed to permit creditors to make a security agreement public by filing a UCC Financing Statement. UCCs are indexed by the name of the debtor, in part to facilitate a streamlined search and to identify pre-existing security interests.

SERIOUSLY MISLEADING

Perfection of a security interest involves drafting and executing a sound security agreement, ensuring the UCC Financing Statement complies with Article 9 of the Uniform Commercial Code and the proper recording of the UCC.

One of the most common - and most preventable - mistakes creditors make is inaccurately or incorrectly identifying their debtor on the Financing Statement. Errors in identifying the debtor may include the wrong legal name, spelling and spacing errors or omissions. Seemingly trivial deviations in the name of the debtor can prevent a security interest from being perfected.

When these errors occur, the filing may be deemed “seriously misleading”.

What constitutes “seriously misleading”? According to UCC Article 9-506(b), a Financing Statement is seriously misleading if a search for the debtor’s legal name does not reveal the filing.

§ 9-506 EFFECT OF ERRORS OR OMISSIONS

(b) [Financing statement seriously misleading.]

Except as otherwise provided in subsection (c), **a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a) is seriously misleading.**

SEARCH LOGIC & NOISE WORDS

“Standard Search Logic” is the holy grail of determining whether or not a filing is seriously misleading. Search logic is created, determined & managed through an algorithm - not entirely unlike a typical Google search, although a Google search is very flexible and the parameters for this search logic are more narrow.

In 2015, [International Association of Commercial Administrators](#) (IACA) released the revised [Model Administrative Rules](#), which includes a specific section that is frequently referred to as “standard search logic”.

One rule for standard search logic is 503.1.2 “*No distinction is made between upper and lower case letters.*” This means that the debtor’s name could be entered as ABC COMPANY INC or ABC Company Inc, and both are acceptable.

Another rule addresses punctuation: 503.1.3 (b) “*Punctuation marks and accents are disregarded. For the purposes of this rule, punctuation and accents include all characters other than the numerals 0 through 9 and the letters A through Z (in upper and lower case) of the English alphabet.*”

IACA recognizes the general idea of “noise words”. Typically noise words include “and,” “the,” “inc” and “co.” Although noise words are addressed in the Model Administrative Rules, the list of actual noise words are determined by each individual filing office.

continued

503.1.3 (c) The following words and abbreviations at the end of an organization name that indicate the existence or nature of the organization are “disregarded” to the extent practicable as determined by the filing office’s programming of its UCC information management system:

[Insert the filing office’s own “Ending Noise Words” list here.]

This difference by jurisdiction could mean that a filing that would not be seriously misleading in Virginia may be seriously misleading in Georgia, based on the individual search logics.

CORRECTLY IDENTIFY DEBTOR

Creditors may assume it is enough to simply conduct an online search to determine the correct spelling of a debtor’s legal name. However, Margit Livingston of DePaul University College of Law, reminds us that “The official comments to 9-503 say that a search in a nonofficial database is not a search, and a search in the Secretary of State’s office using something other than standard search logic is not a search.” Also, UCC Article 9-503 (a) states that the registered entity’s name will be the name as it is found in the **organic public record**.

§ 9-503. NAME OF DEBTOR AND SECURED PARTY.

(a) [Sufficiency of debtor's name.]

A financing statement sufficiently provides the name of the debtor:

(1) except as otherwise provided in paragraph (3), if the debtor is a registered organization, or the collateral is held in a trust that is a registered organization, only if **the financing statement provides the name that is stated to be the registered organization’s name on the public organic record of most recently filed with or issued or enacted by the registered organization’s jurisdiction of organization which purports to state, amend, or restate the registered organization’s name;**

Statute is courtesy of [LLI](#)

ORGANIC PUBLIC RECORD

In 2013, the 2010 Amendments became effective, which offered clarity in determining whether or not a filing is seriously misleading. As mentioned above, creditors should identify their debtor via the organic public record. In most cases, this will be the name as it appears on the Articles of Incorporation. Creditors can search and locate the Articles of Incorporation via the Secretary of State’s website for the state in which the debtor is incorporated.

Why does this proffer clarity? Because, it reduces the potential negative impact that Standard Search Logic could have on a filing.

For example, in the event the standard search logic does not reveal a Financing Statement, but the creditor identified the debtor by the name per the public organic record, the UCC isn’t automatically deemed seriously misleading - because the creditor identified its debtor by the name as it appears on the public organic record.

It is imperative for creditors to carefully review the Articles of Incorporation. Reviewing the information as it appears on the Secretary of State’s Corporate Division search results page is not enough - data entry mistakes are inevitable.

continued

Example of Query via Ohio Secretary of State's Business Search

A search performed on "J & J Flooring" returned a search result which indicated the corporate legal name was "J & J Flooring, Inc." Because Article 9 requires the debtor's legal name as it appears on the public organic record and the state of organization (both of which can be found on the Articles of Incorporation) we reviewed the actual Articles of Incorporation. Upon reviewing the actual Articles of Incorporation, we discovered the entity's name was actually "J & J Flooring, LLC".

The difference of "Inc." and "LLC" is much greater than one may realize - it could void the security interest.

SEARCH LOGIC & NOISE WORDS INVALIDATE SECURITY INTEREST

This first case went before the U.S. Bankruptcy Court for the Eastern District of Virginia in 2006, prior to the enactment of the 2010 Amendments. In [Tyringham Holdings, Inc. vs Suna Bros Inc.](#), the Financing Statement was deemed seriously misleading, due to the omission of "Inc." from the debtor's name.

Tyringham Holdings, Inc. (Tyringham) entered into a consignment agreement to hold items of jewelry for Suna Bros. Inc. (Suna). Suna filed a UCC to perfect a security interest in the jewelry in the amount of \$310,925.

The Financing Statement filed by Suna listed the debtor's name as "Tyringham Holdings." The debtor's name, per the corporate certificate was "Tyringham Holdings, Inc." Evidence submitted in the case revealed that a UCC search, certified by the State Corporation Commission for Virginia, did not yield the UCC Financing Statement under the name "Tyringham Holdings."

Would this case be decided differently today (*post 2010 Amendments*)? It could - if the debtor's name appeared in the public organic record as "Tyringham Holdings" because the public organic record would "override" the state's search logic.

See, in 2006 Suna contended that the State Corporation Commission's search logic was faulty because it did not filter out "Inc." as a "noise word." The court rejected this argument because the filing office's standard logic did not consider "Inc." a noise word. Rather, the standard search logic used by the State Corporation Commission specified that "incorporated" be abbreviated to "Inc." Now, post 2010 Amendments, Suna's argument about search logic could be successful...IF the debtor's name on the Financing Statement was a match to the name on the public organic record.

Now, if the debtor's name on the Financing Statement is not the same as it appears on the public organic record, AND the filing does not appear during a search, then it could be argued that the filing is seriously misleading.

I should note that the court did concede that minor errors and omissions in the name do not necessarily mean that a security interest is automatically unperfected.

§ 9-506. EFFECT OF ERRORS OR OMISSIONS.

(a) [Minor errors and omissions.]

A financing statement substantially satisfying the requirements of this part is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.

Statute is courtesy of [LLI](#)

But the court also reasoned that creditors do not face a significant burden by being forced to use the correct name on UCC filings.

continued

Substantial compliance with the requirements of a UCC Financing Statement may be sufficient, provided that the name of the debtor in the UCC is not “seriously misleading”.

§ 9-506. EFFECT OF ERRORS OR OMISSIONS.

(c) [Financing statement not seriously misleading.]

If a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a), the name provided does not make the financing statement seriously misleading.

Unfortunately for Suna, the court determined that the name was seriously misleading which entitled the debtor to sell the collateral unencumbered by a security interest.

“Insufficient due to the addition of d/b/a”

In Nebraska, the case of [EDM Corporation, doing business as EDM Equipment, doing business as NOVI, LLC, Debtor Hastings State Bank, Plaintiff-Appellant v. Thomas D. Stainaker, Chapter 7 Trustee of EDM Corporation](#), went before the Court of Appeals in 2010 (pre-2010 Amendments).

The court affirmed the bankruptcy court’s ruling that the creditor’s Financing Statement was “insufficient due to the addition of d/b/a” as part of the debtor’s name. When the creditor identified its debtor on the UCC filing it listed both the debtor’s public record name and the debtor’s d/b/a name. Ultimately, when subsequent UCC searches were done, the creditor’s Financing Statement was not revealed, because the name on corporate record was simply “EDM Corporation”.

“...it is clear from the language of the statute itself that § 9-503 requires that, as to registered organizations, the debtor's name (as listed in the name field on the form) must be "the name of the debtor indicated on the public record of the debtor's jurisdiction of organization." [19] Viewed with § 9-503(b)(1), which provides that "[a] financing statement that provides the name of the debtor in accordance with subsection (a) is not rendered ineffective by the absence of...a trade name or other name of the debtor," and § 9-503(c), which provides that "[a] financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor," we interpret the comment to mean that trade or other names may be added as other or additional names on a financing statement, but not in place of, or as part of, the debtor's organizational name.”

(Today, it is possible that one could argue the creditor would maintain its security interest, if the public organic record identified the debtor as “EDM Corporation d/b/a EDM Equipment”.)

A similar case in Texas also determined the d/b/a was too much: [JIM ROSS TIRES, INC.; dba HTC Tire Pro; dba HTC Tires & Automotive Centers, Debtor\(s\)](#). On the UCC Financing Statement, the creditor listed the debtor by including both the debtor’s legal name and d/b/a – “Jim Ross Tires Inc. DBA HTC Tires and Automotive.”

The creditor argued their security interest was perfected, because their filing could be located using a “non-standard wild card search”; unfortunately for the creditor, the court did not agree with their argument.

“Accordingly, the Court finds that the Financing Statements are ineffective to grant security interests in Debtor's collateral. Although this result is harsh, the Court must examine the result in the context of claims between competing creditors.”

Standard search logic, wild card search and human error have been streamlined since the hearing of these two cases. In the effort to make the Uniform Commercial Code uniform, being able to rely on the public organic record eliminates much of the gray area.

continued

AVOIDANCE GRANTED

A consequence of a seriously misleading Financing Statement is avoidance of the security interest. Giving the debtor an opportunity, even though it's unintentional, to avoid the debt means the creditor pays a potentially high price for a simple mistake.

For example, because the debtor was not correctly identified on the Financing Statement in [Wing Foods, Inc., Debtor. Bankruptcy Estate of Wing Foods, Inc., by and through its Chapter 7 Trustee, Gary L. Rainsdon Plaintiff, vs. CCF Leasing Company and B S & R Equipment Company, Defendants.](#), the court ruled that Wing Foods, Inc. (the debtor) was able to avoid CCF Leasing Company's (the creditor) security interest in its Chapter 7 bankruptcy.

HOW SIMPLE THE ERROR IS "SIMPLE"?

In [Receivables Purchasing Co., Inc. v. R & R Directional Drilling, L.L.C.](#), the Georgia Court of Appeals determined the creditor did not have a security interest because the debtor's name had an extra space listed.

The creditor added a space in the name of the debtor's name, listing it as "Net work Solutions, Inc." The creditor requested the Georgia Superior Court Clerks Cooperative Authority (GSCCCA) perform a search:

"The GSCCCA did a certified search under the correct name **Network Solutions, Inc.** The Search did not reveal (debtor's) financing statement, which...was filed incorrectly under **Net work Solutions, Inc.**"

Review the public organic record! ALWAYS.

WHAT IF THE DEBTOR CHANGES ITS NAME?

Aside from the critical need to correctly identify the debtor on a Financing Statement, there is also the vital step of keeping a Financing Statement current, particularly when it comes to a debtor changing its name.

Article 9 – 507(c), provides a 4-month window to amend the filing for a debtor name change that may be considered "seriously misleading." If the debtor's name changes and the change makes the filed Financing Statement "seriously misleading," UCC Section 9-507(c) states the financing statement will only be effective for collateral acquired prior to the name change or within four months following the change.

§ 9-507. EFFECT OF CERTAIN EVENTS ON EFFECTIVENESS OF FINANCING STATEMENT.

(c) [Change in debtor's name.]

If the name that a filed financing statement provides for a debtor becomes insufficient as the name of the debtor under Section 9-503(a) so that the financing statement becomes seriously misleading under Section 9-506:

- (1) **the financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the filed financing statement becomes seriously misleading;** and
- (2) the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the filed financing statement becomes seriously misleading, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the financing statement became seriously misleading.

Statute is courtesy of [LLI](#)

continued

This rule applies even if the creditor has not received actual or constructive notice of the name change from the debtor. A creditor can prevent a UCC from becoming unperfected on collateral acquired beyond this four-month window by filing an amendment to the financing statement with the new business name of the debtor.

CONSEQUENCES OF DEBTOR NAME CHANGE

[Gugino v. Wells Fargo Bank Northwest \(In re Lifestyle Home Furnishings, LLC\)](#), illustrates the consequences of failing to monitor a debtor's name change. In [Gugino v. Wells Fargo Bank Northwest](#), Wells Fargo Bank Northwest ("Wells Fargo") provided a secured loan to Factory Direct LLC ("Factory") and to perfect its security interest, Wells Fargo filed a UCC.

On May 7, 2007, approximately three and a half years after the filing of the UCC, Factory changed its name to "Lifestyle Home Furnishings, LLC." Factory did not provide notice of any kind to Wells Fargo and because Wells Fargo was unaware of the name change, it failed to amend its financing statement.

Thirteen months after the name change, Factory filed for Chapter 7 bankruptcy protection. The trustee (Gugino) challenged Wells Fargo's security interest in an adversary proceeding. The trustee contended that the security interest was unperfected for collateral acquired more than four months after the name change, because the name in the UCC filing was "seriously misleading". The court granted the trustee's motion for summary judgment allowing the trustee to avoid Wells Fargo's security interest.

4 TIPS FOR SECURED PARTIES FACING POSSIBLE DEBTOR NAME CHANGES

Relying solely on the good faith of the debtor to advise its creditor of a name change is much like keeping a wave on the sand - next to impossible. However, there are tactics for encouraging notification and observations creditors can make on their own.

The following tips are courtesy of Ms. Mary Cowan, NCS President and Professor Margit Livingston, DePaul University College of Law, and were originally featured in NCS Whitepaper: Debtor Name Changes Under Article 9: The Importance of Keeping Financing Statements Current and Accurate.

TIP 1: INCENTIVIZE

Incentivize the debtor to keep creditors informed. In the security agreement, the debtor should agree to inform the creditor of any planned name changes and/or relocations [specify number of days] in advance. Failure to do so should constitute default, allowing the secured party to call in the debt.

TIP 2: EXAMINE PAYMENTS

The creditor should routinely examine the payments made by the debtor. If the debtor has been sending payment checks that reflect a certain name or address and that information changes, the creditor should immediately contact the debtor for clarification.

TIP 3: MONITOR CORPORATE STATUS

Every three months, the creditor should check the state corporate registry where the debtor is listed. A change of name or status will be indicated on the registry.

TIP 4: STOP CREDIT

Creditors should not advance additional funds to the debtor beyond the original credit limit amount without verifying the debtor's current name, address and business form.

continued

CLOSING REMARKS

While some creditors attempt to search online for a debtor's business name, minor alterations to the name or the inclusion of a d/b/a could be fatal to the filing. Obtain the debtor's corporate legal name from organic public record (often the Articles of Incorporation) and monitor the entity's name for any subsequent changes.

In addition to confirming the debtor's corporate legal name, it is important to understand the search logic used in the state because including a space where one does not belong or changing "and" to "&" in the debtor's name may be enough to render a UCC filing ineffective.

Creditors need to exercise diligence in monitoring debtors for changes of their name and address, not only to maintain a security interest, but because it is imperative to consistently evaluate risks when extending credit.

Minor discrepancies, coupled with strict state search logic can add up to a costly mistake.

To Learn more:

800-826-5256

SecureYourTomorrow@ncscredit.com

<http://home.ncscredit.com>

