

# Commercial Financial Services Brief: Perfecting Security Interests Granted by Individuals - 8 Things You Need to Know

November 14, 2012

The current Minnesota Uniform Commercial Code (UCC) provides that you may perfect a security interest in most types of personal property by filing a financing statement (UCC-1) in the "name of the debtor". Unfortunately, the UCC never defined what constitutes the "name of the debtor". As a result, it has been left in the hands of the courts to determine whether a lender properly described the name of the debtor in the financing statement and, not surprisingly, the results have been somewhat inconsistent from state to state.

To address these inconsistencies and to help clarify the debtor's name issue, the Uniform Law Commission proposed revisions to Article 9 of the UCC. These changes were adopted in Minnesota in 2011 with an effective date of July 1, 2013. The most important changes to Section 9-503 that were adopted are as follows:

*(4) ...If the debtor is an individual to whom this state has issued a driver's license or state identification card that has not expired, only if the financing statement provides the name of the individual which is indicated on the driver's license or state identification card;*

*(5) If the debtor is an individual to whom paragraph (4) does not apply, only if the financing statement provides the individual name of the debtor or the surname and first personal name of the debtor;*

For the most part, the objectives of clarifying the debtor's name issue were achieved with these changes. However, that does not mean that every issue has been addressed. These changes have caused significant angst for lenders as they prepare for implementing the new naming requirements. The following eight questions and answers represent the most common problems that lenders are facing:

## ***1. If I perfect my security interest before July 1, 2013, what do I need to do after July 1 to maintain perfection?***

Let's use an example to illustrate. You made a loan in 2010 to Maria Smith secured by Maria's personal property. Relying on her birth certificate, you filed a UCC-1 in the name of Maria Jane Smith. After July 1, 2013, you discover that Maria's driver's license shows her name as Mary Jane Smith. Is your security



interest properly perfected?

Assuming that a new creditor searching under the name Mary Jane Smith would not find the prior UCC-1 filed in the name Maria Jane Smith, the original filing would be seriously misleading after the new rules take effect. Similarly, the same would be true if, for example, Maria used the name M. Jane Smith on her driver's license.

So what to do? It is important to note first that Section 9-507 of the UCC provides a four-month grace period to fix a name on a financing statement that has become seriously misleading. In our example, under 9-507 the original financing statement will remain effective for any collateral that the debtor acquired before July 1, 2013, or within four months thereafter. Thus, a security interest against any collateral that the debtor acquires before November 1, 2013, would continue to be perfected by the original financing statement.

If we assume that Maria is operating a small business and has granted the lender a security interest in equipment, inventory, and accounts receivable, that means that any equipment, inventory, or accounts receivable that Maria has that she acquired before November 1, 2013, would continue to be perfected. However, for inventory and accounts receivable acquired after November 1, 2013, or for new equipment acquired after that date, the lender would need to perfect in the name that is on her driver's license.

The rule of thumb should be that if you have an individual borrower who has granted you a security interest in specific collateral that it owns at the time of the loan (e.g., a forklift or tractor), then you do not need to file a new financing statement. On the other hand, if you have a blanket security interest that covers types of personal property (e.g., inventory or equipment) that may be acquired after November 1, 2013, you should take appropriate steps to protect your perfection. The best approach would be to amend your existing filing during the four-month grace period between July 1, 2013 and November 1, 2013. By amending your existing filing you will preserve your priority from the original priority date. Another approach would be to file a new UCC-1 in the name that is contained on the driver's license or identification card. However, doing so would only take care of perfection after July 1, 2013, and would not preserve the original priority of your security interest.

## ***2. What should I do for new loans made to individuals before July 1, 2013, that will extend beyond that date?***

If the name on the debtor's driver's license/identification card is different than the "individual name of the debtor" that you would use for filing prior to July 1, 2013, then you should file a financing statement using both names. The "individual name of the debtor" should be placed in Item 1 of the UCC-1 and the name from the driver's license or identification card should be placed in Item 2 of the UCC-1.



### ***3. What do I do if the borrower does not have a driver's license or identification card from Minnesota?***

The general rule is that perfection is determined by the state in which the debtor is located. An individual is "located" at that person's principal residence. Assuming that the borrower resides in Minnesota, you would generally need to file in the name that is contained on the most recent, valid driver's license or state identification card issued by Minnesota. If the debtor does not have a valid Minnesota driver's license or identification card, then the financing statement will only be sufficient if it contains (a) the individual name of the debtor (e.g., you would need to revert to the pre-July 1 name rules), or (b) the surname and first personal name of the debtor. Unfortunately, the term "first personal name" is not defined. If there is doubt as to what name constitutes the "first personal name," a conservative approach would be to file in the name on the debtor's birth certificate, marriage certificate, or any court order that may have changed the debtor's name. If none of these methods of identification are available, you should consult your legal counsel regarding the proper description of the debtor's name.

### ***4. What if the borrower has a driver's license or identification card from another state?***

If the borrower lives in Minnesota and doesn't have a valid Minnesota driver's license or identification card, but does have a valid driver's license from another state, the rules described in Question 3 above will apply, even if the debtor has a valid driver's license from another state. In other words, you would be required to file using (a) the individual name of the debtor or (b) the surname and first personal name of the debtor.

If the borrower lives in the other state that has issued a valid driver's license or identification card, the law of that state will determine how the security interest is to be perfected. Because the law of the state in which the debtor is living could be different from Minnesota's law, you will need to work with your legal counsel to determine whether a specific state has adopted requirements different from Minnesota.

### ***5. Does it make a difference if the name on the borrower's driver's license is different from his/her actual name?***

In our example in Question 1 above, it makes no difference that Maria's driver's license has a name that is different from that on her birth certificate. After July 1, 2013, you will need to use the name on her most recent, valid driver's license.

### ***6. What happens if the borrower's driver's license expires while the debt is unpaid?***

If the debtor resides in Minnesota, upon expiration of the Minnesota driver's license, the name that appears on the expired driver's license may become ineffective because the name rule will now require that you use the name on an unexpired license. If the name on the license is the same as that used on other official



documents (e.g., birth certificate, etc.), then you would not need to file an amended UCC-1 because that name would constitute the "individual name of the debtor." However, if the name on the license is different from those other documents, then you have two options for an amended UCC-1: (a) use the "individual name of the debtor" [the same name standard that applies pre-July 1, 2013] or (b) use the surname (last name) and "first personal name" of the debtor.

### ***7. What happens if the borrower marries and takes the surname of the spouse?***

As noted in Question 6, and assuming that the debtor resides in Minnesota, if the borrower does not obtain a new driver's license, the proper name in which to file is that on the unexpired driver's license (the pre-marriage surname). If the original Minnesota driver's license with the pre-marriage surname has expired, then you would need to file in the (a) individual name of the debtor or (b) surname and first personal name of the debtor (e.g., the married name of the debtor). If the debtor has obtained a new Minnesota driver's license with the new surname, then the lender would file in the name on the new driver's license.

### ***8. What do I do if the borrower moves to another state while the loan is outstanding?***

Once the debtor establishes a new residence, the law of the state to which the debtor moves will immediately govern perfection. You will need to determine the perfection requirements for the state to which the debtor moved. Assuming that state has a requirement that is the same as Minnesota, you will need to perfect by filing in the new state of residence. If the debtor has not received a driver's license from the new state of residence, then you would file in the (a) individual name of the debtor or (b) the debtor's surname and first personal name of the debtor. If, on the other hand, a new driver's license has been issued, then you would file in the new state in the name contained on the new driver's license. However, your original filing would maintain priority until the earlier of four months after the change of residence or the date the Minnesota filing expires.

### **Suggested Best Practices**

In order to help address the challenges presented by these new filing requirements, we would suggest that you consider the following Best Practices:

- Require that the debtor notify you of any of the following events:
  - Name change
  - Expiration / renewal / replacement of driver's license (or note in the loan file the expiration date and follow-up with the debtor as appropriate)
  - Moving to another state
  - Marriage or divorce



- Issuance of a driver's license by another state
- Periodically verify with the borrower the continuing accuracy of his / her name and state of residence and status of driver's license or identification card.
- For new loans, determine whether the individual previously resided in another state.
- Carefully review borrower provided tax returns and financial statements for evidence of change in residence.
- Consistent with your Customer Identification Program (CIP) policies, consider retaining a copy of the driver's license or identification card in order to document the name that you used on your financing statement.
- **When in doubt, file in multiple names, as applicable.**

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