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Case Note: Clark Contracting Services, Inc. v. Wells Fargo--Does An Assignee Of A CT Lien Entry Become Unperfected?

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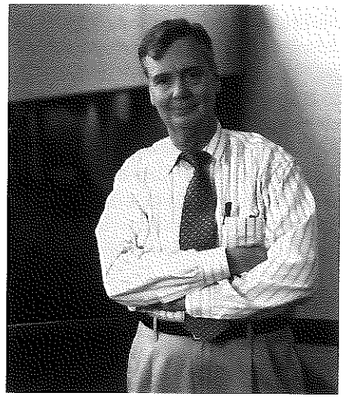

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I. Introduction

In *Clark Contracting Services, Inc. v. Wells Fargo Equipment Finance*,[1] a Texas bankruptcy court considered whether the assignee (here, Wells Fargo) of a security interest previously perfected by the assignor's "lien entry" pursuant to a certificate of title (CT) law, becomes unperfected absent steps to have the assignee indicated as "lienholder" on the CT.[2]

In granting summary judgment for the debtor (Clark Contracting Services) and denying Wells Fargo's motion for summary judgment, Bankruptcy Judge Lief M. Clark indicated that an assignee of a security interest perfected by CT lien entry must re-perfect in the assignee's name in order to be perfected as against the competing lien of a bankruptcy trustee.[3] As explained below, this is based on a series of errors that led the court to an incorrect conclusion. As a consequence, the case misinterprets the relation between Uniform Commercial Code (UCC) Article 9 and state CT laws in fundamental ways that could inappropriately affect a variety of other transactions.

II. Facts and Issues in *Clark*

The facts in *Clark* were straightforward and common. As described by the court, Clark Contracting Services (Clark, or the debtor) was a construction company that owned various vehicles subject to perfected "liens" (*i.e.*, security interests) assigned to Wells Fargo by CIT Group/Equipment Financing, Inc. (CIT). CIT had perfected the security interests pursuant to the Texas CT law,[4] prior to the assignment to Wells Fargo. Relying on the prior perfection by its assignor, as is common practice in the industry, Wells Fargo did not take steps to re-perfect the security interests after the assignment. When Clark filed bankruptcy on January 9, 2008, this created a bankruptcy estate consisting of the debtor's property, and a lien on property of the estate in favor of the bankruptcy trustee (trustee), under sections 541(a) and 544(a)(1) of the Bankruptcy Code.[5] This lien allows the trustee to effectively "avoid" prior security interests on property of the estate, unless the security interest is properly perfected.[6]

Clark's management continued as debtor-in-possession pursuant to Bankruptcy Code section 1101(1), thereby exercising the powers of a trustee.[7] Clark then sought to avoid the Wells Fargo security interests pursuant to Bankruptcy Code section 544(a), on grounds that Wells Fargo was unperfected because its "lien" was not indicated on the CT. Wells Fargo sought partial summary judgment because, under well-established principles of common law, contracts, and the UCC an assignee "steps into the shoes" of the assignor and exercises those rights against competing parties.[8] It is undisputed that the assignor (CIT) was perfected as to all of the vehicles in question.[9]

III. The Arguments in *Clark*

As noted, Wells Fargo did not record the assignment of the CIT security interests with the Texas CT office (the Texas Department of Transportation) and did not seek to have CIT replaced as the secured party indicated on the CT, relying on the general rules of assignment and UCC section 9-310(c)[10] for the proposition that an assignee takes the rights of the assignor.[11]

The debtor argued that section 9-310 (Texas section 9.310) is (in the court's words) "the wrong place to look[,]" being "only a general rule regarding assignment of ordinary liens."[12] In the debtor's view, this "general rule" governing "ordinary liens" is displaced by UCC section 9-311 (Texas section 9.311), and the state CT law governing CT "lien entry" perfection. Section 9-310(b) defers to section 9-311(a), and section 9-311(a) defers to the state CT law for purposes of the mechanics of perfection, and (the debtor argued) the Texas CT law requires that the "lien" be indicated on the CT.[13] The CT law also provides a procedure for recording the assignment of a security interest, resulting in an indication of the assignee as lienholder on the CT. The debtor argued that this procedure is mandatory and exclusive, not permissive, and that it displaces all other law to the contrary, including the UCC (somewhat disingenuously, the debtor then asserted that this displacement means there is no "conflict" with the UCC).[14]

The importance of these issues and arguments to CT transactions cannot be overstated. *Clark* calls into question the established relation between the law of secured transactions (primarily UCC Article 9) and state CT laws that are often poorly drafted at a fundamental level.[15] It also implicates the basic role of CT laws. These interstitial laws came into being as a means to permit the registration of ownership for the purpose of discouraging title fraud.[16] They were never intended to displace other, more comprehensive laws governing property rights, contracts, secured transactions, and debtor-creditor relations. Yet the debtor's arguments in *Clark*, as adopted by the court, do exactly that.

IV. The Court's Analysis--Assignments

The *Clark* court correctly noted that the "dispute thus turns on how the UCC and [CT law] interact with respect to assigned liens on motor vehicles."[17] The court also correctly noted that there are "few helpful opinions" on the issue.[18] However, the court then concluded that the Texas CT law was "enacted specifically to ensure that assigned liens on vehicles subject to the [CT law] must be reflected on the [CT] as a condition to continuous perfection."[19]

This statement is questionable on multiple points, and overall is probably just wrong. As noted, state CT laws were enacted largely in order to allow registration of ownership as a means to combat title fraud.[20] Even so, generally they are not regarded as the exclusive mechanism for transferring ownership; the CT laws continue to be supplemented by property and contract laws and the UCC even as to "core" CT issues relating to ownership.[21]

1. 2008 WL 5459818 (Bankr. W.D. Tex., San Antonio Div. (Nov. 28, 2008)).

2. As is common in cases involving state CT laws, the court (based on the Texas CT law) incorrectly used the term "lien" to reference a Uniform Commercial Code (UCC) Article 9 security interest. *Compare* the UCC definitions at §§ 1-201(b)(35) and 9-102(a)(52); *see also* the UCC scope provision at *id.* § 9-109(a) (Article 9 governs security interest issues except as otherwise provided). *Compare also* the correct use of the terminology in the Uniform Certificate of Title Act (UCOTA). This confusion in the terminology is not surprising given the uneasy relation between state CT laws and the UCC, as illustrated in *Clark*, and the inconsistencies that result. Moreover, the terms "lien" and "security interest" are defined in still different ways in the Bankruptcy Code. *See* 11 U.S.C. § 101(37) and (51). Nonetheless, as provided in Article 9 at § 9-109 and discussed in this article, the issues in *Clark* are governed primarily by Article 9, and in this context the Article 9 terminology should be used.

3. *Clark*, 2008 WL 5459818 at *1 and *11.

4. Chapter 501 of the Texas Transportation Code. *See generally* COMPENDIUM OF STATE CERTIFICATE OF TITLE LAWS (Alvin C. Harrell, Ed.) Ch. 44 (Amer. Bar Assoc. 2009) (*ABA Compendium*) (describing the Texas CT law).

5. *See* 11 U.S.C. §§ 541(a)(1), 544(a)(1).

6. *Id.* § 544(a). The trustee also has the status of a lien creditor for purposes of the priority rules in UCC Article 9. *See* UCC §§ 9-102(a)(52)(C), 9-317(a)(2). The trustee exercises this priority on behalf of all claims against the estate, effectively subordinating an unperfected security interest to all other claims against the estate (and thereby avoiding it). *See, e.g.*, Moore v. Bay, 284 U.S. 4 (1931).

7. *See* 11 U.S.C. § 1107.

8. This principle is black letter law, well-ingrained in statutes and the common law. *See, e.g.*, JOHN D. CALAMARI & JOSEPH M. PERILLO, CONTRACTS Ch. 18 and §§ 18-2, 18-3 (1977); JOHN EDWARD MURRAY, JR., MURRY ON CONTRACTS § 141.A. (1990). There is also an equitable equivalent, commonly known as subrogation. *See, e.g.*, DAN B. DOBBS, REMEDIES 250-252 (1973). In addition, as the *Clark* court noted, 2008 WL 5459818 at *2, under UCC Article 9 § 9-310(c) assignees "need take no further action to enjoy the perfected status of their assignors." This general principle is also reinforced elsewhere in the UCC, *e.g.*, in Article 3 at §§ 3-203(b) and 3-305(a) and (b), applicable to the extent the promissory notes in *Clark* were negotiable instruments under *id.* § 3-104 (an issue not explored in *Clark*), and in Article 9 at sections 9-404-9-406. *See also* UCC § 9-505 and Comment 2; *id.* § 9-514 and Comment 2. It should be noted that Article 9 expressly governs sales of security interests, *e.g.*, as "chattel paper." *See* UCC § 9-102(a)(11) (definition of chattel paper); *id.* § 9-109(a)(3) (sales of chattel paper governed by Article 9). These issues were also explained by the Permanent Editorial Board for the UCC (the PEB), in this very context, in PEB Commentry No. 12 Section 9-302 (Feb. 10, 1994). While not updated to reflect revised Article 9, this PEB Commentary remains generally valid and accurate. *But see infra* note 63.

9. *Clark*, 2008 WL 5459818, at *2.

10. Tex. Bus. & Comm. Code § 9.310(c). This article refers generally to the UCC by citations to the uniform text.

11. *See supra* note 8. Wells Fargo filed precautionary amendments to the UCC-1 financing statements covering certain related collateral, but pointed out that this was unnecessary. *See Clark*, 2008 WL 5459818 at *2. *See also* UCC §§ 9-505 and 9-514, and Comments thereto.

12. *Clark*, 2008 WL 5459818 at *2.

13. It can be noted at this point that one obvious flaw with this reasoning is that, while § 9-310(b) defers to § 9-311(a), the relevant provision in *Clark* is § 9-310(c), which does not defer to § 9-311(a). However, there are also other, perhaps even more fundamental problems with the analysis in *Clark*, as noted below.

14. *Clark*, 2008 WL 5459818 at *2. While there is no conflict to the extent that § 9-311(a) defers to the mechanics of perfection under the CT law, as discussed here the issues in *Clark* go beyond the scope of this deference.

15. The 1999 revisions to the uniform text of Article 9 substantially rationalized the law of CT secured transactions by clarifying the scope and effect of Article 9, as a counterpoint to the confusion so often evident in state CT laws. *See, e.g.*, Alvin C. Harrell, *A Roadmap to Certificate of Title Issues in Revised UCC Article 9*, 53 Consumer Fin. L.Q. Rep. 202 (1999) (describing the Article 9 revisions). To the extent that *Clark* inappropriately expands the role of an ambiguous CT law at the expense of the clarity in Article 9, these benefits may be lost.

16. *See infra* note 20.

17. *Clark*, 2008 WL 5459818 at *2. This statement is largely correct, although it fails to note the important role of contract and property laws, which are not broadly displaced by state CT laws and remain applicable to vehicles and liens. *See* UCC § 1-103 (recognizing the supplementary role of other law); UCOTA § 3 (same).

18. *Clark*, 2008 WL 5459818 at *3. The emphasis should be on "helpful."

19. *Id. See* discussion below and *compare infra* this text and notes 36 - 37 and 48.

20. Ironically, in view of its apparent conclusion to the contrary (*see supra* this text at note 19), the *Clark* court recognized this point. *See* 2008 WL 5459818 at *5, citing Larry T. Bates, *Certificates of Title in Texas Under Revised Article 9*, 53 Baylor L. Rev. 735, 736 (2001). *See also* PEB Commentary No. 12, *supra* note 8 (describing the primary purposes of CT laws, as identified in the case law, to be: "to facilitate the identification of motor vehicles or boats, the ascertainment of their owners, and the prevention of theft or fraud in their transfer," as well as taxation and "stability in the business climate.").

21. *See, e.g.*, UCC §§ 2-401, 2-403, and 9-619 (ownership issues governed by the UCC); *supra* note 17. *See generally* Seward County v. Hauck, 2003 WL 21211373 (Neb. App. May 27, 2003) (unpublished) (common law and equity supplement the CT law); *Seward County* is discussed in Alvin C. Harrell, *Can a Buyer and Secured Party Rely on a Certificate of Title? Part II.*, 76 Okla. Bar J. 447, 448-450 (2005). *See also In re* Foster, 611 P.2d 232, 234 (Okla. 1980) ("...[CTs] in Oklahoma are documents of convenience rather than documents of ownership."). *Foster* is noted in Alvin C. Harrell, *Certificate of Title Lending Under Revised Article 9*, 32 U.C.C. L. J. 422, 434-36 (2000), also noting other, more recent cases that back-away from this somewhat, *e.g.*, Mitchell Coach Mfg. Co., Inc. v.

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For the most part, the enlargement of CT laws to cover perfection of security interests came later, with the enactment of Article 9 and the predecessors of section 9-311. Today, the purpose of "lien entry" perfection under the applicable CT law is to comply with UCC Article 9, in order to achieve Article 9 perfection and priority and provide a system for creating public notice of security interests in accordance with the requirements of Article 9 (*e.g.*, to meet the requirements of section 9-102(a)(10), as a prerequisite for the Article 9 deference to the CT law under section 9-311(a)). Sections 9-102(a)(10) and 9-311(a) require an appropriate procedure to be in place, but demonstrably do not require that a security interest be indicated on the CT as a prerequisite to perfection. Nowhere in the interface between Article 9 and the Texas CT law is there any evidence that the CT law was "enacted specifically to ensure that assigned liens on vehicles" are indicated on the CT as a prerequisite to perfection.

Nonetheless, the *Clark* court concluded that Wells Fargo's "[f]ailure to comply" with the CT law procedure for recording an assignment caused its security interests to become unperfected and therefore avoidable under Bankruptcy Code section 544(a).[22] The court noted the need to perfect a "lien" under Article 9 and the applicable CT law, which pursuant to sections 9-102(a)(10) and 9-311(a) must include compliance with a CT office procedure designed to result in an indication of the security interest on the CT, in an effort to provide public notice to interested parties.[23] But there is nothing in either law that requires a "lien entry" on the CT as a condition to perfection of the security interest; to the contrary (as discussed below), both Article 9 and the Texas CT law provide for perfection to occur upon submission of the initial documentation (sometimes called a "lien entry form") to the CT office, even if the security interest is never indicated on the CT. Nonetheless, the *Clark* court concluded that the security interest must be noted on the CT as a prerequisite to perfection, and then derived a separate and even more questionable conclusion that the assignee also must indicate its interest on the CT.[24] The latter conclusion is expressly contrary to Article 9 (as well as other applicable law[25]), which always has provided that assignments are effective without being recorded and includes specific protections for resultant damages caused by an innocent party's reliance on the public record.[26]

The discussion in Professor Bates' article about proceeds from the disposition of CT collateral (excerpted in *Clark*)[27] is interesting and warrants note here as a general matter. Professor Bates' article discusses the relation between UCC section 9-311(a) and (b) (on CT "lien entry" perfection) on the one hand, and section 9-315(d) (perfection as to proceeds) on the other.[28] He points out that the requirement for continued perfection as to proceeds (after twenty days) under section 9-315(d)(1)(A), by reason of a filed financing statement, generally will not be met for collateral subject to CT lien entry perfection, despite sections 9-311(b) and 9-505(b), because for most such collateral the perfection as to the proceeds "would necessarily be filed in a different office."[29] In effect, assuming the proceeds are not subject to CT lien entry perfection under section 9-311(a), a lien entry filing will not provide continuing perfection as to proceeds under section 9-315(d)(1)(A), even if the lien entry filing is otherwise equated with a financing statement under sections 9-311(b) and 9-505(b).

This is an important and interesting point, well worthy of consideration and comment and perhaps dispositive in the right case. It is a point reinforced by section 9-322(c)–(f), which basically provides that the priority rules for collateral subject to special perfection provisions (sometimes called "non-filing collateral," because perfection is outside the Article 9 filing system, although that label does not quite fit CT collateral, due to sections 9-311(b) and 9-505(b)) extend to proceeds from other types of collateral when the proceeds are in the form of such "non-filing collateral."[30] For example, if a vehicle subject to CT lien entry perfection is sold and the proceeds are deposited in a bank account, the priority rules governing bank accounts apply.[31] If the proceeds of collateral covered by a CT (*e.g.*, a vehicle) are business equipment (subject to perfection by a UCC filing), then the perfection and priority rules for equipment apply. Presumably, as Professor Bates indicates, the security interest in the equipment would be unperfected after twenty days under section 9-315(d), because the security interest in the vehicle was perfected by a lien entry filing in the CT office rather than in the UCC filing office as required for equipment.[32] Of course, if the proceeds are identifiable cash proceeds, perfection continues under section 9-315(d)(2).

Perhaps the most interesting related issue is whether the security interest in a vehicle (perfected by a CT "lien entry" filing) continues to be perfected in the proceeds under section 9-315(d)(1) if the vehicle is sold or traded and the proceeds are in the form of another vehicle, *e.g.*, subject to CT lien entry perfection in the same jurisdiction. Arguably the answer is yes, at least to the extent that the CT law of that jurisdiction provides for perfection to occur upon filing the lien entry form with the CT office.[33]

As noted these are interesting issues, as discussed by Professor Bates whose analysis is quoted in *Clark*.[34] However, these are not the issues in *Clark*, and the relevance of Professor Bates' analysis to the issues in *Clark* is not made clear by the court's analysis in *Clark* or its references to the Bates article. Indeed, to the extent that Professor Bates' analysis emphasizes that a lien entry filing is equivalent to filing an Article 9 financing statement (as indicated at sections 9-311(b) and 9-505(b)), only in a different office (the issue discussed by Professor Bates as relevant under section 9-315(d)), this tends to support Wells Fargo's argument in *Clark* that the UCC Article 9 rules governing continued perfection upon assignment apply to a CT lien entry filing. Nonetheless, following its brief quotation from Professor Bates regarding perfection as to proceeds, the *Clark* court seemingly leaped to the broad conclusion that "[a] failure to notate a continuing security interest correctly on the [CT] can thus be fatal to perfection for a secured creditor."[35] This broad conclusion is unwarranted by the references to the Bates article, and even as a general matter is a misstatement of the law as to the basics of perfection, at least in states where perfection occurs upon the filing of the lien entry form and is not dependent on the security interest being indicated on the CT.[36]

The *Clark* court was correct in stating that Article 9 requires a CT law provision or procedure designed to indicate the security interest on the CT, but this indication may occur as a "result" of the perfection and is not a precondition to it.[37] Thus, contrary to the statement in *Clark*,[38] a failure to indicate a security interest on the CT is not fatal to perfection.[39] The court was correct in stating that "the level of diligence imposed on innocent third parties is low—they are entitled to rely on [the CT], and need look no further."[40] But this does not change the basic fact that Article 9 merely requires the CT law to provide a procedure designed to result in indication of the security interest on the CT,[41] it clearly does not make the indication a prerequisite to perfection.[42] As noted, Article 9 provides protections in the event the indication on the CT is omitted,[43] while recognizing that perfection continues nonetheless.[44] The *Clark* court sought to bolster its contrary conclusion (that an indication on the CT is required for perfection) by stating that "a searchable databases [sic] of filings is not publicly available."[45] But there is no other support for this statement in the *Clark* opinion, and the statement is incorrect as to the law of many if not most states.[46] In any event, it does not change the required elements of perfection.

The court then concluded that "[t]he [Texas CT law] expressly states that notation on the [CT] equals perfection...."[47] As indicated above, this is clearly incorrect.[48] But even if it was true that the CT law requires such notation as a prerequisite to the initial perfection,[49] that does not answer the question presented in *Clark*. That question relates to the effect of an assignment of a security interest that is already perfected, not the initial method of perfection under the CT law. In *Clark*, there is no question that the security interest assigned to Wells Fargo was perfected at the time of assignment; the question was whether the assignment caused it to become unperfected.[50] The court's overly-broad statement that an indication of the security interest on the CT "equals perfection" may seem innocuous as a general shorthand for CT lien entry perfection, but is misleading as a technical matter with respect to both the method of perfection and the impact of an assignment. If a CT lien entry "equals perfection," then it is a short step to conclude, as the *Clark* court did, that an assignee must be indicated on the CT in order to continue the perfection of an existing lien

21. *(Continued from previous page)*

Stephens, 19 F. Supp.2d 1227 (N.D. Okla. 1998). UCOTA draws the appropriate line between these views by defining a CT at § 2(a)(5) as "evidence" (but not necessarily "proof") of ownership. *See also* Alvin C. Harrell, Case Note, Volvo v. McClellan, *Can a Buyer and Secured Party Rely on a Certificate of Title?*, 74 Okla. Bar J. 2641 (2003).

22. *Clark*, 2008 WL 5459818 at *3.

23. *Id.*, at *5. In effect, this is the equivalent of the notice provided by filing a financing statement as to other collateral. *See, e.g.*, UCC § 9-311(b); *id.* § 9-505(b); *id.* § 9-516(a).

24. 2008 WL 5459818 at *5. Notably, any such requirement is absent from §§ 9-102(a)(10) and 9-311(a), as well as being contrary to § 9-310(c). As noted below, the *Clark* court's quotation from the Bates article, regarding proceeds, as providing support for the court's conclusion seems irrelevant on this point. *See Clark, id.*, quoting Bates, *supra* note 20, at 751-752.

25. *Id. See also supra* note 8.

26. *See, e.g.*, UCC §§ 9-310(c), 9-337, 9-338, and 9-339. As noted, these provisions are applicable to CT "lien entry" perfection pursuant to §§ 9-311(b) and 9-505(b). *See generally* PEB Commentary No. 12, *supra* note 8.

27. *See* Clark, 2008 WL 5459818 at *5, quoting Bates, *supra* note 20, at 751-752.

28. *Id.*

29. *Id.*

30. UCC § 9-322 (c) – (f).

31. *Id.* § 9-322(c).

32. *See id.* §§ 9-315(d)(1), 9-501(a)(2).

33. Because, pursuant to §§ 9-311(b) and 9-505(b), this filing is tantamount to a financing statement filed in the correct office under 9-315(d)(1)(A) and (B). Note that these considerations and analyses are different if the vehicles are inventory, because of § 9-311(d).

34. *Clark*, 2008 WL 5459818 at *5.

35. *Id.*

36. *See supra* this text at notes 19-26; and *infra* note 48. *See also* PEB Commentary No. 12, *supra* note 8. A correct interpretation of the Texas CT law is consistent with Article 9. *See* UCC § 9-516(a), which is arguably applicable in this context pursuant to § 9-311(b) and § 9-505(b). In addition, it should *(Continued in next column)*

36. *(Continued from previous column)*

be emphasized again that the Article 9 definition of CT at § 9-102(a)(10) merely requires that the CT law provide a procedure designed to have the security interest indicated on the CT as a "condition *or result*" of the perfection, thus contemplating perfection by a filing with the CT office coupled with a procedure for subsequent indication on the CT. This does not require that the security interest be noted on the CT, only that the security interest be perfected pursuant to a law that provides a procedure for such indication. Section 9-337 then provides protection for innocent parties who are misled by omission of a perfected security interest on a CT subsequently created in another state. *See also* UCOTA § 19(b), (d) (extending this protection to intra-state scenarios).

37. *See* UCC §§ 9-102(a)(10), 9-311(a).

38. *See Clark*, 2008 WL 5459818 at *5; *supra* this text at note 35.

39. *See, e.g.*, PEB Commentary No. 12, *supra* note 8; and *infra* this text and notes 42-50.

40. *Clark*, 2008 WL 5459818 at *5. That is the purpose behind the statutory protection of such parties, *e.g.*, at UCC §§ 9-316(e), 9-337 and 9-338. Indeed, in common (retail) transactions, buyers in ordinary course of business are not even required to examine the CT. *See id.* § 9-320(a). But none of this obviates the basic rules at §§ 9-102(a)(10), 9-310 and 9-311 governing perfection, or protects lien creditors (such as the trustee in bankruptcy).

41. UCC § 9-102(a)(10). *See also* § 9-311(a).

42. *See id.* §§ 9-311(b), 9-505(b), and 9-516(a).

43. *See, e.g., id.* § 9-337; and *supra* notes 21 and 40. *See also* UCOTA § 19(b), (d).

44. *Id.*

45. *Clark*, 2008 WL 5459818 at *5. This statement by the court appears to be incorrect as to Texas. According to the *ABA Compendium*, *supra* note 4, "current security interest perfection information may be obtained from any office of the Texas Department of Transportation, Vehicle Titles and Registration Division, or county assessor-collector." *ABA Compendium*, *supra* note 4, Ch. 44 at Part XII.

46. *See generally* the *ABA Compendium*, *supra* note 4.

47. *Clark*, 2008 WL 5459818 at *6.

48. *See supra* this text and notes 19-26 and 36-37. Tex. Transp. Code Ann. § 501.111 provides that a security interest in a motor vehicle can be perfected "only by recording the security interest on the [CT] as provided by this chapter." But *id.* § 501.113(a) then provides that "[r]ecordation of a lien under this chapter is considered to occur when the [CT office] is presented with an application...." *See also id.* § 501.113(b) (the time of filing is the time of such recordation). *See ABA Compendium*, *supra* note 4, ch. 44. Thus, filing the application (not the CT lien entry notation) constitutes perfection. This is consistent with Article 9. *See* UCC §§ 9-311(b), 9-505, and 9-516(a). *See also* PEB Commentary No. 12, *supra* note 8.

49. Which as noted is not correct. *See id.*

50. *Clark*, 2008 WL 5459818 at *6.

entry. That is precisely the line of reasoning followed in *Clark*.[51] But as noted this is fundamentally incorrect on both points.

The *Clark* court based its analysis partly on the existence of a statutory procedure in the CT law for an assignee to record the assignment and have the CT office replace the assignor with the assignee on a newly-issued CT.[52] But the court's own description of this procedure lends support for the view that it is: (1) optional, not mandatory;[53] (2) a system for recording assignments, not perfection; and (3) a supplementary mechanism applicable to rights also governed by other law.[54]

From this the *Clark* court essentially concluded that an arguably optional CT law procedure for recording an assignment governed by and effective under other law is the exclusive means by which the parties can assign a previously perfected Article 9 security interest: "An assignee who wants to be assured that its lien will 'relate back' to the recordation date of the original lien by the assignor *needs to* follow the procedures set out in [the CT law]."[55] Among other things, this conclusion implies that the laws governing assignments and perhaps even the Article 9 rules governing the priority of security interests are displaced by this CT law recording procedure.[56]

The court emphasized that "only by following this procedure will the Department of Transportation know that the assignee is the current holder of the first lien."[57] While this is true, it is also irrelevant. It is common for all types of interests, including credit contracts, to be bought and sold (and securitized) without any recording office being aware of the transaction.[58] Absent this (and under the *Clark* decision) it is hard to see how securitization transactions could occur. Moreover, it is not clear why the recording office should have any interest in such transactions, or what the office would do differently if it was aware of them. The purpose of a recording office is to accept the records submitted to it, maintain files reflecting this information, and issue appropriate documentation reflecting ownership and a secured party of record, not to monitor other transactions between private parties. Article 9 clearly recognizes this, while protecting innocent private parties who rely on the public records, thus making clear that unrecorded assignments are common and lawful.[59]

As noted, however, the *Clark* court rejected this traditional analysis, concluding that the statutory option to record an assignment:

> seems fairly obviously to imply that an assignee who wants to be able to stand in the shoes of its assignor with continued perfection needs to make sure that the assignee is shown on the face of the [CT]....There is no other means of perfection available under the [CT law], and none other is even implied.[60]

Again this confuses the statutory mechanism for perfection with the laws governing subsequent assignments. Article 9 section 9-311(a) expressly provides that the mechanics of perfection are governed by the CT law, but Article 9 clearly does not defer to the CT law for other issues such as attachment, assignments, priority and enforcement.[61] The CT law does not restate this limitation on its scope (or other principles of secured transactions law) because that would be inappropriate and there is no need to do so; the scope issues pertaining to security interests are governed by Article 9,[62] and the Article 9 deference to the CT law is expressly limited to the mechanics of perfection by filing a lien entry form.[63] The subsequent effects of that perfection are governed elsewhere, *e.g.*, by Article 9 and general principles of law.[64]

Instead of recognizing this, the *Clark* court essentially treated the CT law as creating a comprehensive law of security interests and assignments that displaces other applicable laws, including the UCC. Somewhat ambiguous language in the CT law, that would be taken by your author to indicate that recordation of an assignment is optional ("a lienholder *may* assign a lien...."), was taken as limiting valid assignments to those in compliance with the CT law recording procedure.[65] But even

51. *Id.*

52. *Id.* This procedure is common among the states, and there may be reasons why an assignee might wish to follow the procedure, *e.g.*, in order to become the secured party of record. But a lack of perfection is not one of these reasons. *See, e.g.*, UCC § 9-511 (Secured Party of Record), and *id.* § 9-514, Comment 2. UCOTA expressly addresses these issues, consistent with Article 9. *See, e.g.*, UCOTA §§ 2(a)(25), 15(a), 21, and 26(c). *See also* PEB Commentary No. 12, *supra* note 8.

53. "The original lienholder...*may* assign a [perfected security interest] in accordance with the [CT law's] procedures...." *Clark*, 2008 WL 5459818 at *6 (emphasis added). *See also* PEB Commentary No. 12, *supra* note 8. PEB Commentary No. 12 strongly suggests that any statutory ambiguity on this point be resolved in favor of free assignability. *See also supra* note 8; *infra* note 89.

54. *See Clark*, 2008 WL 5459818 at *6 and *7. There is no suggestion in the CT law, and no basis in the court's opinion, to suggest that the basic contract law principles governing assignments are displaced by this recording procedure. Nonetheless, the *Clark* court embraced such a displacement. *See id. Cf. supra* note 8; *infra* note 89.

55. *Clark*, 2008 WL 5459818 at *7 (emphasis added). Among the other errors in this statement, it should be noted that this is not a matter of a "relation back" analysis, but the acquisition by assignment of an Article 9 security interest entitled to a priority that is determined by the time of its perfection, pursuant to UCC § 9-317.

56. *See, e.g.*, *Clark*, 2008 WL 5459818 at *7 ("...the intent of the [CT law] seems clear.").

57. *Id.*

58. *See, e.g.*, *supra* note 8 (noting the general law of assignment and the application of UCC Article 9); *In the Matter of* MERSCORP, Inc. v. Romaine, 861 N.E. 2d 81 (N.Y. 2006), and Stephen F.J. Ornstein & Matthew S. Yoon, *In the Matter of* MERSCORP, Inc. v. Romaine, 61 Consumer Fin. L.Q. Rep. 914 (2007) (both noting the limited "ministerial" role of a recording office); Derrick M. Land, *Residential Mortgage Securitization and Consumer Welfare*, *id.*, 208 (describing the securitization process, which obviously would be impaired if every assignment of a secured interest had to be recorded). *See also infra* note 89.

59. *See, e.g.*, UCC §§ 9-310(c), 9-337, 9-338, 9-506, 9-511–9-514; UCOTA § 20; *supra* notes 21, 40, and 52-54; PEB Commentary No. 12, *supra* note 8.

60. *Clark*, 2008 WL 5459818 at *7.

61. *See* UCC § 9-311(a).

62. *See id.* § 9-109.

63. *Id.* §§ 9-310(b) and 9-311(a), making clear that it is only the filing of a financing statement that is rendered inapplicable by the Article 9 deference to the CT law. While recognizing that state CT law "lien entry" perfection mechanisms generally do not displace the law of assignments, PEB Commentary No. 12 suggests that a CT law conceivably could do so, *e.g.*, by an express statutory provision requiring indication of the assignment on the CT as a prerequisite to perfection. This is essentially what the court held in *Clark*. However, the PEB Commentary strongly argues that any statutory uncertainty should be resolved against this view. *See* PEB Commentary No. 12, *supra* note 8; and *infra* this text Parts VIII. and IX. Moreover, even that view is potentially in conflict with UCC §§ 9-109, 9-310, 9-311 and 9-505.

64. *Id.* §§ 9-310(c) and 9-311(b); UCC Article 1 § 1-103. *See also* UCOTA § 3 (same).

65. *Clark*, 2008 WL 5459818 at *7.

aside from the question of whether this is a correct interpretation of the Texas CT law, this focus on the language of the CT law does not properly recognize: the proper relation between the CT law and Article 9; the fact that scope issues relating to security interests are governed by Article 9; that regarding security interests the CT law applies only to the extent Article 9 says so, not the other way around;[66] and that Article 9 clearly limits its deference to the CT law at sections 9-310(b) and 9-311(a).

Perhaps in this era of an ever-expanding administrative state, seemingly characterized by comprehensive, preemptive regulatory solutions to every perceived problem, it is natural for a federal court to view an administrative process as displacing the common law and applicable state statutes including the UCC. But in this case that analysis is misplaced. As noted above, state CT laws are interstitial; they do not create a comprehensive regulatory structure governing all aspects of CT transactions, and the relation between Article 9 and the CT law is expressly governed (and limited) by Article 9. A careful consideration of this interface makes clear that an ambiguous provision in the Texas CT law should not displace the law of assignments or related Article 9 provisions.

V. Court's Analysis--Priorities

The *Clark* court next considered the rules governing the relative priorities of security interests, lien creditors (including the trustee in bankruptcy), and buyers at a judicial sale.[67] After a general discussion of the procedure for conducting a "sheriff's sale" of Article 9 collateral, pursuant to enforcement of a lien by a judgment creditor,[68] the court noted that such a sale normally will be conducted without the existing CT (which is likely to be held by a competing Article 9 secured party). The court then stated that the sheriff has no "practical or legal way of knowing of the existence of a prior security interest in the vehicle prior to selling [it], and apparently no need to know either."[69] The court also reasoned that the purchaser at the sheriff's sale "must know that it will get a new, clean and clear [CT] (*i.e.*, one without security interest notations), because it has no way of knowing whether there are any security interests against the vehicle...."[70] From this the court concluded that "the purchaser likely takes free of the consensual and properly notated [security interest]."[71]

Virtually all of this is incorrect. It is well-established that the buyer at a judicial or other disposition sale takes the same legal rights and priorities as the foreclosing creditor.[72] It is also clear that a foreclosing lien creditor is subordinate to a prior perfected security interest.[73] Thus, the buyer at a sheriff's sale takes subject to any such security interest.[74] This is fundamental, and there is absolutely nothing in the CT law to suggest otherwise, even if the CT law governed these issues (which it does not).[75]

In a dramatic reversal of these applicable statutory priorities,[76] the *Clark* court indicated that the buyer at a judicial sale takes free of a prior, perfected security interest and that the proceeds from the sheriff's sale should be paid to the (subordinate) lien creditor conducting the sale.[77] Thus, having incorrectly concluded that a non-ordinary course of business buyer at a judicial sale takes free of a prior, perfected security interest,[78] the court stated that the sales proceeds should be paid to the creditor with the lower priority. Apparently the basis for all of this was the notion that these parties (the buyer, the sheriff and the lien creditor) have no means to discover the security interest perfected by a "lien entry" filing with the CT office.[79]

Having stated that the buyer has no means to discover a previously perfected security interest, the court concluded that "no duty of inquiry [can] be imposed on a purchaser of a vehicle at a sheriff's sale."[80] This again turns on its head the basic legal principle (including the law of assignment) that such a buyer takes the legal rights (and priority) of the creditor conducting the sheriff's sale, *i.e.*, subject to all other prior claims.[81] This principle,

66. *See* UCC §§ 9-109, 9-303, 9-310(b) and (c), and 9-311(a). *See also id.* §§ 9-311(b) and 9-505(b) (regarding application of Article 9 Part 5).

67. *Clark*, 2008 WL 5459818 at*8.

68. It can be noted here that many, probably most, disposition sales of Article 9 collateral are conducted by the Article 9 secured party, not a lien creditor or the sheriff, and are governed largely by the procedures in Article 9, Part 6. So the scenario contemplated by the court is somewhat unusual.

69. *Clark*, 2008 WL 5459818 at *8. This is apparently incorrect. *See supra* notes 45-46.

70. *Clark*, 2008 WL 5459818 at *8. This is also incorrect, as a purchaser at a judicial sale should know full well that the property is being sold subject to prior interests and liens. *See infra* note 72. The absence of a CT is a further red flag on this issue.

71. *Clark*, 2008 WL 5459818 at *8. As noted *infra*, this is a huge and unwarranted leap in the analysis, even assuming the predicates were correct.

72. *See, e.g.*, JAMES J. WHITE, BANKRUPTCY AND CREDITORS' RIGHTS 567 (1985) (citing various authorities). Among other things, this is the law of assignment again. *See supra* note 8.

73. UCC § 9-317.

74. *See, e.g.*, White, *supra* note 72. The *Clark* court conceded that there is authority contrary to its holding on this point. *See Clark*, 2008 WL 5459818 at *8, nn. 24 and 25 (citing, *e.g.*: General Motors Acceptance Corporation v. Byrd, Sheriff of Dallas County, 707 S.W. 2d 292, 296 (Tex. App.–Ft. Worth 1986, no writ); and note, *Secured Creditors Holding Lien Creditors Hostage: Have a Little Faith in Revised Article 9*, 81 Ind. L.J. 733, 735 (Spring 2006)). The *Clark* court concluded, however, that the *General Motors* rationale is contrary to the Texas CT law (not discussed in the *General Motors* case, probably because the CT law does not apply to these Article 9 issues), which (it concluded) controls over the Texas law governing sheriffs' sales. *See Clark*, 2008 WL 5459818 at *8. *But see* UCC § 9-109, and discussion *supra* at Part IV.

The *Clark* court cited as the basis for this conclusion the procedure in the CT law (Tex. Trans. Code § 501.074(a)(5)) that allows the sheriff to sell the vehicle at the sheriff's sale without the CT and then apply for a new CT in the name of

(Continued in next column)

74. *(Continued from previous column)*

the buyer. *Clark*, 2008 WL 5459818 at *8. The court noted that this section does not mention the prior security interest. *Id.* This CT law procedure is wholly inadequate as a basis for overturning the Article 9 priorities: it merely provides a mechanism for obtaining a new CT to reflect the results of a judicial sale. Although as noted many CT laws are not clearly drafted on these points, the new CT undoubtedly should include a notation of any prior security interest.

75. *Id.*

76. *See* UCC § 9-317.

77. *Clark*, 2008 WL 5459818 at *8.

78. *Id. Cf.* UCC § 9-317(b), (e).

79. As noted, this is apparently an incorrect conclusion. *See supra* notes 45-46. Even if it were true, however, this is an obviously inadequate basis for ignoring the applicable secured transactions law and priorities.

80. *Clark*, 2008 WL 5459818 at *8.

81. *See, e.g.*, White, *supra* notes 72 and 74; *see also* Aaron Byrkit, *Reforming Foreclosure Disposition: A Tool for Tempering the Financial Meltdown*, 63 Consumer Fin L.Q. Rep. Nos. 1-2 (2009) [in press] (describing the judicial foreclosure sale process and the impact of the new Uniform Nonjudicial Foreclosure Act (UNFA)).

which is essential to established creditor priorities, is so fundamental and important that it has been preserved as a basic tenet of the law despite its obvious, adverse impact on the prices obtained at sheriffs' sales; it has also been the subject of a recent uniform laws reform process, which addressed this issue while reinforcing the basic principle.[82] The *Clark* court's rather casual overturning of the basic law of secured transactions priorities and debtor-creditor law, on grounds that the buyer at a sheriff's sale has no duty or means to discover prior security interests, may be the most extraordinary aspect of the *Clark* opinion.

The court did concede that the subordinate lien creditor, having been paid the proceeds of the sheriff's sale in derogation of the rights of the prior secured party, would then be obligated to pay those proceeds to the first priority claimant, "on pain of conversion."[83] While recognizing (in a footnote) legal commentary "discussing the difficulties of applying the conversion remedy as a means of enforcing relative rights between senior and junior creditors, including judgment lien creditors, under Article 9,"[84] the *Clark* court did not seem to fully contemplate the consequences of essentially abolishing secured transaction priorities and replacing them with a general tort remedy.

VI. Relating These Issues to CT Transactions

Having articulated its view that: buyers at judicial sales take free of prior perfected liens and security interests; a subordinate creditor conducting the sale should receive the collateral sales proceeds in derogation of prior claims; and a prior secured creditor with first priority is limited to a tort claim against the subordinate lien creditor, the *Clark* court then described the implications for CT transactions:

> The point to be made [from all of this] is that the *original* [assignor secured party] faces [these] practical difficulties [as an Article 9 secured party, as described above] but has an advantage that the assignee who has not followed the [assignment recordation] rules does not.[85]

In other words, the prior Article 9 security interest having been reduced to an unsecured tort claim, the *Clark* court opined that the original secured party "should have little difficulty prevailing" on this tort claim, because the secured party is indicated on the CT.[86] In contrast, the court reasoned, the assignee who is not indicated as secured party on the CT will have a harder time.[87] This was cited as a basis for holding the assignee to be unsecured.

With all due respect, this analysis is unrealistic. For the Article 9 secured party that has lost its security interest to a buyer at a lien creditor's sheriff's sale, and seen its proceeds paid to the subordinate lien creditor, and is reduced to asserting tort liability in a law suit, the burden of proving assignment of the security interest is minimal and the least of its problems. Moreover, even if the burden of proving an assignment was not minimal, that is no basis for holding the assignee secured party to be unsecured. The *Clark* court reasoned that "[p]erhaps the assignee would argue…that it is in fact the 'true' holder of the [security interest]…."[88] Well, yes, that is what assignees assert, because that is correct. And so it has been, for something in excess of 300 years.[89] Upon enforcing the security interest, the unrecorded assignee may face some additional burden in demonstrating its status as assignee; it can avoid this by instead following the optional procedure for recording the assignment in the CT office files and becoming the secured party of record, if it wishes. But apparently not many assignees believe that this procedure is worth the effort and cost, as the common practice is not to record the assignment. And whether or not the assignment is recorded should not affect its validity under other law. If the assignee prefers the cost of establishing its status in the isolated enforcement action, as an alternative to recording every assignment in its portfolio, that is its business. There is no reason to use this customary business decision as a basis for rendering the assignee unsecured, in the process overturning the law of contractual assignments, secured transactions, lien priorities, and debtor-creditor relations.

Nonetheless, the *Clark* court concluded that this is precisely what the CT law requires:

> The problem for such an assignee… is that [the] Texas' [CT law] has a comprehensive and clear scheme for recordation of the assignment, one that makes it express that only by following that procedure will the assignee then succeed to its assignor's lien priority….[90]

The court then cited as authority Tex. Trans. Code section 501.114(e) ("…The time of the recordation of a lien assigned *under this section* is considered to be the time the lien was recorded….").[91] Others can judge for themselves, but to your author this language falls well short of an "express" mandate to abolish the law of assignments and override the application of UCC Article 9 (which by its terms controls).[92] Indeed, a reasonable interpretation of section 501.114(e) would be that it applies only to assignments recorded "under this section," *i.e.*, to confirm the otherwise applicable general rules that: (1) the priority of the assignee is the same as the priority of the assignor; and (2) other law applies to unrecorded assignments, so as to avoid any implication that recordation of an assignment causes loss of the prior perfection date based on the recording date of the assignment. Thus, by its terms section 501.114(e) does not apply at all to unrecorded assignments, much less abolish them. Instead, it carries forward the law applicable to unrecorded assignments, making it explicitly applicable to assignments recorded under the CT law. Surely it would take much more, in the way of direct and specific language, to drastically revoke centuries of otherwise applicable law and the basic modern statute (UCC Article 9) covering such transactions.

VII. The Need for Uniformity

The *Clark* court found it unnecessary to consider the law of other states, given the diversity in state CT laws.[93] The court noted that the Texas CT law is not an enactment of a uniform code, therefore concluding that decisions elsewhere are not relevant as to the meaning of Texas law.[94] While there is some validity to this point, it might also be hoped that courts (and state legislatures) will recognize the need for uniformity on these basic issues (though, to date, the state legislatures have not been very helpful in their formulation of state CT laws, contributing to cases like *Clark*). The prevalence of national credit markets, and the importance of CT issues in common and numerous vehicle financing transactions, mean that non-uniform and poorly-drafted CT laws are a luxury the states and nation can no longer afford. Failing increased CT law clarity and uniformity, issues like those in *Clark*, which implicate fundamental rights and transactions, may have to be litigated over-and-over again in every state before chattel paper purchasers can safely buy and sell (or hold or securitize) vehicle credit contracts.[95] This is a huge and unnecessary burden to impose on an already struggling economy and market segment. It is another compelling reason (as if one more is needed)[96] for enactment of the Uniform Certificate of Title Act (UCOTA), which resolves these problems easily and simply.[97]

VIII. Conclusion

In *Clark*, the court concluded that the assignee of a perfected Article 9 security interest, who fails to record the assignment with the CT office, loses perfection and priority as against a subsequent lien creditor (including the trustee in bankruptcy or a Chapter 11 debtor-in-possession).[98] Along the way, the court seemed to indicate that: (1) interested parties have no means or need to discover prior perfected security interests in vehicles, if the CT is held by a secured party; (2) the buyer at a sheriff's sale takes free of prior, perfected security interests; (3) the subordinate lien creditor conducting the sale is entitled to receive the proceeds despite the existence of a prior security interest; and (4) the prior secured party is limited to a tort claim for conversion.[99] The apparent basis for all of this is that a CT law procedure for recording assignments of security interests is mandatory and exclusive, displacing the law of assignments and the UCC, despite ambiguities on this point in the CT law[100] and specific provisions to the contrary in UCC Article 9.[101]

All of these conclusions by the *Clark* court are contrary to established law. There is no appropriate basis in the law for concluding that the Texas CT law renders unrecorded assignments invalid, or displaces otherwise applicable contracts and secured transactions law and priorities, or causes perfected security interests to become unperfected in this way. Such a dramatic reversal of fundamental and widely recognized principles of law, on the basis of a narrowly-focused anti-fraud recording law, would require a clear and unequivocal expression of legislative intent. To derive such meaning from general (and, at best, ambiguous) statutory language in a narrow law goes beyond an appropriate interpretation. Moreover, if not treated as an aberration, the result could jeopardize millions of common and basic financing transactions, and impose large, unwarranted costs on a market segment already in economic distress.

Unfortunately, this case is just one example of the problems simmering, sometimes just below the surface, in our state CT laws. These laws, on the whole, are so poorly written, apparently with little regard to the other laws with which they interface, that too often they do not reflect the realities of common practice or even the current procedures of the state CT office. The result is a surprising degree of uncertainty and confusion in the laws governing common CT transactions. The issues can be surprisingly complex, and sometimes are not well understood; as a result, there is ample opportunity for courts to be led astray, as in *Clark*, and the potential exists for major problems to arise that may unnecessarily contribute to national economic problems, if this area of law is not rationalized by the states.

Fortunately, there is a ready solution easily at hand, in the form of UCOTA. Unfortunately, it has met resistance in some states, surprisingly in some cases from those who stand to gain (or lose) the most in the resolution of these issues. The Uniform Laws Commission (the National Conference of Commissioners on Uniform State Laws) is to be commended for recognizing the need to provide an efficient, simple, and inexpensive solution to these obvious problems. If the states do not also recognize this, we can expect more cases like *Clark*.

82. *See* Byrkit, *id.*

83. *Clark*, 2008 WL 5459818 at *9.

84. *Id.*, at n. 26, citing Russell J. Hakes, *A Quest for Justice in the Conversion of Security Interests*, 82 Ky. L. J. 837 (1993/1994).

85. *Clark*, 2008 WL 5459818 at *9 (emphasis in original).

86. *Id.*

87. *Id.*

88. *Id.*

89. *See, e.g.*, Murray, *supra* note 8, at 789-790 (citing authorities dating from the year 1688); Calamari & Perillo, *supra* note 8, at 632-33 ("The free alienability of [contracts] is essential to commerce. This is fully recognized by the Uniform Commercial Code.").

90. *Clark*, 2008 WL 5459818 at *9. *Compare, e.g.*, *supra* note 63.

91. *Clark*, 2008 WL 5459818 at *9 (emphasis in by the court).

92. Again, *see, e.g.*, UCC § 9-109; *supra* notes 13, 17, 21, 24, 26, 36, 48, 56, 63 and 66.

93. *Clark*, 2008 WL 5459818 at *10.

94. *Id. Cf.* PEB Commentary No. 12, *supra* note 8.

95. For another example of such litigation, *see, e.g.*, Alvin C. Harrell & Fred H. Miller, *Can a Buyer and Secured Party Rely on a Certificate of Title? Part IV: The* Wilserv *Case*, 79 Okla. Bar J. 2205 (2008) (describing the adverse consequences and extensive litigation resulting from poorly-drafted CT laws in the context of vehicles registered with Indian tribes).

96. *Id.*

97. *See, e.g.*, UCOTA § 26(c).

98. *Clark*, 2008 WL 5459818 at *10.

99. *Id.* at *8, *9.

100. *See supra* this text at notes 88-92.

101. As discussed in this article; *see, e.g.*, UCC §§ 9-102(a)(10), 9-109, 9-310(c), 9-311(a), (b), 9-505(b), 9-511, 9-514, 9-516(a), and accompanying Comments.