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

Alvin C. Harrell, Oklahoma City University School of Law
Case Note: Clark Contracting Services, Inc. v. Wells Fargo—Does an Assignee of a CT Lien Entry Become Unperfected?

By Alvin C. Harrell

Quartely Report

I. Introduction

In Clark Contracting Services, Inc. v. Wells Fargo Equipment Finance, 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. 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 the assignee’s name in order to be perfected as against the competing lien of a bankruptcy trustee. 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 relationship between Uniform Commercial Code (UCC) Article 9 and state CT laws in fundamental ways that could improperly 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 prior to the assignment to Wells Fargo. Relying on the 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.

Clark filed bankruptcy on January 9, 2008, creating a bankruptcy estate consisting of the debtor’s property, and a lien on the property of the estate in favor of the bankruptcy trustee (trustee), under sections 541(a) and 544(a)(1) of the Bankruptcy Code. This lien allows the trustee to “effectively avoid” prior security interests on property of the estate, unless the security interest is properly perfected.

Clark’s management continued as debtor-in-possession pursuant to Bankruptcy Code section 1101(11), thereby exercising the powers of a trustee. Clark then sought to avoid the Wells Fargo security interest pursuant to Bankruptcy Code section 544(a), on grounds that Wells Fargo’s lien was not perfected because its “lien” was not indicated on the CT. Wells Fargo sought partial summary judgment because, under well-established principles of law, contracts, and the mechanics of perfection, and (the debtor argued) the Texas CT law requires the “lien” to be indicated on the CT. 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).

The importance of these issues and arguments to CT transactions cannot be overstated. Clark calls into question the stability of the relationship between the law of secured transactions (primarily UCC Article 9 and state CT laws) that are often poorly drafted at a fundamental level. It also implicates the basic rules of CT law. These interstitial laws came into being as means to permit the registration of ownership as a means to combat title fraud. 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 so as to “core” CT issues relating to ownership.

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 prior to the assignment to Wells Fargo. Relying on the 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.

Clark filed bankruptcy on January 9, 2008, creating a bankruptcy estate consisting of the debtor’s property, and a lien on the property of the estate in favor of the bankruptcy trustee (trustee), under sections 541(a) and 544(a)(1) of the Bankruptcy Code. This lien allows the trustee to “effectively avoid” prior security interests on property of the estate, unless the security interest is properly perfected.

Clark’s management continued as debtor-in-possession pursuant to Bankruptcy Code section 1101(11), thereby exercising the powers of a trustee. Clark then sought to avoid the Wells Fargo security interest pursuant to Bankruptcy Code section 544(a), on grounds that Wells Fargo’s lien was not perfected because its “lien” was not indicated on the CT. Wells Fargo sought partial summary judgment because, under well-established principles of law, contracts, and the mechanics of perfection, and (the debtor argued) the Texas CT law requires the “lien” to be indicated on the CT. 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, although the bankruptcy trustee was not in the position to re-perfect the liens, the CT law was inapplicable in this context because Wells Fargo had the opportunity to do so and failed to do so.

The court, however, rejected the debtor’s argument, holding that the CT law was applicable to the situation because Wells Fargo had the opportunity to re-perfect the security interests and failed to do so. The court also found that the CT law was consistent with the UCC, and that the assignment of the security interest was perfected under the existing statutory framework.

The court's decision in Clark was significant because it clarified the interplay between the CT law and the UCC, and highlighted the importance of re-perfection in cases involving the transfer of security interests. The decision has implications for both the automotive industry and other industries that rely on secured transactions, and serves as a reminder of the importance of proper perfection to ensure the protection of security interests.
The Clark court was correct in stating that Article 9 requires the CT law to provide a procedure designed to indicate the security interest in the CT, but this indication may occur as a "result of the perfection and is not a precondition to it." Thus, contrary to the statement in Clark, the failure to indicate a security interest on the CT is not fatal to perfection. As noted above, this is clearly incor- rect. The interest in question is not in third parties' property — they are entitled to rely on the CT, and need look no further. 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, it is clearly designed to indicate a prerequisite to perfection. As noted, Article 9 provides protection in the event the indication on the CT is omitted, while recognizing that perfection continues nonetheless. The Clark court sought to bolster its contrary conclusion (but an indication on the CT is required for perfection) by stating that "a searchable database [sic] of filings is not publicly available." But there is no other support for this statement in the Clark opinion, and the statement is incorrect in any event, for many if not most states. In any event, it does not change the required elements of perfection. The court then concluded that "[t]he failure to provide this indication on the CT equals perfection..." As indicated above, this is clearly incor- rect. The interest in question is not in third parties' property — they are entitled to rely on the CT, and need look no further.
entry. That is precisely the line of reasoning followed in Clark.64 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.65 But the court’s own description of this procedure leads one to think (1) it is optional, not mandatory;66 (2) a system for recording assignments, not perfection; and (3) (following this procedure) the District of Department of Transportation knowledge that the assignee is the current holder of the lien.67 While this is true, it is also irrelevant. It is common for different types of interests, including credit contracts, to be bought and sold (and securitized) without any recording or filing being aware of the transaction.68 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 did know 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 the interests of all relevant private parties who rely on the public records, thus making clear that unrecorded assignments are common and lawful.69

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 stand in the shoes of his assignor with continued perfection needs to make sure that the assignee is shown on the face of the CT.70 There is no other means of perfection available under the CT law recording procedure.71 The court emphasized that “only by following this procedure will the assignor retain all rights to the assignee’s proceeds.”72 While this is true, it is also irrelevant. It is common for different types of interests, including credit contracts, to be bought and sold (and securitized) without any recording or filing being aware of the transaction.73 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 did know 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 the interests of all relevant private parties who rely on the public records, thus making clear that unrecorded assignments are common and lawful.74

Again this confuses the statutory mechanism for perfection with the laws governing subsequent assignments. Article 9 (and the CT law) give the assignor no interest in the collateral (i.e., the interest of perfection) until the CT is recorded or the assignor’s rights have otherwise been satisfied.75 The CT office is therefore not required to file the CT against a subsequent assignee who is unaware of the prior assignment.76 Article 9 provides that a subsequent assignee is entitled to perfection against the assignor, and Article 9 clearly limits its defeasance to the CT law at sections 9-3100 and 9-3114.77 Perhaps in that era of an expanding administrative state, seems appropriately 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 perfection against the assignor. The court, which recognized 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. Some what ambiguous language in the CT law, that would be taken by your article to indicate that the 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. But even

outside 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; and the fact that regarding security interests the CT law applies only to the extent Article 9 says so, not the other way around,78 and that Article 9 clearly limits its defeasance to the CT law at sections 9-3100 and 9-3114. Perhaps in that era of an expanding administrative state, seems appropriately 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 perfection against the assignor. The court, which recognized 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. Some what ambiguous language in the CT law, that would be taken by your article to indicate that the 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. But even

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 doctrine was initially thought to provide the assignor with no practical or legal way of knowing of the existence of a prior security interest in the vehicle prior to selling or leasing it. The Clark court, however, misread Article 9 (and no apparently recognized) that the sale does not affect the perfected security interest and that the proceeds from the sale of the vehicle to the assignor would pass free of the security interest. The Clark court concluded that the buyer at a judicial sale would have a right to the proceeds of a non-judicial sale, a perfected security interest and that the proceeds from the sale of the vehicle to the assignor would pass free of the security interest. The Clark court concluded that the buyer at a judicial sale would have a right to the proceeds of a non-judicial sale, a perfected security interest and that the proceeds from the sale of the vehicle to the assignor would pass free of the security interest. The Clark court concluded that the buyer at a judicial sale would have a right to the proceeds of a non-judicial sale, a perfected security interest and that the proceeds from the sale of the vehicle to the assignor would pass free of the security interest.

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.79 The court held that a judicial sale was not a perfection of the procedure for conducting a ‘‘seller’s sale’’ of Article 9 collateral, pursuant to enforcing satisfaction by the judgment creditor,80 the court noted that

64. Clark, 496 S.W.2d at 389. This is a fairly common result.
65. See 13 V.T.A. 2d 349, 356 (El Paso 1950). 66. This is also inconsistent, as a partner in a judicial sale cannot later sell the property and claim that the property is free of the prior perfected security interest. The Clark court was apparently unaware of the prior perfected security interest as the ‘‘sale’’ in the Clark court’s decision was not subject to the perfection of a security interest. The Clark court’s decision was not subject to the perfection of a security interest.
67. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
68. See Clark, 496 S.W.2d at 390. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
69. See Clark, 496 S.W.2d at 390. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
70. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
71. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
72. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
73. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
74. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
75. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
76. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
77. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
78. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
79. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.
80. See Clark, 496 S.W.2d at 391. The Clark court appears to suggest that an assignor’s rights may be perfected by the sale to the assignee, while the assignment is not perfected by the sale to the assignee. See Clark, 496 S.W.2d at 389.

Verbatim citation of the CLCCT is 80. This is a fairly common result.
which is essential to established creditor priorities, is so fundamental and impor-
tant that it has a basic tenet of the law despite its obvious, adverse impact on the prices obtained at sheriff's sales; it has also been the subject of a recent uniform laws reform process, which addressed this issue while reinforcing the basic principle. The Clark court's rather nuanced overruling 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 their rights on the handful of occasions where the junior lien will have the lien perfected in the isolated enforcement action, as an alternative to recording every assignment in its portfolio, that it has business. There is no reason to use this customary business decision as a basis for rendering the assignment unsecured, in the process overruling the law of contractual assign-
ments, secured transactions, lien priorities, and debtor creditor relations. Nonetheless, the Clark court con-
cluded that this is precisely what the CT law requires.

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 se-
crator's 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] [in an Article 9 security agreement, as described above] but has an advantage that the assignee who has not followed [the assign- ment registration] rules does not have. In other words, the prior Article 9 security interest in 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. In contrast, the court reasoned, the assignee who is not indicated as a secured party on the CT will have a harder time. 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 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 suit law suit, the burden of prov-
ing 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..., that it is in fact the 'true' holder of the security interest...]."

Well, yes, that is what assignees assert, because that is correct. And so it should be, for something in excess of 300 years. Upon enforcing the security interest, the unrecorded assignor may face some additional burdens 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 appar-
ently not many assignees believe that this procedure is worth the effort and cost, as the court apparently is not to record the assignment. And whether or not the as-
ignment is recorded should not affect its validity under other law. If the assignee can prove that the assignor was not recorded in the isolated enforcement action, as an alternative to record every assignment in its portfolio, that it has business. There is no reason to use this customary business decision as a basis for rendering the assignment unsecured, in the process overruling the law of contractual assign-
ments, secured transactions, lien priorities, and debtor creditor relations. Nonetheless, the Clark court con-
cluded that this is precisely what the CT law requires.

The problem for such an assignee is that the Texas CT law is a comprehensive and clear scheme for recording the assignment, and only by following that procedure will the assignee then succeed to its assignor's lien priority...

The court then cited as authority Texas Trans. Code section 51.114(e) ("...the time of the recording of a lien assigned under this section is considered to be the time the lien was recorded...") and cited that "...Others can judge for themselves, but to your au-
thor this language fails well short of an "express mandate" to abolish the law of assignments and override the application of Article 9 law (which by its terms con-
fers on Article 9 parties the right to record) in a conflict of section 51.114(e) would be that it applies only to assignments recorded "under this section," i.e., to the

other 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 assign-
ments, as so to avoid any implication that recordation of an assignment causes loss of a prior perfection date based on the recording date of the assignment. Thus, by its terms section 51.114(e) does not apply at all to unrecorded assign-
ments. Instead, it essentially carries the law forward applicable to unrecorded assignments, making it explicitly applicable to assignments rec-
coded 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."

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. The court noted that the Texas CT law is not an enactment of a uniform code, therefore conflicting state laws elsewhere are not relevant as to the meaning of Texas law. While there is some validity to this point, it might also be considered that courts (and legislatures) find the need for uniformity on these basic issues (though, to date, the state legislatures have not taken up the issue of conflict of state CT laws, contributing to cases like Clark). The prevalence of na-
tional credit markets, and the importance of CT issues in consumer and non-consumer vehicle financing transactions, mean that even poorly-drafted CT laws are not merely the states and nation can no longer afford. Instead, in the Texas CT 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 securi-
ty) vehicle credit contracts. This is a huge unnecessary burden to impose on an already staggering economic and legal infrastructure and secured transactions law and priori-
ties, or causes perfected security interests to be underperfected in this way. Such a result is both inexplicable and highly recognized principles of law, on the basis of a narrowly focused anti-fraud recording law, would require a clear and sufficiently-crafted opinion for it to be a true statement. To derive such meaning from gen-
eral (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 financial transactions (including auto sales) along the way, the court seemed to indicate that: (1) interested parties have no means or need to discover prior per-
fected 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 sub-
ordinate lien creditor conducting the sale is entitled to receive the proceeds despite the existence of a prior security interest; and (4) the prior security interest is limited to a tort claim for conversion. The ap-
parent basis for all of this is that a CT law procedure for recording assignments of security interests is mandatory and exclu-
sive, displacing the law of assignments and the ICC, despite ambiguities on this very point in the CT law and specific provi-
sions to the contrary in UCC Article 9.

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 ren-
ers unrecorded assignments invalid, or must be displaced otherwise in cases of clear and secured transactions law and priori-
ties, or causes perfected security interests to be underperfected in this way. Such a result is both inexplicable and highly recognized principles of law, on the basis of a narrowly focused anti-fraud recording law, would require a clear and sufficiently-crafted opinion for it to be a true statement. To derive such meaning from gen-
eral (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 financial transactions (including auto sales) along the way, the court seemed to indicate that: (1) interested parties have no means or need to discover prior per-
fected 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 sub-
ordinate lien creditor conducting the sale is entitled to receive the proceeds despite the existence of a prior security interest; and (4) the prior security interest is limited to a tort claim for conversion. The ap-
parent 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 ICC, despite ambiguities on this very point in the CT law and specific provi-
sions to the contrary in UCC Article 9.