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### The PEB Study Group Report and Revised Article 9 With Respect to Certificate of Title Issues

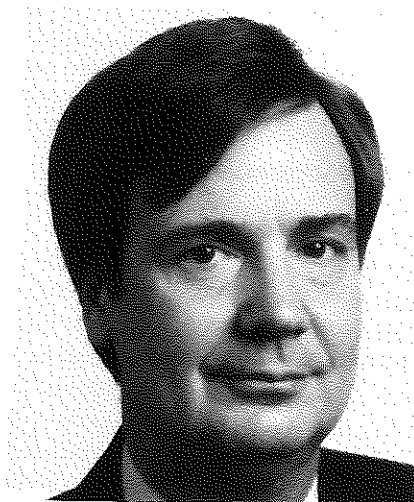
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# The PEB Study Group Report and Revised Article 9 with Respect to Certificate of Title Issues

By Alvin C. Harrell



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## I. Introduction

On December 1, 1992 the Article 9 Study Group established by the Permanent Editorial Board (PEB) of the Uniform Commercial Code (UCC) issued a

Study Group Report recommending consideration of possible revisions to UCC Article 9. Accompanying this Report was a separate book of Appendices (hereinafter Appendices), including Appendix F (Working Document No. M6-39), entitled "Certificate of Title Issues," authored by Francis C. Suarino.<sup>1</sup>

Subsequently, an Article 9 Drafting Committee was formed to consider specific proposals for revision of Article 9.<sup>2</sup> While no final decisions have yet been made, and therefore all deliberations remain tentative,<sup>3</sup> the Article 9 Drafting Committee has considered the recommendations in the Study Group Report relating to certificate of title issues.<sup>4</sup> The Drafting Committee proposals relating to certificate of title issues are now well developed; interested parties should make their views on these issues known without further delay.<sup>5</sup>

## II. The Relation Between Article 9 and State Certificate of Title Lien Entry Systems

All states now provide for certificate of title lien entry (lien entry) perfection for security interests in vehicles (subject to certain exceptions, e.g., vehicles held for resale as dealer inventory). Many states also provide for lien entry perfection for mobile homes and boats.<sup>6</sup> To the extent collateral is subject to lien entry perfection, Article 9 provides an exception to the UCC filing system and defers to the state lien entry system. Current UCC section 9-302(3) provides as follows:

(3) The filing of a financing statement otherwise required by this Article is not necessary or effective to perfect a security interest in property subject to

(a) a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place of filing different from that specified in

1. Copies of the Study Group Report and Appendices may be obtained from the PEB, 4025 Chestnut Street, Philadelphia, Penn. 19104-3099. It should be stressed that the Study Group Report and its Appendices represent discussion drafts only and are not to be cited as authority. No final decisions have yet been made with regard to these issues. The PEB and UCC are joint projects of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute. Appendix F to the Study Group Report (hereinafter "Appendix F") is limited in scope to commercial secured transactions in certificate of title goods and makes no effort to deal with consumer issues. Still, the basic issues also affect consumer lenders.

2. William M. Burke is the Chair. Professors Steven L. Harris and Charles W. Mooney, Jr. are the Reporters.

3. See generally Alvin C. Harrell, *UCC Article 9 Revisions Confront Issues Affecting Consumer Collateral*, 49 *Consumer Fin. L. Q. Rep.* 256 (1995).

4. See, e.g., Alvin C. Harrell, *UCC Article 9 Drafting Committee Considers October 1996 Draft*, 51 *Consumer Fin. L. Q. Rep.* 54 (1997). Since that article was written, the Reporters have produced a revised draft which was considered at the 1997 Annual Meeting of NCCUSL, in July/August 1997 (hereinafter 1997 NCCUSL Annual Meeting draft), and revised October and November, 1997 drafts.

5. Comments may be sent directly to the Reporters: Professor Steven L. Harris, Reporter, Article 9 Drafting Committee. (Continued in next column)

6. (Continued from previous column)

Chicago-Kent University College of Law, 565 W. Adams Str., Chicago, Ill. 60661; Professor Charles W. Mooney, Jr., Reporter, Article 9 Drafting Committee, University of Pennsylvania Law School, 3400 Chestnut Street, Philadelphia, PA 19104.

6. An American Bar Association, Uniform Commercial Code Committee Task Force on State Certificate of Title Laws is compiling a compendium of data on the scope and provisions of state certificate of title laws. See *infra* Pt. VIII. Copies of the Task Force Report are available from your author.

this Article for filing of the security interest; or

- (b) the following statutes of this state; [list any certificate of title statute covering automobiles, trailers, mobile homes, boats, farm tractors, or the like, and any central filing statute.]; but during any period in which collateral is inventory held for sale by a person who is in the business of selling goods of that kind, the filing provisions of this Article (part 4) apply to a security interest in that collateral created by him as debtor; or

- (c) a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection (subsection (2) of section 9-103).

While this limited deference to certain other law (including state certificate of title laws) seems simple, it is the beginning point for a series of potential conflicts and unresolved issues arising from the relationship between Article 9 and state certificate of title laws.

### III. Choice of Law—UCC Section 9-103

Appendix F recommended adoption of the rule in *In re Paige*,<sup>7</sup> allowing a certificate of title to be issued in any state, regardless of whether that state has any other connection to the transaction.<sup>8</sup> The

latest drafts of proposed revisions to Article 9 include this position.<sup>9</sup>

Appendix F recommends language clarifying that Article 9 follows the state certificate of title law in determining whether perfection occurs upon submission of the lien entry form to the proper state official or requires actual notation on the certificate of title.<sup>10</sup> The latest drafts of proposed Article 9 include this rule, providing for perfection pursuant to the local law of the state that issued the certificate covering the goods.<sup>11</sup>

Appendix F recommends deletion of the language at current section 9-103(2)(b), which under certain circumstances currently preserves perfection until the goods are "registered" in another jurisdiction. This language has been applied improperly and inconsistently by some courts.<sup>12</sup> The latest drafts of proposed Article 9 eliminate the concept of "registration" from section 9-103, instead providing that a new choice of law change is triggered when the goods become "covered by" a certificate from another jurisdiction (subject to a four month grace period).<sup>13</sup>

### IV. Section 9-305—Perfection by Possession

Appendix F raises the question whether certificate of title goods should be subject to perfection by possession, as an alternative to lien entry perfection, and expresses ambivalence though ultimately concluding that perfection by possession should be allowed. The 1997

NCCUSL Annual Meeting draft prohibits perfection by possession for certificate of title goods, except as provided at proposed section 9-311(b) which recognizes perfection by possession when allowed under other applicable law.<sup>14</sup>

### V. Modernization of Certificate of Title Acts

Appendix F recognizes prior efforts of the NCCUSL to modernize state motor vehicle and certificate of title laws, including the 1955 "Uniform Motor Vehicle Certificate of Title and Anti Theft Act," and notes that many courts have interpreted state certificate of title laws in a manner consistent with Article 9.<sup>15</sup> However, there remains significant inconsistency, due in part to variations in state motor vehicle laws. Appendix F recommends a series of improvements in state certificate of title laws outside the UCC, and the American Bar Association Task Force on State Certificate of Title Laws was subsequently formed to investigate and pursue this goal.<sup>16</sup>

Related issues identified in Appendix F include:<sup>17</sup>

1. If a debtor sells or trades certificate of title goods, does a prior lien entry perfection extend to cash proceeds or other proceeds under current section 9-306(3)? Proposed section 9-309A of the 1997 NCCUSL Annual Meeting draft provides that perfection by means prescribed in a statute referenced at section 9-306(c) (this would include certificate of title lien entry systems) is equivalent to perfection by filing under Article 9.

9. See, e.g., proposed § 9-303(c) (1997 NCCUSL Annual Meeting draft).

10. See *Lightfoot v. Harris Trust & Savings Bank*, 357 So.2d 654 (Sup. Ct. Ala. 1978).

11. See, e.g., proposed § 9-303(b) (1997 NCCUSL Annual Meeting draft). Goods would become "covered by" a certificate when an appropriate application for a certificate and the required fee are delivered to the proper authority. Proposed § 9-303(a) (1997 NCCUSL Annual Meeting draft).

12. See Appendix F at 4-5d, Appendices at 274-75, citing: *GMAC v. Rupp*, 951 F.2d 283 (10th Cir. 1991); *Strick Corp. v. Eldo-Craft Boat Co., Inc.*, 479 F. Supp. 720 (W.D. Ark. 1979); *Brewton Trading Corp. v. Midland Bank & Trust Co.*, 34 U.C.C. Rep. Serv. 980 (N.Y.S. Ct. 1982).

13. See, e.g., proposed §§ 9-303(b), 9-314(c) (1997 NCCUSL Annual Meeting draft). "Covered by" is defined at proposed § 9-303(a). See *supra* note 11.

14. See also proposed § 9-314(c) (1997 NCCUSL Annual Meeting draft), referenced at proposed § 9-311(b). This would permit perfection by repossession.

15. Appendix F, at 9; Appendices, at 278-79.

16. See *supra* note 6.

17. Appendix I, at 9-10; Appendices, at 279-287.

2. Must a lessor under a lease intended as a security agreement be shown as lienholder on the certificate of title, or is it sufficient to be shown as owner?<sup>18</sup>

3. Should minor errors in compliance with certificate of title laws be fatal to perfection?<sup>19</sup> Or should the UCC Article 9 "harmless error" rules apply? Again, the courts have not been consistent on this issue.<sup>20</sup>

4. Does a secured party already perfected by a certificate of title lien entry need to do anything more to reperfect, upon extending a new loan, refinancing the old loan, or extending future advances?<sup>21</sup> The answer should be "no," but not all courts agree.<sup>22</sup> Variations in state lien entry statutes may contribute to this problem.<sup>23</sup>

5. If a lender, with lien entry perfection, assigns its interest to another lender, must the assignee be substituted in the lien entry? Is this controlled by UCC section 9-302(2), or by other state law?<sup>24</sup>

6. Do the Article 9 provisions on sufficiency of a collateral description (at sections 9-110 and 9-402(1)) apply to collateral descriptions in lien entry forms?<sup>25</sup>

7. To what extent does Article 9 apply to supplement state lien entry systems.<sup>26</sup>

### VI. Accessions

#### A. Introduction

UCC section 9-314 governs security interests in accessions. In operation, it can be one of the more challenging Article 9 provisions. Section 9-314 provides as follows:

- (1) A security interest in goods which attaches before they are installed in or affixed to other goods takes priority as to the goods installed or affixed (called in this section "accessions") over the claims of all persons to the whole—except as stated in subsection (3) and subject to Section 9-315(1).

- (2) A security interest which attaches to goods after they become part of a whole is valid against all persons subsequently acquiring interests in the whole except as stated in subsection (3) but is invalid against any person with an interest in the whole at the time the security interest attaches to the goods who has not in writing consented to the

security interest or disclaimed an interest in the goods as part of the whole.

- (3) The security interests described in subsections (1) and (2) do not take priority over

(a) a subsequent purchaser for value of any interest in the whole; or

(b) a creditor with a lien on the whole subsequently obtained by judicial proceedings; or

(c) a creditor with a prior perfected security interest in the whole to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings obtained or the subsequent advance under the prior perfected security interest is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the whole at a foreclosure sale other than the holder of a perfected security interest purchasing at his own foreclosure sale is a subsequent purchaser within this section.

- (4) When under subsections (1) or (2) and (3) a secured party has an interest in accessions which has priority over the claims of all persons who have interests in the whole, he may on default subject to the provisions of Part 5 remove his collateral from the whole but he must reimburse any encumbrancer or owner of the whole who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of

18. Appendix F, at 10; Appendices, at 280. This issue is being considered by the ABA UCC Committee Task Force on State Certificate of Title Law. See *supra* note 6.

19. Appendix F, at 11-12; Appendices, at 281-282.

20. See, e.g., *id.*, citing *In re Circus Time, Inc.*, 641 F.2d 39 (1st Cir. 1981); see also *In re Eldridge*, 10 B.R. 835 (Bankr. E.D. Mich. 1981) (transposition of vehicle identification numbers fatal to perfection); *In re Bolinger*, 3 B.R. 186 (Bankr. E.D. Mich. 1980) (VIN was correct, but wrong brand name barred perfection). Cf. *City Bank & Trust v. Warthen*, 535 P.2d 162 (Nev. 1975) (minor error in VIN not fatal); ALVIN C. HARRELL, FRED H. MILLER & WILLIAM E. CARROLL, *THE LAW OF PERSONAL PROPERTY SECURED TRANSACTIONS* Ch. 5 (1992).

21. Appendix F, at 12; Appendices, at 282.

22. *Id.*, citing *In re Manufacturers Credit Corp.*, 441 F.2d 1313 (3d Cir. 1971). This does not obviate the need for a new note and security agreement, in the absence of a future advances clause in the original security agreement. See generally William E. Carroll and Alvin C. Harrell, *Texas Kenworth Co. v. First National Bank: The Wrong Side of Coin-Op-Matic*, 16 Okla. City Univ. L.Rev. 81 (1991).

23. *Id.*

24. Appendix F, at 13; Appendices, at 283. This is also being considered by the ABA UCC Committee Task Force on State Certificate of Title Laws. See *supra* note 6.

25. Appendix F, at 13-15; Appendices, at 283-285, citing: *Ray v. City Bank & Trust Co. of Natchez, Mississippi*, 13 U.C.C. Rep. Serv. 355 (D.C. Ohio 1973) (financing statement case; court read §§ 9-110 and 9-402(1) together); *Circus Time*, 641 F.2d 39 (absence of date of security agreement); *In re Ron Fisher, Inc.*, 11 U.C.C. Rep. Serv. 718 (Bankr. S.D. Ohio 1989) (narrow description excluded truck body). See also Harrell, Miller & Carroll, *supra* note 20.

26. Appendix F, at 16; Appendices, at 286, citing *In re Cook*, 32 U.C.C. Rep. Serv. 983 (Okla. S.Ct. 1981) (Article 9 supplements motor vehicle act). This rule is included in proposed Article 9, at § 9-309A of the 1997 NCCUSL Annual Meeting draft.

7. 679 F.2d 601 (6th Cir. 1982).

8. Appendix F, at 2; Appendices, at 272.

the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

Appendix F of the Study Group Report includes a thorough discussion of accession issues and the relevant case law.<sup>27</sup> This article will merely highlight the discussion issues and recommendations described in Appendix F, and their disposition by the Article 9 Drafting Committee.

## B. Discussion Issues—Current Law

1. What is the scope of current section 9-314, as compared to lien entry perfection? When accessions are added to or removed from a vehicle subject to lien entry perfection, competing claims may be asserted under section 9-314 and the lien entry system. Such claims are subject to resolution under current section 9-314, but the courts sometimes misconstrue the scope of section 9-314, for example applying section 9-314 when the secured party is asserting a security interest in the whole vehicle (including accessions) pursuant to lien entry perfection and there is no separate claim to accessions.<sup>28</sup>
2. How is perfection as to accessions achieved (by a party claiming a security interest in the whole)? One issue is the scope of the collateral descrip-

tion. As a practical matter, the description of the whole in the security agreement should automatically include accessions (and, if desired, attachments and replacements), to the extent permitted under section 9-204 (which limits a claim against after-acquired property in a consumer transaction).<sup>29</sup> While a distinct description of accessions in the security agreement is not required under Article 9, in cases where the accession is very important and is easily detachable, such a description may help minimize the risk of a court incorrectly concluding that the accessions are not covered by the lien entry perfection.

3. Where should the secured party search and file regarding accessions? If a lender as to the whole is claiming a security interest in a "future" accession not yet affixed to the whole, or in a vehicle with an easily removable accession that may be subject to a separate perfection, the lender may wish to search and perfect separately as to the accession. The proper place and method of perfection will depend on the classification of the goods under Article 9.<sup>30</sup> This may involve some subtle analysis, for example distinguishing between ordinary goods, "mobile goods" under current section 9-103(3),

and "special mobilized machinery" under a state motor vehicle act.<sup>31</sup>

If the secured party repossesses and sells the vehicle upon default of the debtor, is the secured party liable in conversion to a competing creditor claiming priority as to the accessions under current section 9-314? Note that there is no practical way to discover such competing claims, as a purchase money security interest in consumer goods will be automatically perfected under UCC section 9-302(1)(d), even if the goods subsequently become accessions. The remedies of a senior secured party upon repossession and sale of the collateral by a junior party remain uncertain and subject to dispute.<sup>32</sup>

## C. Recommendations and Proposed Article 9

Appendix F recommends that the term "accessions" not be used in Article 9, due to confusion with common law concepts using the same term.<sup>33</sup> Appendix F also recommends that current section 9-314 be revised to make clear that all normal attachments to a vehicle may be encumbered by a certificate of title lien entry against the vehicle, without a separate Article 9 filing.<sup>34</sup> It also recommends clarification of the distinctions between ordinary goods and "mobile goods," and clarification of the relationship between

31. See, e.g., Harrell, Miller & Carroll, *supra* note 20, Ch. 4; Alvin C. Hurrell and Joseph R. Dancy, *Oil and Gas Financing Under Uniform Commercial Code Article 9*, 41 Okla. L. Rev. 53, 79-85 (1988).

32. See, e.g., Appendix F, at 25-26; Appendices, at 295-296; citing *Stout v. Johnson*, 791 S.W.2d 351 (Ark. S.Ct. 1990). See also *Utility Trailers of Wichita, Inc. v. Citizens National Bank & Trust Co.*, Emporia, Kansas, 2 U.C.C. Rep. Serv.2d 38 (Kan. Ct. App. 1986), cited in Appendix F at 27 and Appendices at 297; UCC § 9-302(1)(d) (exception for "a motor vehicle required to be registered").

33. Appendix F, at 26; Appendices, at 296. Proposed § 9-332 continues to use the term "accessions."

34. Appendix F, at 26; Appendices, at 296. This appears to have been accomplished at proposed § 9-332(e). The proposed rule would provide for priority of a certificate of title lien entry over a separate security interest in an accession, as follows:

(e) A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under Section 9-309A(h).

(Continued on next page)

29. Section 9-204 provides:

9-204. After-Acquired Property; Future Advances.

(1) Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after acquired collateral.

(2) No security interest attaches under an after-acquired property clause to consumer goods other than accessions (Section 9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

(3) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (subsection (1) of Section 9-105).

30. See Comment 5 to § 9-102; § 9-103; and § 9-401.

27. Appendix F, at 17-28; Appendices, at 287-298. Accessions are covered in proposed Article 9 at § 9-332 (1997 NCCUSL Annual Meeting draft).

28. See e.g., Appendix F, at 18; Appendices, at 288, citing *In re Lyford*, 34 U. C. C. Rep. Serv. 754 (Bankr. Me. 1982), and *In re Williams*, 12 U.C.C. Rep. Serv. 990 (Bankr. D. Wisc. 1973), among other cases.

senior and junior secured parties after repossession and sale of collateral by the latter.<sup>35</sup>

## VII. Section 9-504 and Repo Titles

A current question is whether UCC section 9-504 (governing repossession sales of Article 9 collateral) applies to a repossession sale of collateral subject to certificate of title lien entry perfection. While the answer seems clearly yes, contrary implications or requirements in state certificate of title statutes may cloud the issue.<sup>36</sup> Nonetheless, Article 9 seems clear that its deferral to state certificate of title lien entry systems at current section 9-302(3)(b) is limited to filing and perfection issues.

Another problem is the requirement in many states that a "repo title" be obtained in the secured party's name before the repossession sale is conducted. In these circumstances it may be construed as an accord and satisfaction for the secured party to transfer title to itself in preparation for the repossession sale, under current section 9-505. Proposed section 9-617(c) should resolve this problem.

## VIII. Task Force Question Format

In addition to authoring Appendix F, Frank Suarino drafted for the ABA Task Force on State Certificate of Title Laws a list of 20 questions to be answered for each state, regarding that state's certificate of title law. The answers are being compiled by the ABA Task Force on Certificate of Title Laws into a Task Force Report. The questions are as follows:

34. (Continued from previous page)

The apparent theory is that the certificate of title is widely recognized as the preeminent record of title and liens affecting the covered goods, and is relied upon as such by parties dealing with the goods. Accession financiers can be expected to understand that goods which become accessions will be subject to claims against the whole under a certificate of title.

The proposed revisions would codify and clarify this result, reinforcing the preeminent role of the certificates of title. The Drafting Committee is seeking comments on this proposal. You may forward your comments to this office or directly to the Reporters for the Article 9 Drafting Committee.

35. Appendix F, at 27 and 297. The latter should also address the pre-sale notification requirements.

36. See Appendix F, at 29, Appendices, at 299.

1. What is the scope of the Law?
2. Definition of vehicles/house trailers/boats?
3. Definition of term "Owner"?
4. What state agency issues titles?
5. What documents must be submitted in order to have the Certificate of Title issued?
6. How and when is the security interest in titled goods perfected?
7. How is the security interest assigned?
8. What are the procedures for issuing a Certificate of Title for titled goods which were last titled or registered in another jurisdiction?
9. What must a secured party do when its security interest is satisfied?
10. What procedures must a secured party follow in order to foreclose its security interest?
11. Does the Certificate of Title statute specify which provisions of Article 9 are superseded by it and which provisions of Article 9 continue to apply to security interests in titled goods?
12. Does the Certificate of Title statute provide a method for determining the existence of security interests against titled goods by the agency or must the Certificate of Title be examined in order to determine whether there are any security interests against such goods?
13. How does the law deal with rebuilt/salvaged vehicles?
14. How (if at all) does state law protect an assignee lender, if the certificate is lost?
15. Does state law have a provision (like UCC section 9-404) requiring a creditor who has been paid to release the lien in a specified time?
16. Does the state require an MSO as a prerequisite to issuing a new title?
17. How does the state certificate of title law affect leases and securitization, including tort liability?
18. How does state law deal with the relationship between personal property law and real property law with regard to interests in and claims against mobile homes?
19. What are the grace periods for titling?
20. Does the certificate of title law cover boat trailers?

As noted, the responses are being compiled into a comprehensive Task Force Report. Copies of the Final Report will be available soon, at a nominal cost. If you are interested in obtaining a copy, please send a written inquiry to your author.

## IX. Conclusion

Certificate of title issues are an important part of the Article 9 revisions. The proposed revisions are designed to address many of the nagging problems that have arisen under current law. The preceding two articles in this issue describe in more detail the intended and likely impact of these revisions, and interested parties are also invited to request a copy of the Report of the ABA Task Force on State Certificate of Title Laws.