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Common Certificate of Title Litigation and UCC Article 9 Issues, and the Impact of CT Laws

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I. Introduction

A. CT "Lien Entry" Perfection

Prior to the 1998 revisions to the uniform text of Uniform Commercial Code (UCC) Article 9, generally effective July 1, 2001, the proper method of perfecting a security interest in collateral covered by a certificate of title (CT), often including boats and manufactured homes as well as vehicles such as automobiles, motorcycles, trucks and recreational vehicles (CT collateral),[1] long had been by submission of a "lien entry" form pursuant to a state CT law providing for indication of the security interest on the CT.[2] This

1. *See* old (pre-1998) UCC § 9-302(3). The effective date of the 1998 revisions to Article 9 (here called "revised" Article 9, in contrast to the "old" (pre-1998) Article 9) is provided in revised § 9-701. The 1998 revisions to Article 9 now must be distinguished from the 2010 amendments to the uniform text, which provide for an effective date of July, 2013. *See* 2010 amendment at § 9-801. CT "lien entry" perfection is commonly subject to state-specific exclusions, such as vehicles designed primarily for off-road use. *See, e.g.*, COMPENDIUM OF STATE CERTIFICATE OF TITLE LAWS (Alvin C. Harrell, ed. 2009) [hereinafter "Compendium"] (describing CT perfection laws in each state); *infra* note 84. The 2010 uniform text of the UCC includes the 1998 revisions to Article 9, with a few technical amendments, but not amendments approved by the sponsoring organizations in 2010 (the 2010 amendments). Citations to the UCC in this article reference the 2010 uniform text prior to the 2010 amendments, unless otherwise noted.

2. *See* UCC § 9-311(a) (deference to state CT law for mechanics of perfection). States generally began to embrace "lien entry" perfection as to CT collateral in the mid-20th Century, and (although the terminology may vary somewhat from state to state) all states had done so with regard to vehicles, subject to various exceptions (*see* Compendium, *supra* note 1; and *infra* note 84) by the late 1970s. The picture remains more mixed, however, with respect to vessels and manufactured homes, with some states requiring CT lien entry perfection and others relying on UCC Article 9 perfection by filing, and still others permitting a real estate mortgage to cover manufactured homes in limited circumstances. *See infra* Part III.D. Outdated terms such as "lien entry" are commonly used in CT statutes, presumably because many CT statutes and perfection systems predate Article 9 and the modern term "security interest." Thus, the term "lien entry" is used in this article. The Uniform Certificate of Title Act (UCOTA), discussed periodically below,

(Continued on next page)

approach was continued (and reinforced) in the 1998 revisions and again in the 2010 amendments to the uniform text of Article 9.[3] However, these revisions and the retention of this approach did not resolve all related issues regarding perfection and the relationship between CT laws and the UCC, *e.g.*, when: CT collateral is sold without execution of the CT; or there is a forged lien release; or a dispute arises as to whether a secured party has properly perfected its security interest in CT collateral. Many of these issues arise from deficiencies in state CT laws, and therefore cannot be cured in Article 9. This article notes selected cases illustrating such issues and the relationship between CT laws and the UCC.

B. UCOTA

This article also notes briefly the potential impact of UCOTA, where applicable.[4] In 1994 the UCC Committee of the Business Law Section of the American Bar Association (ABA) created a Task Force on State Certificate of Title Laws (Task Force), to assist the UCC Article 9 Drafting Committee (Article 9 Drafting Committee) then formulating what became the 1998 Article 9 revisions. The Task Force provided input on CT issues to the Article 9 Drafting Committee, and the Article 9 revisions reflect this input.[5] However, as indicated above, it was apparent that some CT transaction problems emanated from the CT laws themselves rather than Article 9, and could not be resolved within Article 9. At the same time, the Task Force was creating a Compendium of State CT laws, and this Compendium revealed significant disparities in state CT laws, some of which were contributing to problems in CT transactions.[6]

These facts contributed to a developing consensus that modernization, improved clarity, and increased uniformity of CT laws would be valuable to a wide range of parties in common CT transactions. In roughly 2001 NCCUSL (now known as the ULC) formed a Study Group to consider these issues, and that Study Group subsequently recommended appointment of a Drafting Committee to develop a proposed uniform CT Act. This Drafting Committee was appointed in 2002 (at NCCUSL's 2002 Annual Meeting), and the draft it developed was designated a proposed uniform act (UCOTA) at NCCUSL's 2003 Annual Meeting in Washington, D.C. As noted, UCOTA was approved by NCCUSL at its annual meeting in 2005, with technical amendments being adopted the following year.[7]

On most issues UCOTA merely clarifies and confirms established case law and rules governing CT transactions. However, as illustrated in this article, UCOTA also resolves legal issues that are not addressed in current CT laws, generally in accordance with existing (though sometimes sparse) case law. Thus, UCOTA is largely a proposed codification of current law and practices on a variety of issues, and by-and-large courts are reaching results that are both correct and consistent with UCOTA on CT issues, though sometimes only after extensive litigation and misstating the applicable law. This has left some issues in a state of unnecessary confusion. The extensive litigation that is sometimes needed, and the strained or confusing or even misleading analyses in some of the cases, even when the correct result ultimately is reached, suggest that further statutory guidance is warranted; the nonuniformity and lack of clarity in some of the state CT statutes means that continuing protracted litigation may be necessary as to seemingly settled issues, absent the enactment of statutory reforms such as UCOTA.

C. Electronic CTs

A final introductory point: As this article focuses on selected case law, it is not a comprehensive analysis of current and emerging CT law issues. It merely references the issues and laws implicated in this small selection of cases. While useful, in that this selection of cases illustrates some common problems, the result omits discussion of some cutting-edge issues, including some treated in UCOTA but not yet widely reflected in the case law.

For example, an important aspect of UCOTA is the facilitation of electronic transactions. UCOTA seeks to facilitate the creation of electronic CTs, electronic transfers of CTs, and electronic perfection of security interests, where the parties and state CT office (designated the "office" in UCOTA) so desire, but in a structure that fits the context of other laws such as the UCC. Some states are seeking to electronify their records in a more interstitial fashion; this is typical of the ad hoc approach that has characterized much CT legislation, creating problems such as those noted here.

UCOTA does not mandate electronic transactions or CTs, and is designed to fit seamlessly into the law of any state, regardless of the stage of (or lack of) electronic development in that state. In other words, it works equally well in a state that creates only paper CTs, or a state that creates only electronic CTs, or a state that does both, and permits all three types of states to interchange CTs in a uniform manner consistent with

2. *(Continued from previous page)*

replaces the term "lien" with the more accurate term "security interest."

The sponsors of the UCC are the American Law Institute (ALI) and the Uniform Law Commission (ULC, also known as the National Conference of Commissioners on Uniform State Laws, or NCCUSL). Other uniform laws, such as UCOTA, are sponsored separately by the ULC. Following the approval of UCOTA by NCCUSL in 2005 (and technical amendments approved in 2006), the ULC created separate drafting committees to draft a uniform CT law for vessels and to deal with CT and related issues for manufactured homes. The Uniform Certificate of Title Act for Vessels (UCOTAV) was approved by the ULC in 2010. *See* http://www.nccusl.org/NewsDetail.aspx?title'Uniform%20Certificate%20of%20Title%20Act%20for%20Vessels%20Approved. The manufactured homes project remains ongoing. *See* http://www.uniformlaws.org/Committee.aspx?title'Manufacutured%20Housing%20Act; Marc J. Lifset, *Proposed ULC Manufactured Home Titling Act*, in this issue.

3. *See supra* note 1; UCC §§ 9-303 & 9-311(a)(2) and (b); Thomas J. Buiteweg, *Revised UCC Article 9 Provisions Affecting Vehicle Finance*, 65 Consumer Fin. L.Q. Rep. 147 (2011); sources cited *infra* at notes 4-5.

4. *See generally* Lee M. McCorkle & Edwin E. Smith, *The New Uniform Certificate of Title Act—A Brief Summary*, 64 Consumer Fin. L.Q. Rep. 213 (2006); Alvin C. Harrell, *The Uniform Certificate of Title Act: Myths and Realities*, 39 U.C.C. L.J. 3 (2006). UCOTA resolves many of the issues discussed here. However, at this writing it has not been enacted in any state.

5. For a summary of the revisions, *see* Alvin C. Harrell, *Certificate of Title Lending Under Revised Article 9*, 32 U.C.C. L.J. 422 (2000); Alvin C. Harrell, *A Roadmap to Certificate of Title Issues in Revised UCC Article 9*, 53 Consumer Fin. L.Q. Rep. 202 (1999).

6. The Compendium was subsequently published by the ABA. *See supra* note 1.

7. *See supra* note 2 and authorities cited *supra* at notes 4 & 5.

other law. In contrast, some states have attempted to authorize a form of electronic CT (or the use of an electronic record as a substitute for a CT), but without fully considering the implications for CT transactions and security interests, with potentially adverse consequences. The 2010 amendments to the uniform text of Article 9 attempt to salvage this situation with regard to some issues relating to perfection of security interests,[8] but realistically cannot go beyond this to address the full array of resulting CT and transactional problems. Obviously, some such issues will not yet be reflected in the case law, and therefore are not treated in this article. They will have to await another day, but they are probably coming.

II. Title and Ownership Interests

A. BIOCOB Without Execution of CT

In *In re Dota,*[9] the bankruptcy court (and later the district court) confronted a fundamental issue of continuing importance to vehicle buyers: Can a used car dealer validly transfer ownership of a vehicle to a buyer in the ordinary course of business without executing the CT?

In *Dota* the used car dealer (Dota—who subsequent to the transaction became a bankruptcy Chapter 7 debtor) had obtained inventory "floor plan" financing from the First National Bank of El Campo (the Bank). Under the terms of the security agreement, the dealer turned over all CTs to the Bank until the dealer sold a vehicle, at which time the Bank would relinquish the CT to the dealer and apply the proceeds of the sale to the inventory loan. The plaintiff purchased two vehicles from the dealer and signed applications to transfer the CTs for both vehicles. The plaintiff received only one CT. The plaintiff sued the dealer for a declaratory judgment determining ownership of the other vehicle, and seeking turnover of the CT and damages for conversion.

The issue presented in *Dota* was whether a vehicle dealer is required to execute the CT at the time of the sale, in order for the buyer to be a "buyer in ordinary course of business" (BIOCOB) under the UCC.[10] If the plaintiff was a BIOCOB, Article 9 section 9-320(a) entitled the plaintiff to take the vehicle free and clear of the Bank's security interest. The bankruptcy court held that the sale to the plaintiff was invalid and the plaintiff was not a BIOCOB, because the plaintiff did not receive execution of a CT at the time of the sale.

The United States District Court for the Southern District of Texas reversed the bankruptcy court's decision in *Dota*, holding that:

- the term "owner" does not include a used car dealer for purposes of the Texas CT statute, which requires an owner to execute a CT at the time of sale;
- a buyer who enters into a contract of sale with a vehicle dealer and fulfills all of the requirements of the contract (consideration given, possession of the vehicle taken, and application for a transfer of ownership executed and left with dealer for completion and filing), and who is otherwise a BIOCOB (buying the vehicle in good faith, without knowledge that the sale violated the secured party's security interest, from a seller of goods of that kind), will take the vehicle free and clear of the prior security interest even though the buyer did not receive execution of the CT at the time of the sale;[11] and
- the floor plan (inventory) lender (in *Dota*, the Bank) could only perfect its security interest in the dealer's inventory by filing a financing statement with the Texas Secretary of State, and not by taking possession of the CT.[12] A security interest in inventory, even if perfected, is subordinate to a BIOCOB under section 9-320(a).

With the exception of the first point noted above, the district court decision in *Dota* illustrates the majority view on these issues, and is consistent with UCOTA.[13] UCOTA section 16 entitles a vehicle buyer to require execution of the CT, but provides that a transfer of ownership is not rendered ineffective by a failure to do so. UCOTA section 19(c) allows a BIOCOB to take free of a security interest created by the seller, tracking Article 9 section 9-320(a) but additionally clarifying that BIOCOB status does not require execution of the CT. These UCOTA provisions clarify the law applicable to common practices, and bring the CT law into conformity, rather than creating conflicts, with these practices and the UCC. Under UCOTA, the *Dota* court's odd conclusion that a used car dealer is not the "owner" of its vehicles would be unnecessary.

In *In re Dorsey Trailer Co.*,[14] the buyer of truck trailers took free of the competing security interest in the seller's inventory, even though the buyer did not take possession of the goods (as indicated in the definition of BIOCOB at UCC section 1-201(b)(9)), because it is customary in such transactions to pay first and

8. *See, e.g.*, Buiteweg, *supra* note 3.

9. *In re* Dota, 288 B.R. 448 (S.D. Tex. 2003).

10. *Id.* at 453. *See* UCC § 1-201(b)(9) (definition of BIOCOB); *id.* § 9-320(a) (rights of a BIOCOB as against a secured party of the seller). *See also* UCC § 2-403(2), (3) (the UCC Article 2 "entrustment" rule) (discussed *infra* at Part IV.).

11. *Dota*, 288 B.R. at 461 & 463-64; *see also* UCC § 1-201(b)(9) (definition of BIOCOB).

12. *Dota*, 288 B.R. at 459-60. *See also* UCC § 9-311(d). For a more recent cse that makes this basic point, *see In re* Moye, 211 WL 3585955, 2011 U.S. App. LEXIS 17027 (5th Cir. Aug. 16, 2011) (unpublished).

13. The noted exception is the *Dota* court's conclusion that a vehicle dealer is not an "owner" under the Texas CT law, a tortured interpretation that was apparently necessary to make sense of the statute, and could obviously pose a risk of adverse secondary consequences, illustrating the risks posed by the deficiencies in many CT laws. *See Dota*, 288 B.R. at 456.

14. 68 U.C.C. Rep. Serv.2d 335, 2009 WL 764572 (Bankr. M.D. Ala. 2009).

take possession later.[15] But compare *In re Hatfield 7 Dairy, Inc.*,[16] where the prepaying buyer was denied BIOCOB status because the buyer did not take possession of the goods being purchased.[17]

B. Vehicle Repossessed But Not Sold Before Bankruptcy

1. The Law of *Whiting Pools*

a. Introduction

Almost thirty years after the case was decided, *United States v. Whiting Pools, Inc.*[18] continues to define (and, some would say, confuse[19]) the standards applicable to cases where collateral has been repossessed but not yet sold when the debtor files bankruptcy. *Whiting Pools* was not (at least primarily) a CT case, nor even a consumer bankruptcy case, and did not involve a private secured party.[20] Yet it remains the dispositive United States Supreme Court authority on these issues, for consumer bankruptcy cases and private secured parties. Probably its most common application is in cases involving collateral covered by a CT.

Arguably, in *Whiting Pools* there were two basic and separate issues: (1) Was the entire repossessed property, or only the debtor's legal interests in the property, property of the bankruptcy estate?[21]; and (2) if the property as a whole was property of the estate, was the secured party entitled to relief from the stay[22] as a defense to a turnover order under Bankruptcy Code section 542?[23] The Court's discussion and analysis of the first (and threshold) issue is, to be kind, somewhat murky and unclear.[24] The court focused almost entirely on the second issue,[25] seeming to suggest that this analysis also answers the first question (which clearly it does not).

b. The Threshold Question—What Does Section 541(a) Cover?

The Bankruptcy Code at section 542 ("Turnover of property to the estate") allows the trustee to demand turnover of "property that the trustee may use, sell, or lease under [Bankruptcy Code] section 363…."[26] Section 363 makes clear that it is limited to "property of the estate,"[27] which in turn requires reference to section 541 ("Property of the estate").[28] Thus, turnover pursuant to section 542 is limited to property of the estate as defined in section 541, which in turn is limited to the "legal or equitable interests of the debtor in property [[29]] as of the commencement of the case."[30]

This line of statutory reasoning seems clear, and was acknowledged by the *Whiting Pools* Court.[31] The Bankruptcy Code clearly limits turnover to property of the estate, in turn limited to property interests of the debtor. The defining of property interests is limited to state law,[32] and state law recognizes the division of property interests, *i.e.*, as analogous to a "bundle of sticks" or separate property interests which, together, constitute the property.[33] Ownership of one or two sticks (*e.g.*, legal title and a right to redeem possession under specified conditions) is not the same as the entire bundle (the property as a whole). Thus, it would seem that the bankruptcy estate includes only those property interests (the "sticks") owned by the debtor, and therefore turnover under section 542 is likewise limited to those same interests.

In *Whiting Pools,* the Supreme Court did not see it that way, concluding that section 541 does not limit the reach of section 542, and indeed saying, *i.e.*, that the latter governs the former rather than the other way around. The exact reasoning for this is murky:

> Although these statutes could be read to limit the estate to…"interests of the debtor in property…," we view them as a definition of what is included in the estate, rather than as a limitation.[34]

There is some elaboration of this reasoning in the *Whiting Pools* opinion (mostly in footnotes), but nothing that adequately confronts the plain meaning of the Bankruptcy Code on this point. For example, footnote 8 of the *Whiting Pools* opinion recognizes that the language of Bankruptcy Code section 541 specifies that the bankruptcy estate includes "the debtor's 'interests…in property', rather than property in which the debtor has an interest," which seemingly defeats the claim to turnover of the entire "bundle of sticks"

15. *Id. See also* other language in UCC § 1-201(b)(9), allowing BIOCOB status if the sale "comports with the usual or customary practices in [that] kind of business…."

16. 425 B.R. 444 (Bankr. N.D. Ohio 2010).

17. *Id. See also In re* Sunbelt Grain Wks, LLC, 427 B.R. 896 (D. Kan. 2010) (same).

18. 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983).

19. *See, e.g.*, Thomas E. Plank, *The Creditor in Possession Under the Bankruptcy Code: History, Text and Policy*, 59 Md. L. Rev. 253 (2000); Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 Emory L. J. 1193 (1998). *Cf.* Stephen J. Ware, *Security Interests, Repossessed Collateral, and Turnover of Property to the Bankruptcy Estate*, 2 Utah L. Rev. 775 (2002) (defending *Whiting Pools*).

20. In *Whiting Pools* the Internal Revenue Service had repossessed swimming pool construction equipment from a corporate debtor, who then filed for reorganization under what is now Chapter 11 of the Bankruptcy Code.

21. *See* 11 U.S.C. § 541(a).

22. 11 U.S.C. § 362(d).

23. 11 U.S.C. § 542.

24. *See, e.g.*, William D. Warren & Daniel J. Bussel, Bankruptcy 37 (8th ed. 2009) (describing the Supreme Court's explanation as "Delphic" and "obscure.").

25. At least in the text. *Cf.*, however, *Whiting Pools* at nns. 8, 10, 12, 14, 15 & 17.

26. 11 U.S.C. § 542(a), referencing 11 U.S.C. § 363.

27. 11 U.S.C. § 363(b)(1).

28. 11 U.S.C. § 541.

29. As defined pursuant to state law, as per Butner v. United States, 440 U.S. 48 (1978).

30. 11 U.S.C. § 541(a)(1).

31. *See, e.g., Whiting Pools,* 462 U.S. at 203.

32. *See, e.g., Butner*, 440 U.S. 48.

33. *Id. See also* sources cited *supra* at note 19.

34. *Whiting Pools*, 462 U.S. at 203. But wait, isn't the purpose of a definition to limit the meaning of the defined terminology? *See again* Warren & Bussel, *supra* note 24 (quoting this language from *Whiting Pools* and describing it as "Delphic" and "obscure").

in a case like *Whiting Pools*; however, the Court went on to speculate that "this choice of language was not meant to limit the expansive scope of [section 541]."[35] This seems to dismiss the plain (and admitted) meaning of the statutory language by simply stating that it means essentially the opposite of what it says.

Other lines of reasoning in the text and footnotes of the *Whiting Pools* opinion are no more compelling: Footnote 10, for example justifies this expansion of sections 541 and 542 on grounds that other Bankruptcy Code sections ("*See, e.g.*, [sections] 543, 547, and 548") similarly expand the trustee's reach to interests not owned by the debtor.[36] But this reasoning is inapposite: The language of these sections specifies this effect (and, accordingly, these sections are sometimes referred to as being among the trustee's unique "strong arm" powers[37]), whereas sections 541 and 542 say precisely the opposite. This reasoning is in fact a strong argument *against* the *Whiting Pools* analysis: Congress clearly knows how to say so when it wants to create extraordinary Bankruptcy Code powers to override state property laws, and in view of cases like *Butner* (which recognize the application of state property law and, in total, go back more than 100 years[38]) Congress can be expected to do so with great specificity and clarity, as in sections 543, 547, and 548. This is very different from a court creating a rule that rejects what the statute says.

In the end, one is left with the distinct impression that the *Whiting Pools* Court did the latter, in order to achieve a desired policy objective, namely "the congressional goal of encouraging reorganizations" in bankruptcy.[39] This leaves open various questions, *e.g.*: How does such a policy apply in alternative scenarios, *e.g.*, consumer Chapter 7 and 13 cases involving repossessed goods covered by a CT?[40] And, how much of an "interest in property" does the debtor need in order to claim the entire property as part of the bankruptcy estate?[41] And, how does transfer of ownership to the secured party, *e.g.*, by obtaining a "repo" CT before bankruptcy, affect the analysis?

c. Relief from the Stay

A related issue, that arises *after* a determination that repossessed goods are property of the estate under section 541 and subject to turnover under section 542, is whether the secured creditor is entitled to relief from the Bankruptcy Code automatic stay[42] in order to continue with its UCC Article 9 disposition sale.[43] The *Whiting Pools* analysis seems almost to blur the distinctions between these issues, essentially assuming that sections 541 and 542 are governed by the same considerations that would determine a motion to lift the stay under Bankruptcy Code section 362(d). This seems clearly incorrect, given the differences between these sections.

d. Other Illustrative Cases

Thompson v. General Motors Acceptance Company[44] illustrates the continuing uncertainties (and risks) left in the wake of *Whiting Pools*. *Thompson* involved a typical repossession/bankruptcy scenario: GMAC repossessed the vehicle after its debtor defaulted on the retail installment sales contract, and the debtor then filed a Chapter 13 bankruptcy petition. Echoing the policy underpinnings of *Whiting Pools*, the debtor sought turnover on grounds the vehicle was necessary to the Chapter 13 plan because he needed it to drive to work; GMAC resisted on grounds it was entitled to adequate protection as an alternative to relief from the stay.[45] The debtor then moved for the bankruptcy court to sanction GMAC for violating the stay. The bankruptcy court denied the motion for sanctions, but certified the case for direct appeal to the United States Court of Appeals for the Seventh Circuit.

The Seventh Circuit reversed the bankruptcy court's order denying the debtor's motion for sanctions, rejecting the standard procedure in the bankruptcy court of allowing the secured party to retain possession pending a determination on the issue of adequate protection, and instead following various decisions in the Sixth, Eighth, Ninth and Tenth Circuits holding that this retention of possession violates the automatic stay.[46] As in *Whiting Pools*, the *Thompson* court seemed to assume away the issue of whether the secured

35. *Whiting Pools,* 462 U.S. at 204, n. 8.

36. *Id*., at 209, n. 10.

37. *See, e.g*., Fred H. Miller & Alvin C. Harrell, The ABCs of the UCC—Related Insolvency Law 75-96 (2nd ed. 2006).

38. *See, e.g*., Long v. Bullard, 117 U.S. 617 (1886).

39. *Whiting Pools*, 462 U.S. at 204. While the quoted sentence of the *Whiting Pools* opinion also references "methods to protect secured creditors" (*see id.*), one is left with the impression that this was not a major focus of the Court's decision. *See also id*. at 203 & 208.

40. The *Whiting Pools* Court left this open. *See, e.g*., *id*. at 208-209 n. 17.

41. For example, the *Whiting Pools* Court stated that "some minor interest such as a lien or bare legal title" is not enough. *Id*. at 204 n. 8. But the debtor in a case like *Whiting Pools* has little more than "bare legal title" (*e.g*., bare ownership and a right of redemption), and in most cases involving consumer CT collateral there is little or no possibility of the debtor having an "equity" in the goods (*i.e*., an ownership value in excess of the secured debt), under even the most creative valuation methodology. Thus, under the standard in *Whiting Pools* footnote 8 the Court's rationale would seldom apply to vehicle repossession cases. Moreover, there is ample authority, in other contexts, for the proposition that a transfer which leaves a debtor with bare legal title but not equitable ownership does not leave the debtor with a beneficial interest or other attributes of ownership. *See, e.g*., Cacy v. Cacy, 619 P.2d 200 (Okla. 1980); Kunze v. Wilkerson, 426 P.2d 340 (Okla. 1967); Wadsworth v. Courtney, 393 P.2d 200 (Okla. 1967).

42. *See* 11 U.S.C. § 362(d). On related notice issues, *see infra* Part VII.

43. *See* Article 9 Part 6. Relief from the stay essentially negates the turnover order.

44. 566 F.3d 699 (7th Cir. 2009). *Thompson* is also noted in David. B. McCrea & Alvin C. Harrell, *Overview and Update on Vehicle Secured Transactions, Certificates of Title, and Related Issues*, 64 Consumer Fin. L.Q. Rep. 342, 348 (2010).

45. *Thompson*, 566 F.3d at 701 & 704-08. *See also* 11 U.S.C. §§ 361, 362(d); *Whiting Pools*, 462 U.S. at 203-204 & 208. Note that, as in *Whiting Pools*, this focused on issues that would be relevant under § 362(d), without adequately explaining those under 11 U.S.C. § 541. The closest factor of relevance in § 542 is the limitation regarding property of "inconsequential value" to the estate. *See* 11 U.S.C. § 542(a); *Whiting Pools*, 462 U.S. at 201, n. 5. The *Thompson* court essentially dismissed the § 541 issues, stating: "There is no debate that Thompson has an equitable interest in the [vehicle], and, as such, it is property of the bankruptcy estate." *Thompson*, 566 F.3d at 701 (citing *Whiting Pools*).

46. *Thompson*, 566 F.3d at 702-03. *See also* 11 U.S.C. § 362(a)(3) (prohibiting any exercise of "control" over estate property).

party or the estate owned the right to possession under section 541 and *Butner*.[47]

Much of the other recent litigation has been similarly unhelpful on these issues, as illustrated in most of the cases noted below. First, however, an oddly helpful case from the United States Court of Appeals for the Ninth Circuit should be briefly noted. In *In re Stinson,*[48] the debtor's father-in-law made various loans to the debtor and ultimately took possession of the debtor's vehicle in satisfaction of the debt. More than a year later the father-in-law obtained a new CT in his name, indicating a change of ownership. Six days later the debtor filed bankruptcy, and the trustee sought to avoid the transfer of ownership (by execution of the CT) as a preferential transfer within ninety days of the bankruptcy.[49] The court rejected this argument on grounds that issuance of a CT is not necessary to transfer ownership and that equitable ownership was transferred when the father-in-law took possession of the vehicle in satisfaction of the debt (which occurred outside the Bankruptcy Code preference period).[50] While not directly analogous to a repossession under UCC Article 9, the *Stinson* case illustrates a scenario where the debtor's retention of bare legal title to repossessed goods was insufficient to provide a basis for a claim of the bankruptcy trustee.[51]

An interesting case that may provide some comfort to both debtors and secured parties is *In re Sheridan*,[52] where the secured party was seeking relief from the stay in order to repossess the debtor's boat. The secured party argued that the boat was not property of the estate, a somewhat weak argument, given that the secured party did not have possession.[53] Instead of pointing out this obvious (and significant, if not dispositive) fact, the *Sheridan* court repeated the error of *Whiting Pools* by stating broadly that the debtor's "equitable property interest under the right of redemption" meant that "the boat is property of the estate under [section] 541."[54] It can be noted that, in some ways, this court's error was even worse than *Whiting Pools*, since the Court in *Whiting Pools* at least could emphasize the bankruptcy policy of facilitating a corporate reorganization, as an excuse for stretching the statutory language of section 541.[55] It would be difficult for a recreational boat to meet that criteria.

The *Sheridan* court recognized the latter point (though not its relevance to the *Whiting Pools* analysis of section 541), by subsequently rejecting the debtor's argument that he could use the boat to generate income for payment under his Chapter 13 plan, on grounds that the debtor's financial projections were inadequate to support this claim. The *Sheridan* court deemed this relevant under section 362(d), in granting the secured party's motion for relief from the automatic stay, but failed to recognize the inappropriate policy role of this factor in applying the *Whiting Pools* test to section 541.

In a seemingly rare case where the court confronted the section 541 issue head-on, a Florida bankruptcy court held that a repossessed vehicle did not become property of the bankruptcy estate. *In re Diaz*[56] involved the typical scenario: The debtor defaulted, the vehicle was repossessed, and two weeks later the debtor filed bankruptcy. The *Diaz* court had the benefit of Eleventh Circuit precedent on these issues,[57] but confronted a debtor argument that the Article 9 revisions at section 9-619[58] superseded the prior Eleventh Circuit precedent. The court rejected this argument, holding that collateral repossessed prepetition does not become a possessory interest of the bankruptcy estate under section 541 and thus (absent exercise of the debtor's right of redemption) is not subject to turnover under section 542.[59] In support of this conclusion, regarding the impact of Article 9 section 9-619, it can be noted that the issue under Bankruptcy Code section 541 is not whether the debtor has a right to redeem under Article 9 (the issue addressed under section 9-619), but whether sections 541 and 542 expand that state law right to include an immediate possessory interest, without such a redemption, despite *Butner*, state law, and the plain statutory language of the Bankruptcy Code. The *Diaz* court correctly answered this in the negative.[60]

In contrast, in a case that was essentially a Chapter 13 version of *Whiting Pools*, in *In re Barrett*[61] the debtor was in the paving business and sought turnover of four trucks (needed in the business) that were repossessed prior to bankruptcy. Following the policy prescription of *Whiting Pools*, the court held that turnover pursuant to sections 363 and 542 was appropriate (and relief from the stay was denied) because the trucks were needed to operate and reorganize the debtor's business pursuant to a Chapter 13 plan.

2. The *Rozier* Case and the Impact of Article 9

Motors Acceptance Corp. v. Rozier[62] is another reminder of how the *Whiting Pools*[63] analysis can generate confusion, this time with respect to CT laws. *Rozier* initially held that the ownership

47. *See Thompson*, 566 F.3d at 701; *supra* note 45.

48. 443 B.R. 438 (9th Cir. 2010).

49. *See* 11 U.S.C. § 547.

50. Note that this is consistent with the *Whiting Pools* exclusion of property from the estate when the debtor has "bare legal title." *See Whiting Pools*, 462 at 204, n. 8.

51. *Id.*

52. 2010 WL 3222407, 2010 Bankr. LEXIS 2712 (Bankr. D. Vt. Aug. 16, 2010).

53. *Id.* A writ of repleven had been issued on behalf of the secured party, but not yet executed when the debtor filed bankruptcy. *Id.*

54. 2010 WL 3222407. *See* discussion of *Whiting Pools supra* at Part II.B.1.a., b.

55. Which obviously has support in the Bankruptcy Code, whatever the other deficiencies in the analysis. *See, e.g., supra* note 45.

56. 416 B.R. 902 (Bankr. S.D. Fla. 2009).

57. *See infra* note 67.

58. *See* UCC § 9-619(c), distinguishing a "repo CT" from the Article 9 disposition sale.

59. *See* 11 U.S.C. §§ 541, 542.

60. *Diaz*, 416 B.R. 902.

61. 2009 WL 2058225, 2009 Bankr. LEXIS 1823 (Bankr. N.D. W.Va. July 14, 2009).

62. 290 B.R. 910 (W.D. Ga. 2003).

63. 462 U.S. 198. *See supra* Part II.B.1.

of a motor vehicle remains with the debtor even after the secured creditor has repossessed it. While this is generally correct, until a transfer of ownership such as completion of the disposition sale under UCC Article 9,[64] it is also clear that the debtor's ownership rights prior to the disposition sale are not unfettered and involve a complex relation between the UCC, the Bankruptcy Code, and the applicable CT law. This is an excellent example of the "bundle of sticks" analogy, recognizing multiple types of property interests, which can be held by different parties.[65] In *Rozier,* Motors Acceptance Corp. repossessed the debtors' car a few days before the debtor filed for Chapter 13 protection. After the filing, the debtor sought to regain possession of the vehicle for inclusion in the bankruptcy estate. When Motors Acceptance refused to return the vehicle, the debtor filed a Motion for Contempt, which the bankruptcy court granted.

The *Rozier* court squarely faced the issue of whether the repossessed vehicle was included in the bankruptcy estate and therefore whether Motors Acceptance violated the automatic stay[66] by resisting turnover. The bankruptcy court concluded that, under the applicable Georgia law, repossessed property generally is included in the bankruptcy estate. The district court was asked to reconsider this premise in light of contrary decisions from the United States Court of Appeals for the Eleventh Circuit construing Alabama and Florida law.[67] The *Motors Acceptance* court opined that the Eleventh Circuit rulings did not specifically address the issue of how the UCC Article 9 provisions impact the debtor's ownership upon repossession of the collateral by a secured party, but that Georgia law was clear on the subject.

Applying Georgia law, and interpreting the default provisions of UCC Article 9 Part 6, the court noted that ownership does not automatically pass to the secured party upon the debtor's default or repossession of the collateral. Article 9 gives the debtor more than just the right of redemption--ownership remains with the debtor after repossession, until a disposition sale.[68] The court reasoned that the debtor's ownership of the vehicle, plus the debtor's right of redemption, constituted a substantial interest in the vehicle (there is no question about that), and therefore the entire vehicle was properly included in the bankruptcy estate (a more questionable assertion, which does not necessarily follow from the first).

Consequently, the court held that Motors Acceptance was in contempt of the automatic stay for refusing to return the vehicle to the debtor. This analysis is largely correct up to the point of its conclusion, at which point major aspects of the required analysis are simply skipped or ignored, including the scope of the bankruptcy estate under Bankruptcy Code section 541, the related requirements for turnover in Bankruptcy Code section 542, the impact of the applicable CT law, and distinctions between ownership and the right to possession under UCC Article 9.

3. Conclusion—Article 9, CT Law, and the Bankruptcy Code

These issues have been the subject of litigation in other jurisdictions as well, and some commentary.[69] Perhaps the most fundamental point to note is that Article 9 does not always answer the question of ownership in these circumstances. Article 9 governs the notice and redemption rights of the debtor, and the requirements for a commercially reasonable disposition of the collateral, and provides for a "transfer statement" as a means to obtain a new CT to reflect or facilitate a disposition sale.[70] But other issues relating to ownership are covered separately or left to other law, *e.g.*, the applicable CT law.[71] In addition, as noted, the Bankruptcy Code imposes various limits on turnover in these circumstances, as recognized in *Whiting Pools* and elsewhere.[72]

It is primarily these other laws and issues that determine to what extent the vehicle is property of the estate under 11 U.S.C. section 541. On its facts *Motors Acceptance* may or may not have been correctly decided, but the more important point is to recognize that (contrary to *Whiting Pools*) only the rights of the debtor become property of the estate, and this is not an issue governed exclusively by Article 9 or 11 U.S.C. section 542. One example is cases where ownership is transferred to the secured party before the bankruptcy filing, *e.g.*, via a "repossession CT" pursuant to a state CT law. Neither the Bankruptcy Code nor Article 9 completely answers the question in these circumstances, and the applicable CT statute is a part of the governing law.[73]

As specifically provided in Article 9 section 9-619(c), none of this operates to cut off the debtor's right to redeem or other Article 9 rights; but likewise, the converse is true: The Article 9

64. *See* UCC §§ 9-610 - 9-614 (disposition sale); *id.* § 9-617 (rights of transferee).

65. *See* authorities cited *supra* at note 19.

66. 11 U.S.C. § 362.

67. Charles R. Hall Motors, Inc. v. Lewis, 137 F.3d 1280 (11th Cir. 1998) (Alabama law); Bell-Tel Federal Credit Union v. Kalter, 292 F.3d 1350 (11th Cir. 2002) (Florida law).

68. *See* UCC § 9-619.

69. *See, e.g., In re* Moffett, 288 B.R. 721 (Bankr. E.D. Va. 2002) (Chapter 13); *In re* Robinson, 285 B.R. 732 (Bankr. W.D. Okla. 2002) (Chapter 13); authorities cited *supra* at note 19.

Of all of these cases, the best statement in support of *Whiting Pools* is the courts' explanation in *Robinson*, opining that the repossessed vehicle is property of the estate, not because of the state law right of redemption under UCC Article 9, but because of the debtor's bankruptcy Chapter 13 rights to modify liens (section 1322(b)(2)) and cure defaults (section 1322(b)(3)), which negate the secured party's right to accelerate the debt, declare default, and repossess the vehicle. This may be viewed as a statute-based articulation of the vague policy grounds stated by the Supreme Court in *Whiting Pools*. *See Robinson*, 285 B.R. at 738. *See also Moffett*, 288 B.R. at 731, making essentially the same point. Obviously, however, this rationale

(Continued in next column)

69. *(Continued from previous column)*

is not applicable in Chapter 7 cases, and requires a separate Chapter 13 analysis.

70. *See* UCC §§ 9-610 - 9-616, 9-619 & 9-623.

71. *See, e.g.*, UCC § 9-619 ("Transfer of Record or Legal Title"), allowing use of a "transfer statement" to transfer ownership to the secured party and issuance of a CT, separately from the rights and obligations relating to the disposition sale. Many CT laws also allow this, independently of Article 9. This Article 9 provision does not purport to be a comprehensive statute governing ownership issues, which are mostly left to the CT law and other state property laws.

72. *See supra* Part II.B.1.

73. Along with UCC § 9-619 (*see supra* note 71), to determine ownership interests.

redemption and other rights do not expand the property interest of the debtor or otherwise impair the property interests of the secured party, as provided under state law, protected under *Butner*, and recognized by the limits on the bankruptcy estate in Bankruptcy Code section 541.

Cases like *Thompson v. General Motors Acceptance Company*,[74] where the court required turnover of a car (repossessed but not sold by the secured party before bankruptcy) to a debtor who needed it to drive to work and wanted the vehicle included in the Chapter 13 plan, may or may not be correct on the basis of Chapter 13,[75] but are not well supported by most courts' analyses of sections 541 and 542. In *Thompson*, the secured party sought adequate protection as a prerequisite to turnover under Bankruptcy Code section 542. The Seventh Circuit rejected this argument, even though it was the common procedure in the Seventh Circuit, and remanded the case to determine if the resulting stay violation was willful (which could result in sanctions).[76] While the court's analysis may or may not have been correct as regards Bankruptcy Code section 362(d) (relief from the stay), it is questionable as to the more basic issues under sections 541 and 542, as was the *Whiting Pools* analysis on these issues.

III. Creation and Perfection of Security Interests

A. Attachment by Substantial Compliance

In *In re Giamo*,[77] the application for a CT and the CT submitted with it indicated there was a security interest in the vehicle. This was sufficient to constitute a written security agreement and create attachment of the security interest. The court distinguished cases holding that a financing statement alone is not sufficient for attachment,[78] because a filed financing statement may mean only that negotiations have begun, while execution of a CT and CT application are evidence of a completed transaction.

In *In re Johnson*,[79] the security agreement described the collateral as a "2004 R-Vision Condor 1351," while the CT for the vehicle said it was a "2003 Ford F-5." It was in fact a 2004 Vision Condor recreational vehicle body mounted on a 2003 Ford truck chassis. The court concluded that the security agreement described the upper half of the vehicle while the CT described the lower half; nonetheless, reading the two together the security agreement description was sufficient for attachment and perfection.[80]

B. Perfection by Substantial Compliance

In *In re Walling*[81] the court held that a security interest was not perfected by a CT lien entry because the CT was not issued in the county where the debtor resided, as required by the CT statute.

In *In re Charles,*[82] the United States Court of Appeals for the Tenth Circuit held that a secured party is required only to substantially comply with the perfection provisions of the appropriate CT statute in order to perfect a security interest in a vehicle. In *Charles*, the debtor entered into a lease agreement with CIT for four trucks. CIT was named owner of the trucks on the CTs, and no lienholder was shown on the CTs. The debtor then filed bankruptcy. The bankruptcy trustee argued that the lease agreement was really a disguised security agreement between the debtor and CIT, and that CIT did not perfect its security interest in the trucks by a "lien entry" as required under the Kansas CT law. At issue was whether Kansas had adopted a strict compliance standard or a substantial compliance standard for perfecting a security interest under the Kansas CT statute.[83]

The Tenth Circuit noted in the *Charles* opinion that under Kansas law there are two alternative methods for a secured party to perfect a security interest in a vehicle: (1) by submitting a lien entry form with the CT; or (2) by filing a notice of security interest (NOSI). When a vehicle lease is deemed a disguised Article 9 security agreement, showing the name of the lessor as owner rather than lienholder on the CT is sufficient for perfection because no third party could be misled. The Tenth Circuit determined that the substantial compliance standard is the majority rule among the states and is consistent with the Kansas substantial compliance standard for Article 9 financing statements.[84] The Tenth Circuit then upheld the bankruptcy court's analysis and conclusions that:

- the test for perfection under the substantial compliance standard is whether the creditor gave adequate notice of its interest to other potential secured creditors; and

74. 566 F.3d 699 (7th Cir. 2009). *See supra* Part II.B.1.d.

75. *See, e.g., Robinson,* 285 B.R. 732; discussion *supra* at note 69.

76. *See supra* Part II.B.1.d.

77. 440 B.R. 761 (6th Cir. BAP) (2010).

78. *See, e.g., In re* Checknet Systems, Inc., 227 B.R. 166 (Bankr. E.D. Ark. 1998) (noting other cases).

79. 422 B.R. 183 (Bankr. E.D. Ark. 2010).

80. *Id. See generally* UCC § 9-108 (description is sufficient if it "reasonably identifies the collateral"); *Checknet Systems*, 227 B.R. 166, at 169 (noting the "composite document rule"); UCC § 9-335 (security interests in accessions). A related issue is whether attachment can occur by reason of a "dragnet" (cross-collateral) clause in an otherwise unrelated security agreement. *See, e.g., In re* Fassigner, 246 B.R. 513 (Bankr. W.D. Pa. 2000) (rejecting cross-collateral claim on grounds the debts had to be the "same class" of obligation). Revised Article 9, in turn, rejects this requirement. *See* UCC § 9-204(c) & cmt. 5; *In re* Renshaw, 447 B.R. 453 (Bankr. W.D. Pa. 2011).

81. 2010 WL 5421148 (Bankr. E.D. Ky. Dec. 20, 2010).

82. *In re* Charles, 323 F.3d 841 (10th Cir. 2003) (applying Kansas law).

83. An unresolved issue in the relation between UCC Article 9 and CT laws is the role of UCC § 9-506 (the Article 9 harmless error rule) in CT lien entry perfection. Arguably, all of Article 9 applies, including § 9-506, pursuant to § 9-109, except the mechanics of perfection (pursuant to § 9-311(a)). *See also* UCC § 9-311(b) (CT lien entry is equivalent to filing a financing statement). However, the emphasis on the debtor's legal name in § 9-506 is inappropriate for CT cases, where indexing is by VIN and errors in the name of the debtor/owner are relatively unimportant. *See also infra* this text and notes 84-88; David B. McCrea & Alvin C. Harrell, *Overview and Update on Vehicle Secured Transactions, Certificates of Title, and Related Issues*, 64 Consumer Fin. L.Q. Rep. 342, 344-5 & 354 (2010). *Compare In re* PTM Techs., Inc., 452 B.R. 165 (Bankr. M.D. N.C. 2011) (error in the debtor's name made the financing statement seriously misleading).

84. *See, e.g.*, UCC § 9-311(b) (lien entry form is equivalent to a financing statement under Article 9); *id*. § 9-506 (minor errors are irrelevant to perfection unless seriously misleading). *But see supra* note 83. Note also that if the vehicle is consumer goods subject to a purchase-money security interest and is not of a type subject to a CT lien entry statute, perfection is automatic pursuant to UCC § 9-309. *See, e.g., In re* Winchester, 2011 WL 3878336 (Bankr. E.D. Ky. Sept. 2, 2011) (all-terrain vehicle, or "ATV").

- the creditor in *Charles* substantially complied with the perfection requirements under Kansas law for CTs because examination of the CT or a search of the Kansas CT records would put other interested parties on notice that the secured party (CIT) was claiming an interest in the vehicle.

The *Charles* analysis is correct, but these issues lack clarity in many jurisdictions. UCOTA section 26(b) specifically embraces the *In re Charles* view, providing that a lessor or secured party may be indicated on the CT as owner, and the effect (as appropriate) is to perfect the security interest. Section 26(b) also provides that this shall not be a factor in determining whether the interest is a security interest.[85] In addition, UCOTA provides a harmless error rule, patterned on UCC section 9-506 but tailored specifically to CT records and files.[86]

A case similar to *Charles* is *In re My Type, Inc*.[87] As in *Charles*, the lessor of vehicles was named as owner (rather than lienholder) of the vehicles. The court recharacterized the leases as secured transactions, and the bankruptcy trustee argued that listing the lessor (*i.e.*, the secured party) as lessor rendered the secured party unperfected. As in *Charles*, the *My Type* court applied a substantial compliance standard in holding that the erroneous CT did not preclude perfection. While this is clearly correct, UCOTA would avoid the uncertainties of this test by specifically validating perfection in these circumstances.[88]

C. Lien Entry Omitted from CT

In *Johnson v. Branch Banking & Trust Co.*,[89] the court held that a security interest in collateral covered by a CT is not perfected until the security interest is actually indicated on the CT. The court recognized an ambiguity in the statutory language of the Kentucky CT law on this point, and viewed this narrow interpretation as being supported by prior Kentucky law.[90] This is a potential problem in a significant number of states.[91] UCOTA solves this problem by adopting rules consistent with UCC Article 9.[92]

In re Moddelmog[93] provides another example of the potential problems surrounding this issue. In *Moddelmog*, the bankruptcy court concluded that if a security interest is not noted on the vehicle's CT, the security interest is unperfected, despite the fact that the omission was not due to the secured party's fault.

In *Moddelmog*, the debtor purchased and financed a vehicle from a dealership in Kansas. The dealership immediately assigned its security interest in the vehicle to Boeing Wichita Credit Union (BWCU), which sent a properly executed Notice of Security Interest (NOSI) to the Kansas Department of Revenue, Motor Vehicle Division. The debtor received the CT, which listed BWCU as the lienholder. The debtor later moved to Colorado, applied for a Colorado CT, surrendered the Kansas CT and received a "clean" Colorado CT for the vehicle, with no indication on the Colorado CT of the BWCU security interest. Subsequently, the debtor moved back to Kansas and applied for a new CT in Kansas. A new CT was issued in Kansas and, once again, BWCU was not shown as a security party on the CT. The debtor then filed bankruptcy. BWCU had no notice or knowledge of either the Colorado CT or the new Kansas CT until after the bankruptcy petition was filed. The bankruptcy trustee filed a complaint arguing that BWCU's security interest was unperfected and should be avoided. The bankruptcy court entered judgment in favor of the bankruptcy trustee.

On appeal the district court had to decide whether BWCU's security interest in the vehicle was unperfected because it was not indicated on the CT. After reviewing the perfection process for security interests in vehicles in Kansas, the court concluded that whenever a CT is surrendered and a new CT is issued without an indication of a security interest, that security interest becomes unperfected. The court concluded that, regardless of BWCU's diligence or lack thereof, the law compelled a finding that BWCU's security interest was unperfected because it was no longer listed on the vehicle CT. This analysis and result are directly contrary to the plain and obvious language of revised Article 9 at section 9-316(d) (the transactions in question occurred prior to the effective date of revised Article 9, and therefore were governed by old Article 9). *Moddelmog* is incorrect on this point under Article 9; nonetheless, it also illustrates the potential for confusion on these issues, partly derived from deficiencies in state CT laws.

UCOTA would add clarity on this issue by providing that perfection occurs upon receipt of the security-interest statement by the CT office (as provided for Article 9 financing statements in UCC section 9-516(a)); of course, the *Moddelmog* issue and related matters are also addressed in Article 9, *e.g.*, at sections 9-311(b), 9-316(d)-(e), 9-337, and 9-516(a). So UCOTA would not alter the correct outcome in a case like *Moddelmog*, which in any event was wrongly decided under Article 9. However, UCOTA might make the fraud (or error, as it may be) in *Moddelmog* less likely, by providing uniform standards for a CT application that would require carry-forward of any applicable security interest perfection, and specifying that

85. *See also* UCOTA § 25(a) (requirements for sufficiency of a security-interest statement that are consistent with Article 9); UCC § 9-505 (precautionary filing by a lessor is not a factor in characterizing the transaction).

86. *See* UCOTA § 20 ("Effect of omission or incorrect information"); *supra* note 83.

87. 407 B.R. 329 (Bankr. C.D. Ill. 2009).

88. *See* UCOTA §§ 25 – 26; *supra* notes 83-84; sources cited *supra* at note 4.

89. 313 S.W.3d 557 (Ky. 2010). *See also In re* Shepard, 2010 WL 1257672 (Bankr. D. S.D.) (same).

90. *Cf.* UCC §§ 9-311(b), 9-506 & 9-516(a) (arguably mandating the opposite result, at least in some circumstances).

91. *See, e.g.*, Compendium of State Certificate of Title Laws, *supra* note 1 (surveying state CT laws); example discussed immediately below.

92. *See supra* notes 84-88.

93. *In re* Moddelmog, 291 B.R. 545 (D. Kan. 2003).

perfection occurs upon submission of the security-interest statement to the CT office, consistent with Article 9.[94] On the facts of *Moddelmog,* UCOTA section 9 also would require the Kansas CT office to include on the second Kansas CT the security interest noted in the files of the Kansas CT office.

D. CT Perfection for Manufactured Homes

1. Real Property or CT Law?

In re Trible[95] illustrates perfection issues in the context of a security interest in a manufactured home (MH). The *Trible* court held that the exclusive method of perfecting a security interest in a MH under Kansas law was by notation of the security interest on the CT or by filing a NOSI, even though the transaction refinanced real property improved with the MH. Citi Financial recorded a mortgage to perfect its security interest in the MH and the real estate. Citi Financial, however, did not file a NOSI with the Kansas Department of Revenue, Division of Vehicles, nor was its security interest indicated on the MH's CT. The debtor subsequently filed bankruptcy.

The court addressed three questions: (1) Did Citi Financial have a perfected security interest in the MH?; (2) was the bankruptcy trustee entitled to avoid Citi Financial's security interest, even though the debtor claimed an exemption in the MH?; and (3) if so, how much of the security interest should be avoided (*i.e.*, what was the proper apportionment between the avoided security interest on the MH and the non-avoided mortgage on the real estate)?

The *Trible* court found that the exclusive way that Citi Financial could have perfected its security interest in the debtor's MH was by filing a NOSI with the Division of Vehicles of the Department of Revenue or notation of its security interest on the CT covering the MH.[96] Having failed to do so, Citi Financial's security interest in the MH was unperfected. In addition, the court held that the unperfected security interest could be avoided for the benefit of the bankruptcy estate by operation of the avoidance provisions in Bankruptcy Code sections 544 and 551, even though it was claimed by the debtor as exempt property.[97] The court apportioned the avoided security interest based on the allocation of the estimated total value of the real estate and MH together, as compared to the separate value of the MH.

Similarly, in *In re Dickson*,[98] the MH was covered by a CT and there had not been any filing of an affidavit of conversion to real property; therefore, the secured creditor's interest was not perfected by recording a real estate mortgage or filing a lis pendens. A state court order had later converted the MH to real property, and this created a mortgage lien on the MH, but this came during the bankruptcy preference period and thus the mortgage lien was avoidable under Bankruptcy Code section 547.[99]

Consistent with *Trible* and *Dickson*, in *Citizens National Bank of Jessamine County v. Washington Mutual Bank*[100] a MH that was not affixed to real property was covered by a CT lien entry perfection and not an earlier lis pendens filed by a competing creditor. The CT lien entry perfection thus had first priority even though the lis pendens was earlier in time.

2. UCOTA

The scope of UCOTA does not include MHs, although UCOTA logically could be made applicable to MHs by a simple revision of the UCOTA scope provisions. With such a change, UCOTA is equally and logically applicable to MHs covered by a CT.[101] Thus, under the current uniform text, UCOTA would not apply on the *Trible, Dickson* or *Citizens National* facts, but this could be easily changed by a revision to the UCOTA scope provisions; if UCOTA did apply the results would be the same, to the extent that the MH is subject to the CT perfection system. UCOTA sections 24 and 25 would then provide for submission of a "security-interest statement" to the state CT office in order to perfect the security interest.

3. Other MH Cases and Issues on Real Versus Personal Property

As suggested by the cases noted above, the question of whether a MH has been "converted" to real property, *e.g.,* by "cancellation" of the CT or some other conversion process, continues to arise in the context of security interests, even though some of these conversion procedures are directed at tax treatment rather than the characterization of property interests.[102]

For example, in *In re Melara*,[103] Chapter 13 bankruptcy debtors had executed a deed of trust (*i.e.*, a real estate mortgage) covering land on which a MH was located. The debtors argued that the MH was not affixed to the land and therefore was not subject to the mortgage lien.[104]

94. *See* UCOTA §§ 8, 9, & 25-26.

95. *In re* Trible, 290 B.R. 838 (D. Kan. 2003).

96. *Id* at 842-44. The court also described various subsequent statutory amendments to Kansas law. *Id. See also In re* Walling, 2010 WL 5421148 (Bankr. E.D. Ky. Dec. 20, 2010) (same—Kentucky law); *In re* Ritchie, 416 B.R. 638 (6th Cir. BAP 2009) (there was no perfection under a real estate mortgage because the MH had not been converted to real property). On Kentucky law, *see also infra* this text and notes 100 & 106. *See generally* Marc J. Lifset, *Proposed ULC Manufactured Home Titling Act*, in this issue.

97. 11 U.S.C. §§ 544 & 551. The debtor could subsequently reclaim the property from the estate. *See id.* § 522. *See generally* Fred H. Miller & Alvin C. Harrell, The ABCs of the UCC—Related Insolvency Law 75-79 (2d ed. 2006).

98. 427 B.R. 399 (6th Cir. BAP 2010).

99. 11 U.S.C. § 547.

100. 309 S.W.2d 792 (Ky. Ct. App. 2010).

101. The ULC/NCCUSL has a current MH drafting project; it is focused on the procedure for cancellation of the CT so as to bring the MH under real property law. *See Lifset, supra* note 96.

102. *See, e.g.*, David B. McCrea & Alvin C. Harrell, *Overview and Update on Vehicle Secured Transactions, Certificates of Title, and Related Issues,* 64 Consumer Fin. L.Q. Rep. 342, 352 n. 96 (2010) (noting: *In re* Jones, 2009 WL 4907028 (Bankr. E.D. Ky. 2009); and *In re* Ritchie, 416 B.R. 638 (6th Cir. BAP 2009)). That discussion is not repeated here.

103. 441 B.R. 749 (Bankr. M.D. N.C. 2011).

104. The debtors also argued that the MH was in poor condition and had no significant value, and would likely be removed by a purchaser of the land, and therefore the cost of moving

(Continued on next page)

The court agreed that the MH was personal property, because North Carolina law[105] provides that a MH is real property unless its moving hitch, wheels and axles are intact (which was the case here). In addition, the CT had not been cancelled.

Similarly to *Melara*, in *In re Starks*[106] the secured party (a second lien mortgagee) held a mortgage on land on which the debtor's MH was located. The secured party asserted that the MH ws affixed to the land and therefore subject to the mortgage lien. However, the MH was covered by a CT and had not been converted to real property under state law. The court held that the MH was personal property not subject to the mortgage lien.

A slightly different aspect of the real property versus personal property conundrum was illustrated in *Green Tree Servicing, LLC v. Circle N Ranch, Ltd.*,[107] where the owner of land leased it to the retail purchasers of MHs (as, *e.g.*, in a MH park). The MHs were subject to security interests granted by their owners, and when the MH owners defaulted on these loans they also stopped paying rent to the landowner. Sometimes this period of default continued for an extended period, giving the landowner a sizeable claim for past due rent. The trial court agreed with the landowner that the landowner had an affirmative right to recover this claim from the MH secured party.[108] However, on appeal this was reversed; under Texas law the landowner has a possessory statutory lien on the MH, but this is limited to enforcement against the property and does not create personal liability against property interest owners.[109]

In *In re Browillette,*[110] it was alleged that a real estate mortgage did not cover a modular home (a prefabricated home installed on a permanent foundation), because it was a MH that should have been covered by a CT. The court rejected this argument, noting that a CT is only required for a MH built on a chassis, not for prefabricated modular structures. The real estate mortgage was sufficient to perfect the lien.[111]

4. Impact on Bankruptcy "Cramdown"

The difference between characterization of a MH as real or personal property also can have an impact on "cramdown" of the secured party's lien in Chapter 13 bankruptcy cases. Bankruptcy Code section 1322(b)(2) allows the modification (sometimes called "cramdown") of liens in the Chapter 13 plan, except home mortgage liens on real estate occupied as the debtor's principal residence.[112] The "debtor's principal residence" can include a MH, but this helps the lien holder under section 1322(b)(2) only if the MH is also real property.[113]

For example, *In re Coleman*[114] held that the secured party's lien on the MH was not protected from cramdown under section 1322(b)(2), and therefore could be reduced to the value of the MH (rather than flowing through bankruptcy unimpeded[115]), because the MH was personal property under state law. Similarly, *In re Reinhardt*[116] allowed cramdown of a security interest in the debtor's MH because the MH was personal property and therefore fell outside the protective scope of section 1322(b)(2). In *Reinhardt*, the debtor had purchased the land and MH located on it in a single transaction, but financed the land via a mortgage and the MH via a separate installment sale contract. Moreover, the MH was personal property under state law. *Coleman* and *Reinhardt* illustrate that, for bankruptcy Chapter 13 purposes, it may not be enough for the secured party to correctly identify the character of the MH as personal property and perfect the security interest accordingly.[117] The United States Court of Appeals for the Fourth Circuit has also embraced this view.[118]

E. Failure to Issue CT

In *In re Philliber*,[119] the secured party submitted its lien entry form and CT application with the existing CT and an affidavit as to the transfer of ownership by a previous owner. The CT office rejected the application and sent notice of rejection to the secured party (who claimed the notice was not received). The bankruptcy trustee and debtor argued that the security interest was unperfected and therefore avoidable under Bankruptcy Code section 544(a). The secured party argued that it had

104. *(Continued from previous page)*

the MH should be deducted from the value of the land in determining the amount of the mortgagee's secured claim. However, since *Melara* involved a Chapter 13 plan that provided for the debtors to retain the land and MH as their residence, it was inappropriate to deduct moving expenses for the MH from the value of the land on which the MH was located. *Id*.

105. N.C. Gen. Stat. § 105-273(13)(d)(2).

106. 2011 WL 248521, 2011 Bankr. LEXIS 268 (Bankr. E.D. Ky. Jan. 24, 2011). On Kentucky law, *see also supra* notes 96 & 100.

107. 325 S.W.3d 869 (Tex. App.-Austin 2010).

108. *Id*. (citing Tex. Fin. Code Ch. 347).

109. *Id*. (citing Tex. Fin. Code §§ 347.402 & 347.403). There may be other scenarios where a secured party does not want to claim a lien on MH collateral. For example, in *In re* Brooks, 452 B.R. 809 (Bankr. D. Kan. 2011), the bankruptcy trustee sought to avoid and recover the bank's lien on a MH pursuant to Bankruptcy Code §§ 544(a), 550 & 551. The bank argued that it did not have a lien on the MH, but only a mortgage on the land. The court agreed with the trustee, and awarded the trustee the value of the avoided lien. *See also infra* this text at notes 112 – 118.

110. 389 B.R. 214 (Bankr. D. Kan. 2008).

111. *Id*. at 220-221. *Id*. *But compare* 21st Mortg. Corp. v. Stovall, 221 WL 3307516, 2011 Tex. App. LEXIS 6027 (Tex. App.—Dallas, Aug. 3, 2011), reversing the trial court's grant of summary judgment as to whether a modular home was permanently affixed so as to be part of the real property, despite the home having a "permanent foundation."

112. 11 U.S.C. § 1322(b)(2).

113. *See* 11 U.S.C. § 101(13A) (Bankruptcy Code definition of "debtor's principal residence").

114. 392 B.R. 767, 770-772 (BAP 8th Cir. 2008), *affmg*. 373 B.R. 907 (Bankr. W.D. Mo. 2007) (also noted in McCrea & Harrell, *supra* note 102).

115. *See* Nobelman v. American Savings Bank, 508 U.S. 324 (1993).

116. 563 F.3d 558 (6th Cir. 2009).

117. *See also in re* Jordan, 403 B.R. 339 (Bankr. W.D. Pa. 2009) (same). In *Jordan*, the court said the subjective intent of the parties, as to whether they intended the MH to be affixed to the real estate, was irrelevant. The separate security interest in the MH (purchased after the debtors bought the land) was said to indicate that the MH was personal property; oddly, the court also emphasized that the MH was not on the land when the debtors bought the MH and the transaction documentation was executed--but this will frequently be the case, even if there is a subsequent affixation to the land.

118. *See In re* Ennis, 558 F.3d 343 (4th Cir. 2009) (security interest in a MH perfected by a CT lien entry is not protected from cramdown under § 1322(b)(2)).

119. 395 B.R. 653 (Bankr. W.D. MO. 2008).

complied with the requirements for perfection. The court held that rejection of the CT application (based on inadequacy of the affidavit, on grounds the signature of the assignor had to be on the CT) meant the security interest was unperfected, and could be avoided by the trustee.[120]

As noted, UCOTA would address this by permitting perfection by a lien entry form, separate from the CT application, and by recognizing a CT-specific equivalent of the UCC harmless error rule.[121]

Similarly to *Philliber*, in *In re Green*[122] the secured party financed the debtor's purchase of a vehicle (a motorcycle), and submitted the existing CT and an application for a new CT with the secured party's lien entry. A discrepancy between the odometer reading on the CT application and the existing CT caused a delay in issuing the new CT, and during that delay the debtor filed bankruptcy. The secured party argued that either: (1) the application was sufficient and the security interest was perfected; or (2) if it was not sufficient the debtor was not the owner and the vehicle was not part of the bankruptcy estate. The court rejected both alternatives, holding that the defective application was sufficient to transfer ownership but not to perfect the security interest.[123]

A better example, and one made explicit by UCOTA, is *In re Rumble*[124] where the court characterized an error on the CT application (that resulted in the CT issuance being delayed) as a clerical error that did not render the lien entry invalid or the security interest unperfected. The error caused a delay in issuance of the CT, and a subsequent return of the CT application to the local office for correction. In the meantime, the debtor filed bankruptcy, and the bankruptcy trustee argued that the security interest was unperfected when the bankruptcy petition was filed.[125] The court disagreed, distinguishing the case of a minor clerical error from cases where the CT application was invalid when submitted.[126]

Additional issues are presented in states where the CT law requires indication of the security interest on the CT as a prerequisite to perfection. Under North Carolina and Virginia law, a secured party whose security interest is not indicated on the vehicle's CT does not have a perfected security interest in the vehicle. In *In re Durham*,[127] the debtors, North Carolina residents, purchased a new vehicle from a Virginia dealership, with financing provided by U.R.W. 831 Members Federal Credit Union (the credit union). The debtors executed a promissory note and security agreement granting the credit union a security interest in the vehicle. When the dealership delivered the vehicle to the debtors, it also delivered a certificate of origin with an assignment to the debtors and a CT application, to be used to apply for a CT for the new vehicle. The CT application named the debtors as owners and the credit union as the secured party. Approximately seven months later, the debtors filed a Chapter 7 bankruptcy petition. A CT had never been issued because the required application had not been sent to the North Carolina Division of Motor Vehicles. By agreement, the vehicle was sold and both the bankruptcy trustee and credit union claimed the proceeds.

The main issues in *Durham* were whether the vehicle was property of the bankruptcy estate under section 541 of the Bankruptcy Code,[128] and whether the credit union had a perfected security interest in the vehicle at the time of the filing of the bankruptcy petition. Based on the sales contract reflecting the debtors as the purchasers of the vehicle and the dealership's delivery of both the certificate of origin and the vehicle to them, the court concluded that the debtors were the owners of the vehicle. Under Virginia law (the state where the transaction took place), ownership may be transferred by either a CT, in the case of a used vehicle, or a certificate of origin in the case of a new vehicle. Because the debtors were found to be the owners of the vehicle, the vehicle became property of the bankruptcy estate when they filed their Chapter 7 petition.[129]

The *Durham* court also found that, under both Virginia and North Carolina law, a party with a security interest in a vehicle in the possession of the debtor can perfect the security interest only by having the security interest indicated on the CT.[130] The *Durham* court held that the credit union did not have a perfected security interest because the security interest was not indicated on the CT covering the vehicle. Therefore, the proceeds from the sale of the vehicle were to be included in the bankruptcy estate.[131]

UCOTA expressly recognizes that, under ordinary contracts and property law, the ownership of a vehicle may be transferred without execution of a CT.[132] Therefore the sale of the vehicle in *Durham*, as recognized in that case, would pass ownership to the buyers and the vehicle would be included in their bankruptcy estate. UCOTA section 16(c) states that a transfer of ownership without execution of the CT does not affect the rights of other persons claiming an interest in the vehicle, in order to protect parties who may be relying on the CT or the files of the office from "secret" non-CT transfers. But this would not preclude

120. *Id.* at 656-57. *Compare* UCC § 9-516(a). *See also* UCC § 9-311(b); *supra* this text and notes 81-94.

121. *See supra* this text and notes 85 – 88 & 94; UCOTA §§ 20 & 25 – 26; authorities cited *supra* note 4.

122. 410 B.R. 904 (Bankr. D. Idaho 2009).

123. *Id.* As noted above, UCOTA would solve this, *e.g.*, by recognizing perfection by filing a security-interest statement, independently of the CT application. *See supra* note 121.

124. 2011 WL 1740966, 2011 Bankr. LEXIS 1589 (Bankr. W.D. Mo. April 29, 2011).

125. Allowing the trustee to "avoid" the security interest. *See* 11 U.S.C. § 544(a), and the *Philliber* and *Green* cases noted immediately above.

126. *Rumble*, 2011 WL 1740966, at *2. *See* UCC § 9-506 (harmless error rule); UCOTA § 20 (similar rule); *supra* this text and notes 85-95 & 119-123.

127. *In re* Durham, 2003 WL 21459555 (M.D. N.C. June 23, 2003).

128. 11 U.S.C. § 541. *See generally supra* Part II.B.

129. *Durham*, 2003 WL 21459555, at *2 – *3. *See also supra* note 128.

130. *Durham*, 2003 WL 21459555, at *3.

131. *Id.* at *4.

132. *See* UCOTA § 16(c) (transfer of ownership). *See also* UCOTA § 3 (general principles of law and equity supplement the statute); *id.* §§ 2(a)(4) & 7 (certificates of origin).

transfer of ownership to the buyers on the facts in *Durham*, whose interest then became part of the bankruptcy estate by reason of 11 U.S.C. section 541.

UCOTA would, however, provide a means for the secured party to protect itself in these circumstances, by filing a "security-interest statement" (essentially the UCOTA term for a lien entry form) in order to achieve perfection, even if the debtor has not (and does not) apply for or obtain a CT.[133] Thus, on the facts in *Durham*, the secured party could easily protect itself under UCOTA, by perfecting its security interest (and thereby obtaining a lien and secured claim in the subsequent bankruptcy case), regardless of the debtor's failure to apply for a CT.

F. Equitable Subrogation

1. The *Morgan* Case

In *In re Morgan*,[134] the court considered whether the exclusive method for perfecting a security interest in a vehicle in Tennessee is by having the security interest indicated on the CT, and whether a secured party who failed to have its security interest indicated on the CT is entitled to be equitably subrogated to the rights of a previous secured party whose security interest is indicated on the CT.

The debtor purchased a vehicle from a dealership, and financed it through First American National Bank (Bank 1). Bank 1's lien on the vehicle was noted on the CT. Soon after, the debtor refinanced the loan with LaSalle Bank (Bank 2) and paid off the prior loan with Bank 1. Two years later, the debtor filed a petition under Chapter 7 of the Bankruptcy Code. Two months after the bankruptcy filing, Bank 2 applied for and received a CT transferring the CT indication of the security interest from Bank 1 to Bank 2. During that same time, the debtor was involved in an accident that totaled the vehicle and her insurance company paid Bank 2 an amount that fully satisfied her loan to Bank 2. The bankruptcy trustee contended that Bank 2's post-petition indication of its security interest on the CT violated the Bankruptcy Code automatic stay and that its receipt of the insurance proceeds constituted a post-petition payment in violation of Bankruptcy Code sections 362 (the automatic stay) and 549.[135]

The question in *Morgan* was: whether Bank 2's security interest was perfected by virtue of subrogation to Bank 1's lien entry rights and indication on the CT, in which case the insurance proceeds were not property of the bankruptcy estate and the automatic stay was not violated; or alternatively whether Bank 2's security interest was unperfected at the time of the bankruptcy filing and therefore it had to return the proceeds to the estate.

Despite a strong argument that Bank 2 was entitled to equitable subrogation, the *Morgan* court was not persuaded that equitable subrogation existed between Bank 1 and Bank 2, on grounds that the statutes governing perfection and CTs do not provide for an equitable remedy.[136] The *Morgan* court concluded that even though Bank 1 had a duty to deliver the CT to Bank 2, it was ultimately Bank 2's responsibility to get possession of the CT from Bank 1 or to obtain a duplicate CT, as it eventually did more than two years later.[137] The court found that Bank 2's security interest was unperfected because the risk of loss from failing to properly indicate a security interest on a CT is on the secured party seeking perfection.[138]

Since Bank 2 took no action to have its security interest indicated on the CT until after the bankruptcy petition was filed, the court concluded that Bank 2 violated the automatic stay, regardless of its intent.[139] Consequently, the perfection was voided, Bank 2's unperfected security interest was avoided, and the proceeds from the insurance claim were returned to the trustee of the bankruptcy estate. As noted,[140] this reasoning is flawed to the extent that it fails to fully account for the possible perfection of Bank 2 by subrogation to the lien entry of Bank 1. While the argument would be easier if Bank 2 had taken an assignment from Bank 1, rather than paying off the Bank 1 loan, courts should recognize that the same result can be accomplished by way of equitable subrogation.

2. UCOTA

As with some of the other cases described in this article, *Morgan* (noted immediately above) involved a relation between UCC Article 9, common law, and bankruptcy issues that is not directly within the scope of any CT law, including UCOTA, *e.g.*, issues relating to equitable subrogation, the automatic stay in bankruptcy, and the effects of perfection or a lack of perfection (*i.e.*, priority). UCOTA would not change the law on those issues. However, UCOTA would ameliorate the inequitable aspects of those rules as illustrated in cases like *Morgan*, where Bank 2 was not able to separately perfect its security interest in part because Bank 1

133. UCOTA §§ 4, 25, and 26. *See also supra* this text and notes 85 – 95 & 119 – 121.

134. *In re* Morgan, 291 B.R. 795 (Bankr. E.D. Tenn. 2003).

135. *See* 11 U.S.C. §§ 362 and 549.

136. This reasoning is incorrect, since the nature of an equitable remedy is that it serves to avoid a forfeiture or other injustice when the legal remedy is inadequate, and the UCC is specifically supplemented by principles of equity. *See, e.g.*, UCC § 1-103(b); William Q. deFuniak, Handbook of Modern Equity 9 (2d. ed. 1956). Moreover, while it is clear that there is no equitable alternative to perfection, which is an exclusive statutory procedure designed to provide notice, that was not the issue here. *Morgan* involved the transfer of rights to an existing lien entry security interest perfection, not the act of perfection itself. Transfer of these rights can occur, under the common law, by an unrecorded assignment or by equitable subrogation. *See, e.g.*, UCC § 9-310 and cmt. 4; Permanent Editorial Board (PEB) Commentary No. 12 (the UCC does not defer to the CT law on issues regarding transfer of a perfected security interest—*compare* UCC § 9-311); *In re* Clark Contracting Services, Inc., 438 B.R. 913 (W.D. Tex. 2010) (under Texas law, "re-titling in the name of the assignee is optional."); *In re* Scott, 427 B.R. 123 (Bankr. S.D. Ind. 2010) (same). On subrogation generally, *see, e.g.*, LaSalle Bank, N.A. v. White, 246 S.W.3d 616 (Tex. S.Ct. 2008); French Lumber Co., Inc. v. Commercial Realty & Finance Co., Inc., 346 Mass. 716, 195 N.E. 2d 507 (1964). UCOTA should make this more clear. *See* UCOTA § 3 (CT law is supplemented by principles of equity); UCOTA § 26(c) (assignment of security interest does not require new CT); *infra* Part III.F.2.

137. *Morgan*, 291 B.R. at 803. Regarding the liability of Bank 1 in this scenario, *see generally infra* Part III.H.

138. *Morgan*, 291 B.R. at 803.

139. *Id.* at 804.

140. *See supra* note 136. The *Morgan* court considered equitable subrogation but rejected it on grounds the Tennessee CT law did not authorize the court to recognize equitable principles. *See Morgan*, 291 B.R. at 801. *Compare* discussion *infra* and notes 142 – 159.

did not release the CT in timely fashion, and in fact should not have been required to do so given Bank 1's prior CT lien entry. As noted above at Part III. E., in these circumstances UCOTA sections 4, 25, and 26 would permit a secured party in the position of Bank 2 to file a "security interest statement" with the CT office as a means to perfect its security interest, without access to or submission of the CT. This would provide a simple and cost-effective procedure to allow Bank 2 to perfect its security interest in a timely manner no matter what Bank 1 did. In addition, UCOTA section 26(c) would make clear that there could be an assignment of the Bank 1 perfection to Bank 2, without any indication on the CT or in the files of the office.[141]

3. Subrogation and Assignment

Despite resolution of the *Clark* case, essentially characterizing the bankruptcy court's decision as incorrect and an aberration,[142] some issues relating to assignment and subrogation (the latter essentially an equitable assignment[143]) of security interests remain somewhat obscure.[144] Clearly the UCC is supplemented by general principles of equity,[145] and there is no reason why this should exclude subrogation. Moreover, subrogation is commonly cited in other types of commercial litigation, *e.g*., involving insurance and sureties.[146]

Perhaps the best known example in secured transactions law is the scenario illustrated by *National Shawmut Bank v. New Amsterdam Casualty Co*.,[147] where the surety's claim of subrogation to rights of workers and materialmen on payments made pursuant to a completion bond was recognized as an equitable remedy not dependent on secured transactions law; this included subrogation to the rights of workers and materialmen who had lien rights superior to the competing bank's perfected security interest in the construction contract and proceeds of the contract.[148] This rejected a previously prevalent view that the surety's claim was a security interest governed by Article 9 because it was created by contract (in the completion bond).[149] The *National Shawmut* rationale has subsequently held sway, almost universally in such cases.

Nonetheless, and for reasons that are not readily apparent, secured parties have sometimes had less success in claiming subrogation to the rights of a prior, perfected secured party. In the *Wilserv* case,[150] for example, the lower courts and United States Court of Appeals for the Tenth Circuit rejected this theory, for reasons not fully explained in the courts' opinions.[151] It would seem that in such cases the analysis would benefit from more extensive consideration of traditional equitable subordination issues.[152]

Of course, in a case like *Clark*[153] the assignee has the benefit of an express assignment of rights (not to mention, as regards perfection of the security interest, UCC section 9-310 and Official Comment 4). The cases generally reflect this, well beyond the scope of the *Clark* scenario. For example, in *Barcosh, Ltd. v. Dumas*[154] the court recognized (in dictum) that perfection can be assigned via a merger (though the principle did not apply because the predecessor had no loan to the debtor outstanding when the merger occurred). In addition, the rights of an assignee may be limited by equitable considerations with respect to the status of innocent third parties.[155]

Despite some apparent confusion on the subject (as suggested by cases like *Wilserv* and *Morgan*,[156] not to mention the bankruptcy court's decision in *Clark*), it should be clear that (absent equitable considerations relating to intervening parties, as in *Barcosh*[157]) when a second secured party buys or pays off a prior secured party the second secured party should succeed to the rights and priority of the prior secured party, either by reason of an assignment or equitable subrogation.[158] Of course, as noted, the plain language of UCC Article 9 governing assignments of security interests

141. *See also* discussion of the *Clark* case, immediately below.

142. *In re* Clark Contracting Services, Inc., 438 B.R. 913 (D. Ct. W.D. Tex 2010), *reversing* Clark Contracting Services, Inc. v. Wells Fargo Equipment Finance (*In re* Clark Contracting Services, Inc.), 399 B.R. 789 (Bankr. W.D. Tex. 2008). *See infra* Part VI.

143. *See, e.g*., Dan. B. Dobbs, Handbook on the Law of Remedies 250-52 (1973); William Q. deFuniak, Handbook on Modern Equity 239-40 (2d ed. 1956); and *supra* note 136.

144. *See, e.g*.: discussion of the bankruptcy court's decision in *Clark*, 399 B.R. 789, in Alvin C. Harrell, Case Note, Clark Contracting Services, Inc. v. Wells Fargo, *Does an Assignee of a CT Lien Entry Become Unperfected?*, 62 Consumer Fin. L.Q. Rep. 274 (2008); the treatment of subrogation issues in Malloy v. Wilserv Credit Union (*In re* Harper), 516 F.3d 1180 (10th Cir. 2008), as noted in Alvin C. Harrell & Fred. H. Miller, *Can a Buyer and Secured Party Rely on a Certificate of Title? Part IV: The Wilserv Case*, 79 O.B.A.J. 2205, 2206 & notes 18 – 19 (2008).

145. *See* UCC § 1-103(b).

146. *See, e.g*., Safeco Ins. Co. v. Wheaton Bank & Trust Co., 2009 WL 2407740 (N.D. Ill. Aug 4, 2009) (surety's claim of subrogation).

147. 411 F.2d 843 (1st Cir. 1969).

148. *Id*. This analysis has found widespread acceptance in this context (*see, e.g*., Mid-Continent Casualty Co. v. First National Bank and Trust Co., 531 P.2d 1370 (Okla. 1975) (same)), as an apparent exception to the broader rule that equitable considerations should not alter the UCC Article 9 perfection and priority rules (on the latter, *see, e.g*., Knox v. Phoenix Leasing, Inc., 29 Cal. App. 4th 1357 (Cal. Ct. App. 1994)).

149. *See, e.g*., French Lumber Co., Inc. v. Commercial Realty & Finance Co., Inc., 346 Mass. 716, 195 N.E. 2d 507 (1964); UCC § 9-109 (scope of Article 9).

150. 516 F.3d 1180; *see supra* note 144.

151. *See, e.g.,* Harrell & Miller, *supra* note 144.

152. *Id. See also* UCC § 3-203 ("shelter rule," essentially a codification of the law of assignment and equitable subrogation in the context of negotiable instruments). *See also, e.g*., Lodge *(Continued in next column)*

152. *(Continued from previous column)* v. United States, LLC, 2011 WL 1740717 (E.D. N.Y. May 5, 2011) (assignee succeeded to holder in due course status of the assignor pursuant to the shelter doctrine); Anderson v. Burson, 9 A.3d 870 (Md. Ct. Spec. App. 2010) (assignee of note had standing to foreclose, even without possession of the note--*see also* UCC § 3-301); Taylor v. Deutsche Bank Nat'l Trust Co., 44 So. 3d 618 (Fla. Dist. Ct. App. 2010) (same). On equitable subrogation, *see supra* notes 136 & 143.

153. 438 B.R. 913; *see supra* note 142.

154. 2010 WL 3192984 (M.D. La. 2010).

155. *See, e.g., In re* Snyder, 436 B.R. 81 (Banrk. C.D. Ill. 2010) (the marshalling rights of a second-priority secured party were preserved when the third-priority secured party purchased the debt and security interest of the first-priority secured party).

156. *See Wilserv*, 516 F.3d 1180; *Morgan*, 291 B.R. 795.

157. *See Barcosh*, 2010 WL 3172984. *See, e.g*., *supra* this text and notes 154 – 55; American Sterling Bank v. Johnny Management LV, Inc., 2010 WL 4246894 (Nev. 2010) (increase in interest rate on the second loan was not a material prejudice to the intervening lien holder, but the extended term was a material prejudice).

158. On subrogation, *see, e.g*., *LaSalle*, 246 S.W.3d 616; *French Lumber*, 195 N.E.2d 507; Dobbs, *supra* note 143; *supra* note 136.

bolsters these long-standing principles of law, making the results even more clear where there is an express assignment; but, even without that, barring exceptional circumstances the same result should follow by reason of equitable subrogation.[159]

G. Change in Use of Collateral: Vehicles Traded-In to Dealer

In *First National Bank of the North v. Automotive Finance Corp.*,[160] a secured party who had financed vehicle purchases for consumers retained its perfected security interests in the vehicles after the vehicles were returned by the consumers to the dealer's inventory as trade-ins; the secured party was not required to file financing statements in order to have priority over the previously-perfected security interest in the dealer's inventory.[161]

In *First National Bank,* each vehicle was sold to the consumer (who qualified as a BIOCOB) by the dealer, free and clear of the competing security interest of the dealer's inventory lender.[162] The defendant, Automotive Finance Corporation (AFC), was the dealer's inventory "floorplan" lender, who financed the dealer's purchase of inventory for the car dealership. AFC took a security interest in the dealer's inventory, including all vehicles owned or acquired in the future (pursuant to an after-acquired property clause),[163] and filed a financing statement with the Minnesota Secretary of State, as required by the UCC.[164] The dealer then sold three vehicles to separate retail buyers who obtained financing from the plaintiff, First National Bank of the North (the consumers' secured party). This sale "cut-off" the prior inventory security interest of AFC under Article 9 section 9-320(a). The consumers' secured party took a security interest in each of the vehicles as collateral for the purchase-money loans, which it perfected on each CT. The consumers' secured party thus had the first perfected security interest in the vehicles.

The consumers then "traded in" their vehicles to the dealer as part payment for the purchase of other vehicles, without paying off the loans to the consumers' secured party. On transfer of ownership to the dealer the vehicles were placed back in the dealer's inventory and again became subject to the inventory security interest, pursuant to the after-acquired property clause. Subsequently, both the dealer (a debtor to AFC) and the three separate consumers (debtors to the consumers' secured party) defaulted on their loans. Before the consumers' secured party could repossess, AFC repossessed the dealer's entire inventory, including the trade-in vehicles securing the loans of the consumers' secured party. AFC then argued that, when the vehicles were traded in, the security interests of the consumers' secured party became unperfected because the consumers' secured party failed to file a financing statement as required for inventory collateral and the vehicles were once again subject to AFC's inventory security interest.[165]

The basic issue for the *First National* court to decide was whether the valid and perfected security interests of the consumers' secured party, indicated as required on each CT, had priority over the competing perfected security interest in the dealer's inventory, after the vehicles were returned to the dealer's inventory.[166]

The *First National* court construed the Minnesota CT statute as exempting a dealer who buys vehicles to hold for resale (*i.e.*, inventory) from applying for a new CT and indicating the security interest on the CT,[167] but not from obtaining the original CT or the other rules governing ownership. In accepting the trade-ins, the court concluded that the dealer acquired no greater rights than those of the consumer sellers and could not obtain a clean CT covering any of the vehicles without the consent of the consumers' secured party, as the first secured party at the time of the trade-in. Because the dealer did not obtain execution of the CTs for the three traded-in vehicles, the court reasoned that ownership was not transferred, and AFC's security interest did not attach. Therefore, the consumers' secured party had priority.

The *First National* court reached the correct decision, but the court's analysis is flawed and unnecessarily muddled.[168] It can be noted that UCOTA would be helpful in this respect. For starters, the *First National* opinion is incorrect in indicating that AFC's debtor (the dealer) had insufficient rights in the collateral for the AFC security interest to attach. Ownership of vehicles can be transferred under general contracts and property law (and UCC Article 2), and clearly the trade-in transactions were sales of goods that conferred rights in the collateral on the dealer; when placed in the dealer's inventory, the vehicles also became subject to the AFC security interest. UCOTA section 16(c) would make more clear that the dealer obtained ownership of the vehicles as against the consumer sellers, even without execution of the CT, and this was sufficient for the AFC security

159. *See, e.g., supra* this text and notes 143-146 & 150-158; *In re* Scott, 427 B.R. 123 (Bankr. S.D. Ill. 2010) (assignment of a security interest perfected by CT lien entry, to a securitization trust, meant that the security interest continued to be perfected despite a failure to indicate the assignment on the CT). *See also Clark*, 438 B.R. 913 (D. Ct. W.D. Tex. 2010).

160. First National Bank of the North v. Automotive Finance Corp., 661 N.W.2d 668 (Minn. Ct. App. 2003).

161. *Id*. A security interest in inventory must be perfected by filing, even if the collateral is covered by a CT. *See* UCC § 9-311(d). However, a security interest perfected by a proper means does not lose perfection merely because the use of the collateral (and therefore the means of a new perfection) changes. *See id*. § 9-507.

162. *See* UCC § 9-320(a).

163. *Id*. § 9-204.

164. *See id*. §§ 9-310, 9-311(d).

165. *See id.*

166. As noted, UCC § 9-311(d) provides that vehicles held in inventory are subject to perfection by filing, even if the collateral is covered by a CT. *See supra* note 161. Interestingly, as framed by the *First National* court in terms of who had attachment and perfection, this should be an easy question, clearly answered by UCC § 9-507. The better question is: recognizing that both secured parties were perfected, who had priority? AFC might well claim that upon re-attachment of its security interest it was entitled to priority based on its time of filing, pursuant to the first-in-time rule at § 9-322(a). However, the consumers' secured party should prevail due to its purchase-money priority, the purchase-money security interest of AFC having been lost when that security interest was cut-off under § 9-320(a). But these are seemingly less apparent issues than those addressed by the *First National* court.

167. In reality, as regards the security interest, the latter issue is governed by UCC Article 9. *See* UCC § 9-311(d).

168. *See supra* notes 166 & 167.

interest to attach under Article 9 sections 9-203 and 9-204.[169] This would prevent AFC from being unperfected if the dealer filed bankruptcy. But the *First National* court was correct in holding that the consumers' secured party had first priority under Article 9.[170] Once the consumers' secured party properly perfected its security interest under the CT law, it remained perfected under that law and that perfection was not terminated by return of the vehicles to the dealer's inventory.[171]

H. Lost CT in Refinance

1. The *Moore* Case

In *Moore v. Firstar Bank*,[172] the court considered whether a vehicle buyer was damaged by the seller's refusal to execute the CT, or by the failure of the seller's secured party to deliver a replacement for the lost CT. The plaintiff purchased a vehicle from a seller who had delivered possession of the CT to defendant Firstar Bank (Bank), in order for the Bank to perfect its security interest in the vehicle as collateral for a loan. In buying the vehicle the plaintiff paid the Bank the balance of the Bank's loan and, with the seller, instructed the Bank to turn over the CT to the plaintiff. The Bank agreed to release its security interest but never delivered the CT to the plaintiff. The Bank informed the seller that the CT had been lost but did not disclose this information to the plaintiff. The Bank instructed the seller to obtain a duplicate CT and to assign that CT to the plaintiff. The seller did obtain a duplicate CT, but did not execute it to the plaintiff. In your authors' experience, this scenario is not unusual as once the seller has been paid he or she has little immediate incentive for further performance. The plaintiff ultimately filed this complaint against the Bank for breach of contract, promissory estoppel, and negligence.

At issue in *Moore* was whether the plaintiff sufficiently pled a cause of action against the Bank. On the breach of contract claim, the court held that the plaintiff had failed to show damages as a result of the Bank's action or inaction. The court stated that the seller was the record owner of the vehicle and the only way to transfer ownership was for the seller to execute the CT. The Bank only had possession of the CT and could not transfer ownership of the vehicle. Promissory estoppel was inapplicable because enforcing the Bank's promise to deliver the CT was not the only method of curing the injustice, given that the seller could be ordered to assign the CT to the plaintiff. The plaintiff could not maintain a negligence claim against the Bank because the plaintiff failed to show that the Bank had a duty to deliver the CT to the plaintiff or that the plaintiff was damaged by the Bank's failure to deliver the CT.

2. Impact of UCOTA

The *Moore* case illustrates several problem areas addressed by UCOTA. As noted, the fact pattern is apparently a common one, *e.g.*, a scenario where a consumer buys a car and is then unable to obtain an executed CT from the seller. Sellers, in turn, often claim that they are unable to do so because their secured parties cannot or will not release the CT to them. Not uncommonly the CT is lost. As illustrated in *Moore*, current CT laws are largely silent or confused on the crucial issues, and consumers often are left with recourse that is too expensive, or uncertain common law judicial remedies (which also are often uneconomical given the relatively low value of the used vehicle involved).

UCOTA addresses this in several ways. First, UCOTA section 16 makes clear the obligation of the seller to sign and deliver ("execute," as that term is defined in UCOTA) the CT to the buyer, while providing that the sale is effective between the parties despite a failure to do so. UCOTA section 23 then provides the buyer with a simple and economical procedure for obtaining a substitute CT if the seller fails to perform, by providing basic documentation to the CT office, evidencing the sale. The seller's property and due process rights are similarly protected. UCOTA section 27 requires the secured party to terminate its security interest and release possession of the CT, within thirty days after the loan payoff or within fourteen days of an appropriate demand from "a debtor."[173] UCOTA sections 25 and 26 allow the buyer's secured party to perfect its security interest by filing a security-interest statement, independently of the buyer's efforts to obtain execution of the CT.[174]

I. Unfiled Lien Release Terminated Perfection

In *In re Passa*,[175] the secured party refinanced the debtor's vehicle loan, and in the process erroneously issued a lien release to the debtor by signing the release on the CT and sending it to the debtor. The debtor did not submit the CT to the CT office, and the secured party did not submit a notice of the release to the CT office as required by the CT law for release of a lien. Therefore, the secured party remained the secured party of record. However, the debtor filed bankruptcy and argued that the security interest was unperfected. The court agreed, rejecting the secured party's request for a duplicate CT indicating the security interest. The court reasoned that the CT law requires the secured party to have possession of the CT as a prerequisite to perfection, and that the secured party's request for a duplicate CT to accomplish this purpose was "duplicitous." Therefore, the security interest was unperfected despite its indication on the CT and in the CT office files, and

169. The *First National* court's errors on this simple and fundamental issue illustrate again the dangers of poorly drafted CT statutes in conjunction with fundamental but specialized issues that are not within the daily experiences of many lawyers and judges. In such circumstances, clear and accurate statutory guidance is apparently essential, and too often lacking.

170. *See* UCC § 9-322(a) (first-in-time, first-in-right); *id.* § 9-324 (purchase-money priority); *supra* this text at notes 167 – 168.

171. *See* UCC § 9-311(a), (b); *id.* § 9-507; UCOTA § 25(a), (e), § 26(d).

172. 96 S.W.3d 898 (Mo. Ct. App. So. Dist. Div. 1, 2003). *See also supra* Part III.F.1

173. *See* definition at Article 9 § 9-102(a)(28), incorporated by reference at UCOTA § 3(b)(3).

174. *See generally supra* Parts III.B., C. & E.

175. 436 B.R. 120 (Bankr. D. N.D. 2010).

the fact that the debtor's possession of the CT was wrongful and the result of a unilateral mistake with advantage taken.

Arguably this analysis is incorrect under Article 9, as section 9-311(b) suggests that this issue should be treated like an unfiled termination statement.[176] In any event, the resulting forfeiture of the security interest illustrates again the dangers of a poorly-drafted CT law in the hands of some courts. UCOTA is clear in avoiding this result.[177]

IV. Entrustment—The Role of UCC Article 2

In *Madrid v. Bloomington Auto Co.*,[178] the UCC Article 2 entrustment provisions[179] rather than the CT statute determined the rights to ownership of a vehicle because a CT statute is a "registration" system and not an exclusive "ownership" system. While as noted below this is correct, it runs the risk of understating the role of the CT law, an error repeated through-out the court's opinion that somewhat impairs the analysis, although the court reached the correct result.

In *Madrid*, defendant 1 (Used Car Dealer) operated a used car dealership and from time to time utilized defendant 2 (New Car Dealer), a new car dealership, to "share" sales leads. Typically, the arrangement between Used Car Dealer and New Car Dealer was that a purchaser would pay the New Car Dealer for one of its vehicles as sold by the Used Car Dealer, and New Car Dealer would pay Used Car Dealer a "finder's fee."

The *Madrid* plaintiffs contacted Used Car Dealer, from whom they had previously purchased new and used cars, about purchasing a used car. Used Car Dealer located an appropriate vehicle at New Car Dealer's premises and requested that New Car Dealer deliver it to Used Car Dealer so the plaintiffs could inspect it. After the plaintiffs purchased the car via Used Car Dealer, the latter collected the proceeds and promised to deliver the CT, paperwork, and a mobile phone the next day. Unbeknownst to the plaintiffs, however, Used Car Dealer was not authorized to sell the vehicle because it had not purchased it from New Car Dealer. When Used Car Dealer failed to deliver any of the sales or ownership documentation or promised accessories to the plaintiffs, they filed a complaint against both dealers, seeking possession of an executed CT covering the vehicle.

The *Madrid* court addressed two issues: (1) whether the transfer of ownership of a vehicle is governed by the state CT law or by the UCC Article 2 sales of goods provisions; and (2) whether the plaintiffs, as buyers of the vehicle, received ownership under the entrustment provisions of UCC Article 2.[180]

The *Madrid* court concluded that Indiana's UCC provisions on the sale of goods should govern the transfer of ownership to the vehicle. The court correctly reasoned that the purpose of Indiana's CT law is to create procedures and methods for filing and registering public notice of ownership and security interests, and in this sense it acts as a registration system. Unlike an exclusive "ownership" system, where rights do not pass until specified formalities are executed, under a registration system the registry is supplemented by standard commercial laws governing vehicle ownership.[181]

The court determined that the buyers received ownership of the vehicle pursuant to the entrustment provisions of UCC Article 2 because: New Car Dealer entrusted the vehicle to Used Car Dealer; Used Car Dealer was a merchant who dealt in goods of that kind; and the buyers were BIOCOB's.[182] The court also observed that this analysis and result is consistent with the UCC policy of placing the burden on the entrusting party (New Car Dealer), as the party in the best position to prevent fraudulent transactions.

The *Madrid* decision was correct, and the analysis noted immediately above is clearly correct, but this case still reflects some of the all-too-common confusion over the relation between CT laws and the UCC (here, UCC Article 2). Of course, there is no question that Article 2 applies to the sale of a vehicle (as a sale of goods[183]); and there is no doubt that the CT law is supplemented by other commercial law; but that does not mean the CT law is inapplicable on the facts of *Madrid*. The *Madrid* court's efforts to get the case outside of the CT law (by reasoning that the Indiana CT law covers only "registration," and not "ownership") is disingenuous. In fact, although the CT law is a "registration" rather than an exclusive "ownership" system, both UCC Article 2 and the CT law apply to ownership issues, and it is the interaction between them that resolves the issues in these types of cases.

The dispositive rule in *Madrid* was indeed the Article 2 entrustment rule, although the CT law also could be relevant, *e.g.*, to determine whether the buyers qualified as BIOCOBs (an essential element of the entrustment rule) despite the lack of a CT. UCOTA confirms the *Madrid* result and clarifies these issues by essentially adopting section 2-403 at UCOTA section 18 and specifying that BIOCOBs can prevail in these circumstances despite the lack of a CT. This makes clear the correct result without the necessity of the analytical gyrations of the *Madrid* decision.

176. *See* UCC §§ 9-311(b), 9-513(d) (CT lien entry "is equivalent to filing a financing statement" under Article 9; termination statement is effective "upon…filing…with the filing office….").

177. *See* UCOTA §§ 25, 26.

178. 782 N.E.2d 386 (Ind. Ct. App. 2003).

179. *See* UCC § 2-403(2), (3). *See also infra* Part V.D.

180. *See id.*, and statement of facts *supra* at notes 178 – 179.

181. Thus, UCC Article 2 applies to the sale of a vehicle. UCOTA makes this clear, as does the UCC. *See* UCOTA § 3; UCC § 1-103(b). It is sometimes surprising to your authors how many public officials apparently do not understand this basic point. *See also infra* note 183.

182. *See supra* note 181; *supra* Part II.A. (BIOCOB rules); *infra* note 183 (scope of UCC Article 2).

183. *See* definition of "Goods" at UCC § 2-105(1); scope of UCC Article 2 as defined at *id.* § 2-102. *See also infra* Part V.D.

V. Fraudulent Lien Release and Subsequent Purchasers—the *NXCESS* Case

A. Introduction

In *NXCESS Motor Cars v. JPMorgan Chase Bank*,[184] the Court of Appeals of Texas, Houston (1st Dist.) affirmed a questionable decision of the trial court on the impact of a fraudulent lien release. In *NXCESS*, James Cavazos (Cavazos) purchased a new Mercedes-Benz automobile (the vehicle) from a Mercedes dealer, and financed the purchase by granting a purchase-money security interest to JPMorgan Chase (Chase), which was duly perfected by a "lien entry" on the original Texas CT. Cavazos then obtained a duplicate CT ("a certified copy of the original [CT]") and executed a forged lien release.[185]

The duplicate CT was executed to Avatar Trust (by execution of the "assignment of title" form on the back of the certified copy of the CT[186]), and along with the forged lien release this was used to sell the vehicle to Avatar Trust. Avatar Trust then submitted this documentation to the Texas CT office and obtained a new CT indicating Avatar Trust as the owner and that there was no security interest in the vehicle. The validity of this CT is a crucial issue in the court's analysis, affecting the ability of innocent parties to rely on a CT; the analysis on this issue is also the most questionable aspect of the *NXCESS* court's opinion.

The vehicle was then sold by Avatar Trust to NXCESS, which resold the vehicle to Xavier Valeri (Valeri), who financed the purchase by granting a security interest to U.S. Bank. There is every indication that each of these parties, beginning with Avatar Trust, was a good faith purchaser (GFP) under UCC Article 2,[187] and NXCESS specifically alleged that it went beyond what is required in performing "the usual and customary due diligence to determine good, clean, clear title."[188] Of course, no amount of reasonable due diligence by NXCESS would have discovered the Chase security interest, as it had been released of record by reason of the forged lien release.[189]

When all of this came to light, Chase sued Cavazos for fraud and conversion, and the Texas CT office, Valeri and U.S. Bank for conversion and a declaration that its security interest had priority over all subsequent ownership and secured claims. When Chase moved for summary judgment, NXCESS responded because Valeri and U.S. Bank had sued NXCESS on various breach of contract, warranty and Deceptive Trade Practices Act claims.[190] NXCESS argued that it and Valeri were BIOCOBs who took free and clear of Chase's security interest.[191] The trial court granted Chase's motion for summary judgment, ordered Valeri to deliver possession of the vehicle to Chase, declared Chase's security interest superior to all other claims and interests, and directed the CT office to issue a new CT to Chase. The court of appeals affirmed.[192]

B. Forged Lien Release Created Void CT

On rehearing, the court of appeals again rejected the argument that NXCESS and Valeri qualified as BIOCOBs.[193] It is here that the court of appeals, like the trial court,[194] went astray. It is irrelevant whether NXCESS was a BIOCOB, and whether it bought the vehicle "from a person…in the business of selling goods of that kind," as required in the definition of BIOCOB at UCC section 1-102(b)(9).[195] This does not matter, because UCC section 9-320(a) only protects a BIOCOB from a security interest created by the seller. Instead of recognizing this basic point as dispositive, the court of appeals ventured into an unnecessary (and erroneous) analysis as to whether the CT issued to NXCESS was "void."

It should be noted that the *NXCESS* court's errors in this respect were largely a compounding of similar errors in a case from the Austin Court of Appeals.[196] Both *NXCESS* and *Lee* extrapolated, from the Texas Supreme Court's prior and very reasonable conclusion that a forged CT does not transfer ownership,[197] that an otherwise effective transfer of ownership is rendered ineffective if accompanied by a forged lien release.[198] There is no apparent basis, in any law, for this extrapolation. Clearly, there are numerous ways that the owner of a vehicle can transfer ownership to a buyer;[199] and without doubt one of those ways is by execution of a validly-issued duplicate CT by the owner to the buyer. A forged lien release

184. 317 S.W.3d 462 (Tex. App.—Houston [1st Dist.] May 20, 2010) (on rehearing); *see also id.*, 2010 Tex. App. LEXIS 1143 (Tex. App. Feb. 18, 2010). For further background, and analysis of the decision of the court below, *see* David B. McCrea & Alvin C. Harrell, *Overview and Update on Vehicle Secured Transactions, Certificates of Title, and Related Issues,* 64 Consumer Fin. L.Q. Rep. 642, 366-67 (2010).

185. *NXCESS*, 317 S.W.3d at 464.

186. *Id.*

187. *See* UCC § 1-201(b)(20), (29), (30); UCC § 2-403.

188. *NXCESS*, 317 S.W.3d at 464.

189. Theoretically, Avatar Trust could have contacted Chase to confirm the validity of the lien release, or inquired of Cavazos where he got the funds to pay off the prior lien. However, this is neither customary nor, perhaps, economically feasible or effective given the practicalities involved. In any event, NXCESS did not have the information needed to do so, and in a correct analysis the UCC warranty of title shifts the resulting loss back to Avatar Trust, who bore this risk. *See* UCC § 2-312, and discussion *infra*.

190. *NXCESS*, 317 S.W.3d at 465. *See also* UCC Article 2 § 2-312 (warranty of title). If Chase prevailed against Valeri and U.S. Bank, presumably in turn they would prevail against NXCESS. *NXCESS*, 317 S.W.3d at 465.

191. Note that this argument is disingenuous, as UCC § 9-320(a) only protects the BIOCOB against a security interest created by the immediate seller.

192. *See supra* note 184.

193. *NXCESS*, 317 S.W.3d at 467.

194. *See* McCrea & Harrell, *supra* note 184.

195. Tex. Bus. & Com. Code § 13201(9) (Vernon 2009), quoted by the *NXCESS* court, 317 S.W.3d at 467, without apparent recognition of this point.

196. Lee v. The Bank, N.A., 23 S.W.3d 129 (Tex App.—Austin 2000, no pet.). The factual similarity of *NXCESS* to *Lee* is striking and lends credence to the notion that these issues and scenarios are not uncommon.

197. Drake Ins. Co. v. King, 606 S.W.2d 812 (Tex. 1980). Absent, of course, a dispositive preclusion or estoppel. *See, e.g.*, Alvin C. Harrell, *Can a Buyer and Secured Party Rely on a Certificate of Title—Part One*, 60 Consumer Fin. L.Q. Rep. 224 (2006).

198. *NXCESS*, 317 S.W.3d at 467: "[In *Lee*, the] Austin Court of Appeals…extended [the Texas Supreme Court's *Drake*] holding to include situations in which the [CT] itself is not forged, but a release of lien, on which the [CT] is based, is forged." An obvious flaw in this reasoning is that the CT issued to NXCESS by the Texas CT office was not "based on" the lien release, it was based on assignment of the valid duplicate CT, executed by the owner of the vehicle. This was clearly sufficient to transfer ownership and is a far cry from the forged CT at issue in *Drake*.

199. *See, e.g.*, discussion of related issues, *supra* at Part II.

is not effective to terminate the security interest,[200] but does not render void an otherwise effective transfer of ownership.[201]

The *NXCESS* and *Lee* courts reasoned that "the buyer acquires no title when any link in his chain of title is forged."[202] This is true as a general proposition. But, of course, there was no ownership link that was forged in either of those cases. A lien or security interest is a property interest, but it is not ownership.[203] A bogus lien or lien release may inappropriately impair rights relating to an incumbrance, and this may create hidden risks for parties claiming an ownership interest. These issues and scenarios may require (as provided in UCC Article 9 for interstate transactions) perfection and priority rules to sort out the priorities of competing claims,[204] but they do not represent any break in the chain of title or impair otherwise valid transfers of ownership rights.

The *NXCESS* court's analysis of these issues does not support its conclusion that this was a case where "a forged document on which the [CT was] based void[ed] that [CT]."[205] If this statement were true, any unauthorized signature on peripheral documentation separate from the assignment of ownership could be used to void the CT and the ownership interests of innocent parties who reasonably relied on a CT issued by the state.[206] This would sharply reduce the utility of CTs in facilitating millions of routine transactions; and, as illustrated in *NXCESS*,[207] there would be no means to protect against these risks (except perhaps by adding an expensive new layer of title insurance requrements). Moreover, as noted, this entire line of analysis was unnecessary, and it does not matter whether NXCESS qualified as a BIOCOB: even if it did it would not take free of Chase's security interest because that security interest was not created by the seller (Avatar Trust).[208]

C. Proper Analysis

In a proper analysis, Avatar Trust received a valid transfer of ownership from Cavazos (the owner of record), subject to Chase's perfected security interest (the forged lien release being ineffective). Avatar Trust was not a BIOCOB (because, *e.g.*, Cavazos was not a merchant), and thus the sale to Avatar Trust did not cut off the Chase security interest under UCC section 9-320(a);[209] the subsequent owners (NXCESS and Valeri) may have been BIOCOBs, if (unlike Avatar Trust) they bought the vehicle from sellers who sold goods of that kind in the ordinary course of business;[210] however, as noted, this makes no difference as against Chase, because UCC Article 9 section 9-320(a) only protects a BIOCOB from security interests created by his or her seller.[211] In *NXCESS*, Cavazos (who granted the security interest to Chase) was not the seller to NXCESS or Valeri, and therefore the Chase security interest was unaffected even if these subsequent buyers were BIOCOBs. Instead of recognizing this, the *NXCESS* court concluded that the subsequent buyers (NXCESS and Valeri) were not BIOCOBs because "[n]one of the subsequent purchasers took valid title to the car[,]"[212] a clearly erroneous and unnecessary view under any of the applicable laws.

The *NXCESS* court similarly mishandled its analysis of the argument that NXCESS acquired "good title" under the voidable title rules at UCC Article 2 section 2-403(1).[213] NXCESS argued that its transferor (Avatar Trust) acquired voidable title from Cavazos (the fraudster), and therefore could transfer "good title" to a good faith purchaser for value (GFP) such as NXCESS. In fact, there should be no doubt that NXCESS was a GFP, and acquired "good title" (*i.e.*, ownership), though this ownership was subject to Chase's security interest.[214] Indeed, since Cavazos had "good title" (again, ownership subject to Chase's security interest), and transferred that ownership interest to Avatar Trust by execution of a valid CT, Avatar Trust had more than "voidable title": Avatar Trust acquired full ownership, good against any competing ownership claims, subject only to the security interest of Chase. So it was disingenuous (and unnecessary) for NXCESS to argue that it became the owner only because its transferor had voidable title under UCC section 2-403. Even if NXCESS had succeeded with this dubious (and unnecessary) argument, it would not have affected the outcome: The "voidable title" (and "transaction of purchase") rules of section 2-403 merely allow the transfer of a seller's rights free of adverse claims by competing owners; they do not cut off previous security interests perfected under Article 9--only Article 9 does that.[215]

So the *NXCESS* court's tortured line of reasoning (essentially, that Avatar Trust did not acquire voidable title because it did not defraud Cavazos, the fraudster!) was entirely unnecessary and inappropriate (and irrelevant—as

200. Any more than any other forgery is effective, absent estoppel. *See, e.g.*, Harrell, *supra* note 197.

201. Except, apparently, in parts of Texas.

202. *NXCESS*, 317 S.W.3d at 467, quoting *Lee*, 23 S.W.3d at 131.

203. *See, e.g.*, UCC Article 9 Part 6, carefully governing the procedures needed to convert one to the other.

204. *See, e.g.*, UCC §§ 9-316(d), (e) & 9-337.

205. *NXCESS*, 317 S.W.3d at 467, quoting *Lee*, 23 S.W.3d at 131, and citing Dublin Nat'l Bank v. Chastain, 167 S.W.2d 795 (Tex. Civ. App.—Eastland 1942, writ ref'd).

The *NXCESS* court quoted *Dublin* as follows: "Proof of forgery of a link of title is tantamount to proof that the claimant of such title has none, or, in other words, that he is not the owner of the property." *Dublin*, 167 S.W.2d at 797. However, as noted, it could not be more clear that there was no "forgery of a link of title" in *NXCESS*. Moreover, note that the rationale of the *NXCESS* court means that a fraudster can execute a valid CT to an innocent purchaser and then claim that he or she is still the owner of the vehicle by reason of an intentional forgery of extraneous documentation.

The *NXCESS* court recognized that "none of the [CTs] involved in this chain of transactions are forged…." *NXCESS*, 317 S.W.3d at 467. However, the court did not seem to recognize the implications for its analysis.

206. That is, of course, exactly what happened in *NXCESS*: "Avatar Trust [the buyer who received execution of the CT from the owner] thus had no title…." *NXCESS*, 317 S.W.3d at 467.

207. *See* description of facts, *supra* this text and notes 185-187.

208. *See supra* this text and notes 187-192.

209. *Id.*

210. *Id.*

211. *Id.*; and UCC § 9-320(a).

212. *NXCESS*, 317 S.W.3d at 468.

213. *Id.* at 468 – 69. The court did not address the alternative "transaction of purchase" rules at § 2-403(1).

214. *See, e.g.*, UCC § 9-315(a)(1); *supra* this text Part V.B.

215. *See, e.g.*, UCC §§ 9-320, 9-337 (not applicable on these facts).

was the NXCESS argument on the same issue). In the end, the court relied on the mistaken notion that a forged lien release voids the entire CT, so that Avatar Trust (and consequently NXCESS and Valeri) received no ownership interest whatsoever by reason of the successive executions of otherwise valid CTs.[216]

D. Relation Between the CT Law and UCC

NXCESS also argued that the Texas CT statute[217] conflicts with the Texas UCC,[218] so that the former should be preempted by the latter.[219] Specifically, NXCESS argued that section 501.134(c) of the Texas CT law,[220] which states the basic law of assignment (and was relied on by Chase to make NXCESS subject to the security interest created by Cavazos[221]), is inconsistent with the "voidable title" rules of UCC Article 2 section 2-403.[222]

On this issue the *NXCESS* court's initial analysis is sound: The court noted that both the Texas CT law and UCC Article 2[223] apply, and "essentially state that a subsequent purchaser cannot acquire greater rights and title than their transferor has, although [Texas UCC] section 2.403 [section 2-403 in the uniform text] creates an exception when a person with voidable title transfers the goods to a good-faith purchaser for value: the purchaser receives good title."[224] This recognizes a theme that runs through-out the UCC; *i.e.*: codifying the law of assignments (limiting the transferee to the rights of the transferor) while creating exceptions to provide additional rights in specified innocent parties.[225]

However, the *NXCESS* court subsequently concluded that the section 2-403 GFP rules protecting innocent purchasers were not applicable because Avatar Trust held void, not voidable title, because it accepted the forged lien release; therefore, Avatar Trust and all subsequent ownership claimants "received void title to the vehicle due to the forgery in the chain of title."[226] In fact, as noted above,[227] Cavazos validly conveyed his ownership interest to Avatar Trust, by executing an assignment of the CT valid under every applicable law: the CT statute; UCC section 2-401; and the common law of contracts. This divested Cavazos of all ownership rights,[228] and transferred "good title" (*i.e.*, ownership) to Avatar Trust, subject to the prior security interest of Chase.

Thus, Avatar Trust (and the subsequent owners) had more than void or even voidable title: They had ownership (subject, as are many owners, to a security interest); the entire voidable title regime at UCC section 2-403 was unneeded and inapplicable, as was the analysis of ownership and "void title" generally. Avatar Trust, NXCESS, and Valeri all, in turn, acquired ownership (*i.e.*, "good title") of the vehicle; but this was irrelevant to the issue in the case, because ownership does not protect the owner from a prior perfected security interest.[229] The failure of the court to recognize this basic, dispositive point apparently led the court down the path of finding a perfectly valid assignment of ownership to be entirely "void" because it was accompanied by an ineffective lien release.

E. Liability for Conversion

The chain of analytical errors noted above in turn led the *NXCESS* court to affirm the trial court's conclusion that Valeri committed conversion by exercising control over the vehicle and refusing to "return" it to Chase.[230] There is no doubt that Chase was entitled to repossess the vehicle, under UCC Article 9.[231] But there also should be no doubt that Valeri was the owner of the vehicle,[232] and as such could not be liable for conversion of his own property. On this issue there was no need for Valeri to

216. *NXCESS,* 317 S.W.3d at 468. The court took the opportunity of this context to repeat its prior errors: "The protection usually afforded to a bona fide purchaser for value without notice does not apply when such purchaser's claim is dependent upon a forged instrument." *Id.*, at 468-69, quoting Kirkpatrick Joint Venture v. Loots, 826 S.W.2d 205, 210 (Tex. App.—Fort Worth 1992, writ denied), without apparent consideration of the fact that none of the ownership interests in *NXCESS* was dependent on a forged instrument. *See supra* this text at notes 193-212.

217. Tex. Transp. Code Ch. 501.

218. Tex. Bus. & Com. Code Chs. 1-9.

219. Normally there should be no conflict between a CT statute and UCC Article 9, as the former is dependent on the scope provisions of the latter, which clearly delineate the relation between the two laws as to all but a few issues. *See* UCC § 9-109 (Article 9 is the governing state law for security interests in personal property, except as it provides otherwise); *id.* § 9-310 (perfection by filing is required, except as stated otherwise); *id.* § 9-311(a) (exception to perfection by filing for goods subject to a CT statute; in such cases Article 9 defers to the CT statute, but only as regards the mechanics of perfection).

However, there is no such clarity as to the relation between the CT statute and UCC Article 2, unless a statute like UCOTA is enacted (which resolves this conundrum by way of creating consistency between the laws). For example, the *NXCESS* court noted that First Nat'l Bank v. Buss, 143 S.W.3d 915 (Tex. App.—Corpus Christi 2004, pet. denied), held that UCC Article 2 § 2-401 (transfer of ownership) conflicts with and supercedes Tex. Transp. Code §§ 501.071(a) and 501.073. *See NXCESS*, 317 S.W.3d at 469. This sometimes leads to interpretations that create unnecessary and irreconcilable conflicts between the CT law and the UCC, as in *NXCESS*, with corrosive effects on the judicial construction of both statutes. *See, e.g.*, further discussion below.

220. *See* Tex. Transp. Code Ann. § 501.134(c).

221. An unnecessary argument: *See* UCC Article 9 § 9-315(a)(1).

222. Another unnecessary argument. The latter are clearly exceptions to the former. *See NXCESS,* 317 S.W.3d at 470. *See generally supra* this text at Part V.C.

223. Tex. Transp. Code § 501.134(c); Tex. Bus. & Com. Code § 2.403(a) (UCC § 2-403(a)).

224. *NXCESS,* 317 S.W.3d at 470, citing Tex. Bus. & Com. Code § 2.403(a). *See also* related issues and an additional exception noted *supra* at Part V.

225. *See, e.g.*, UCC §§ 3-203(b), 3-305(b) & 3-306; *id.* §§ 9-315(a), 9-320(a).

226. *NXCESS*, 317 S.W.3d at 470. *See* rebuttal to this analysis, *supra* this text at Part V.C. At this point in the *NXCESS* opinion, the court provided a footnote addressing the argument that Avatar Trust received assignment of ownership quite aside from the CT; the court rejected this argument, on grounds that recognizing such a transfer would defeat the CT statute's "goal of disclosing existing liens." *NXCESS,* 317 S.W.3d at 470. Suffice it to say that there is no evidence of a legislative intent in the CT statute to wipe out the entire law of assignment on this basis. *See also infra* Part VI. But again, it would be nice if the CT law made this clear, as do UCOTA and the UCC. *See supra* this text and note 181; *supra* Part III.F.

227. *See supra* this text at Part V.C.

228. Note again that the *NXCESS* court's conclusion that Avatar Trust and its successors had "void title" would mean that the wrongdoer (Cavazos) who defrauded these innocemt parties would be rewarded by retaining ownership despite selling the goods and being paid for an apparently valid transfer of that ownership. *See supra* notes 201, 205 & 206.

229. *See* UCC § 9-315(a).

230. *NXCESS*, 317 S.W.3d at 470. Chase, of course, was not and never had been the owner; its rights were limited to repossession and enforcement of its security interest under Article 9 Part 6. The only person to whom ownership could be "returned" as a result of voiding the CT was the perpetrator (Cavazos), who obviously was not entitled to ownership or possession of the vehicle. *But see supra* note 228

231. *See* UCC § 9-609.

232. *See supra* This text Parts V.B., C., & D.

argue that he was a GFP or BIOCOB;[233] this was irrelevant, as such status would provide no protection against a security interest created by a person other than the immediate seller (NXCESS).[234]

In *NXCESS*, Valeri needed only to demonstrate ownership, in order to avoid liability for conversion. The court had apparently foreclosed this argument by its erroneous and unnecessary holding that Valeri had "void title." Thus, we are treated to the spectacle of an innocent owner (who apparently qualified as both a GFP and a BIOCOB for other purposes), who held a state-issued CT issued in his name that was traced through an unbroken line of valid CT assignments by the prior owners, being held liable for conversion of his own property.

VI. Assignments of Security Interests Perfected by CT Lien Entry

The issue of whether an assignment of a security interest perfected by a CT "lien entry"[235] must be recorded with the CT office (or by reissue of the CT), as called into question by the infamous decision of a Texas bankruptcy court,[236] has seemingly been put to rest. The bankruptcy court's decision was heavily criticized by commentators,[237] rejected by other courts[238] and the Texas legislature,[239] and ultimately reversed on appeal.[240] Now, all that remains is to consider the state of the law in the aftermath of these developments. A good starting point is the the 2010 district court decision reversing the bankruptcy court's 2008 decision.

The good news is that the traditional principles of the law of assignments generally have been preserved, if not expressly articulated. However, consistent with the judicial principle of deciding only the narrow issue presented, and given the state-specific orientation of CT laws, the judicial resolution in *Clark* is focused on Texas statutory interpretation and thus has a limited effect on broader issues.

Despite this, however, there are some kernels of general interest in the district court's *Clark* decision.[241] First, in addition to the assignment issue noted above, the district court expressly recognized that the 2009 amendment to the Texas CT law also clarified that a CT lien entry perfection of a security interest gives the secured party priority over the rights of a judicial lien creditor.[242] While this should be clear from Article 9 (which governs the priority issue[243]), this basic point was called into question by some of the most troubling language in the bankruptcy court's *Clark* decision.[244]

Both the Texas legislature, in amending the Texas CT law, and the district court in its *Clark* decision, essentially rejected the bankruptcy court's suggestion that a competing party (including the successor or equivalent to a lien creditor) could prevail over a security interest perfected by a prior CT lien entry.[245] Moreover, both the district court and the authority it cites note that the issue of priority is governed by Article 9, and that CT lien entry perfection is treated as perfection by filing for Article 9 priority purposes.[246]

The district court specifically considered arguments to the contrary, including the argument that the bankruptcy debtor was contesting only the perfection of the security interest (an issue governed by the CT law, pursuant to UCC section 9-311(a)), not the validity or enforceability of an assignment.[247] This was a cogent argument, given the Article 9 deference to the CT law on the issues.[248] However, the district court correctly pointed out that, once the security interest is perfected pursuant to the CT lien entry system, a subsequent assignment of that security interest (including the issue of continuing perfection and priority) is governed by other law (including UCC section 9-310(c)).[249] The district court rejected the bankruptcy court's conclusion that the CT law "bests the UCC," and that there is a "complete deference by the UCC to state [CT] statutes."[250]

There are some minor disappointments in the district court's opinion. Having properly recognized the relative scope of the CT law and its relation to UCC Article 9, the court focused on the 2009 amendments to the Texas CT law as evidence of the legislature's intent.[251] While generally this is a fine idea (and in this case made for an easy decision), it may distract from a broader recognition that the issues are governed by Article

233. *See NXCESS*, 317 S.W.3d at 471 (rejecting the argument that Valeri was a BIOCOB); *supra* Part V.B.

234. *See* UCC § 9-320(a). Here, the Chase security interest was created by Cavazos, not NXCESS. *See supra* this text Part V.A.

235. Regarding CT "lien entry," *see supra* notes 2 & 5.

236. *See In re* Clark Contracting Services, Inc., 399 B.R. 789 (Bankr. W.D. Tex. 2008); *supra* Part III.F.3.

237. Including Barkeley Clark and your author. *See, e.g.,* Red Flag: *Texas Court Requires Assignees of Vehicle Contracts to Get Lien Noted on New Certificate of Title,* Clark's Secured Transactions (Feb. 2009); Alvin C. Harrell, Case Note, Clark Contracting Services, Inc. v. Wells Fargo: *Does an Assignee of a CT Lien Entry Become Unperfected?,* 62 Consumer Fin. L.Q. Rep. 274 (2008).

238. *See, e.g., In re* Scott, 427 B.R. 123 (Bankr. S.D. Ind. 2010) (describing the bankruptcy court's *Clark* decision as an "anomaly" and citing Barkley Clark, *supra* note 237, and Harrell, *supra* note 237); *In re* Johnson, 407 B.R. 364 (Bankr. E.D. Ark. 2009); *In re* Gaines, 414 B.R. 494 (Bankr. E.D. Ark. 2009).

239. In June 2009 the Texas legislature revised the Texas CT statute to make clear that assignment of a security interest perfected *(Continued in next column)*

239. *(Continued from previous column)*

by a CT lien entry does not require a filing with the CT office or reissuance of the CT in order to preserve the perfection for the assignee. *See* Texas Senate Bill 1592, 81st Leg., Reg. Sess. (Tex. 2009), amending Tex. Transp. Code Ann. § 501.114 (Vernon 2007). The legislature made clear that this was a clarification, not a change in the law, so that it has retroactive effect. *Id.*

240. *In re* Clark Contracting Services, Inc., 438 B.R. 913 (D.C. W.D. Tex. 2010); *supra* Part III.F.3.

241. *Id.*

242. *Id.*

243. *See* UCC §§ 9-109, 9-317.

244. *See* discussion of this issue in Harrell, *supra* note 237.

245. *See Clark*, 438 B.R. at 922 – 925 (citing: Michael D. Jewesson, *Texas Legislature Passes Certificate of Title Bill Negating Effect of Clark Contracting Decision*, 28 No. 8 LJNEQLN 1, at 1 – 2 (Sept. 2009); and Tex. S.B. 1592 § 4, amending Tex. Transp. Code Ann. § 510.113(b) (Vernon 2007)).

246. *Id.* (citing UCC § 9-311(b)).

247. *Id.*

248. *Id.* (citing UCC § 9-311(a)).

249. *Id.* (noting that under § 9-310(c) "assignees of perfected security interests…enjoy the perfected status of their assignors."). *See also supra* Part III.F.

250. *Clark*, 438 B.R. at 919.

251. *See, e.g., id.*, as well as the court's subsequent discussion.

9, which did not change, rather than the CT law. Moreover, the district court referred to the resulting priority of the assignee as a "relation-back" that occurs despite the lack of a "re-titling." While relation-back might be an apt concept in the context of reissuing a new CT to reflect the assignee's retention of priority,[252] your author has some discomfort with the use of this terminology in the context of security interest assignments generally: The original perfection (and priority) is simply transferred to the assignee; there is nothing that should be said to "relate back" in a legal sense.[253]

The district court is to be commended for recognizing fundamental aspects of the relation between the CT law and Article 9, and that the bankruptcy court "created an unnecessary conflict between the Texas [CT] statute and the UCC."[254] The deference of Article 9 to the CT law, at Article 9 section 9-311(a), is expressly limited to the procedure for CT lien entry perfection (which is treated like a filed financing statement for most purposes, pursuant to section 9-311(b)), and assignments are also governed by section 9-310(c).[255] Unless the CT statute explicitly requires reissuance of the CT as a prerequisite to perfection, these Article 9 rules are the governing law.[256] Again, the only real weakness in the district court's analysis of these issues is the periodic suggestion that Article 9 controls because the CT law says so.[257]

The district court also cited public policy considerations, all of which (though unnecessary to the analysis) weigh against the bankruptcy court's decision.[258] In all, the district court's analysis is a good treatment of the issues, despite a somewhat excessive reliance on amendment of the Texas CT law that gives the decision an unnecessarily narrow focus. In the end, the law of assignment was preserved in Texas, and the proper role of the UCC was mostly recognized. Not a bad day's work for the United States District Court, Western District of Texas, San Antonio Division.[259]

VII. Some Quirky Repossession and Notice Issues

It is clear that UCC Article 9 does not require notice to a defaulting debtor prior to the repossession of collateral.[260] However, some lawyers have been able to mix and match other laws and theories to create a cause of action for failure to give such a notice.

For example, in *Buzzell v. Citizens Auto. Fin., Inc.*,[261] the debtor successfully alleged that a course of conduct between the debtor and secured party (in which the secured party accepted late and partial payments and tolerated a default status) modified the terms of the security agreement[262] to preclude repossession without prior notice that the modification was revoked. Since the vehicle was repossessed without such notice, the repossession was unauthorized and constituted conversion and trespass. Moreover, since the federal Fair Debt Collection Practices Act (FDCPA)[263] prohibits (as an "unfair or unconscionable means to collect a debt") the "[t]aking…[of] any nonjudicial action to effect dispossession…of [collateral] if…[t]here is no present right to possession…[,]"[264] the repossession was also a violation of the FDCPA.

Nonuniform, state-specific notice requirements also may affect these issues. For example, in *Wilder v. Toyota Fin. Servs. Ams. Corp.*,[265] a Massachusetts law[266] provided the debtor a right to cure not afforded in the UCC. The court agreed with the debtor's argument that the secured party's related freeze on her electronic payment account may have prevented exercise of her right to cure, and allowed the debtor's claims for fraud, and breach of the duties of good faith and fair dealing, to go forward in a jury trial (denying the secured party's motion to dismiss). In *Aguayo v. U.S. Bank, N.A.*,[267] the debtor's claim that a national bank had failed to comply with post-repossession notice requirements in California's Rees-Levering Act survived the bank's federal preemption defense.

Other post-default notices (*e.g.*, of the disposition sale or accounting for the deficiency[268]) also can give rise to litigation, despite the relative clarity of Article 9.[269] One remaining question, at least in some jurisdictions (as a result of the decision to leave the issue unaddressed in Article 9), is how much notice must be given

252. Perfection and priority of the new lien entry would relate back to the original CT lien entry.

253. *Cf.* the relation-back that occurs when a security interest is perfected within a grace period and consequently "relates-back" to the beginning of that period. *See, e.g.*, UCC §§ 9-317(e), 9-324(a).

254. *Clark*, 438 B.R. at 922.

255. *Id.* (noting that this is explained in PEB Commentary No. 12, which was considered but rejected by the bankruptcy court).

256. *Id.*

257. *See id.* ("Finally, even if there were a conflict between the [Texas CT law] and the UCC, the [Texas CT law] states that the UCC rule prevails."). *Cf.* UCC §§ 9-109, 9-310, 9-311.

258. *Id.*

259. District Judge Fred Biery. The decision of the bankruptcy judge was reversed, and the case was remanded with instruction to grant Wells Fargo's motion for partial summary judgment. *Clark*, 438 B.R. 925.

260. *See, e.g.*, UCC § 9-609 (secured party's right to take possession of collateral upon default); *cf.* Article 9 notice requirements, *e.g.*, at *id.* §§ 9-611 – 9-614.

261. 2011 WL 2728299, 2011 U.S. Dist. LEXIS 75820 (D. Minn. July 13, 2011).

262. *See, e.g.*, UCC § 1-303(a), (b). Other issues may arise in "spot delivery" scenarios, where the dealer seeks to rescind the transaction and repossesses the vehicle without prior notice, *e.g.*, due to an inability of the dealer to sell the credit contract. *See, e.g.*, Cappo Mgmt., Inc. v. Britt, 711 S.E.2d 209 (Va. 2011) (statutory damages under UCC Article 9 for wrongful repossession).

263. 15 U.S.C. §§ 1692 – 1692p (2006).

264. *Id.* § 1692f(6)(A).

265. 764 F. Supp.2d 249 (D. Mass 2011).

266. Mass. Gen. Laws ch. 255B, § 20A(e).

267. 653 F.3d 912 (9th Cir. 2011). *But see* Epps v. JPMorgan Chase Bank, N.A., 2010 WL 4809130 (D. Md. 2010) (state-specific post-repossession notice in Maryland law preempted by federal law); Baptista v. JPMorgan Chase Bank, N.A., 640 F.3d. 1194 (11th Cir. 2011) (Florida law limiting bank's check-cashing fees was preempted by federal law). These cases predate the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010); however, the Office of the Comptroller of the Currency (OCC) has taken the position that the Dodd-Frank Act does not alter the appropriate analysis of these issues. *See, e.g.*, Stephen F.J. Ornstein & William W. Carpenter, *OCC Proposed Rule Implementing Dodd-Frank Changes to Preemption and Visitorial Powers*, 65 Consumer Fin. L.Q. Rep. 3 (2011).

268. *See* UCC §§ 9-611 – 9-616.

269. *Id. See generally* Hartt v. Flagship Credit Corp., 2010 WL 2736959 (E.D. Pa. July 8, 2010), noted in John Krahmer, *2010-2011 UCC Update*, 65 Consumer Fin. L.Q. Rep. 64, 74 (2011); Colonial Pacific Leasing Corp. v. Elite S-W Mo., Inc., 2010 WL 3119448 (W.D. Mo. 2010), noted in Stephen L. Sepinuck, *Secured Transactions and Bankruptcy Developments*, 65 Consumer Fin. L.Q. Rep. 96, 115 (2011).

before disposition of repossessed consumer goods.[270] In *Hudson v. Eaglemark Sav. Bank*,[271] the debtor argued that the ten day notice given to the debtor of a proposed Article 9 disposition sale of consumer goods (a motorcycle) was not a sufficient "reasonable time" under UCC section 9-612, partly on grounds that the state retail installment sales law required fifteen days prior notice.[272] The *Hudson* court correctly noted that the retail installment sales law applies only to credit sales by dealers, not loans, and was not applicable to the lender's loan to the debtor. The debtor also argued that the notice of sale was deficient because it did not include: an itemized statement of the amounts due; the current location of the motorcycle;[273] and provision for return of the debtor's other personal items.[274] The court concluded that the ten days notice provided to the debtor was sufficient under UCC section 9-614 and need not include the omitted components.[275]

In *In re Harward*,[276] the secured party's notice of intent to sell repossessed collateral of a bankruptcy Chapter 7 debtor did not violate the Bankruptcy Code automatic stay[277] because the notice was required by UCC Article 9 section 9-611 and was permitted under the terms of the court's stay order.

VIII. Conclusion

The differences in the CT statutes among the states are often significant. Non-uniform CT laws, poorly drafted and ambiguous CT law provisions, and the uneven relations between those laws and companion statutes such as the UCC, increase the risk of inconsistent or flawed legal and judicial interpretations and opportunities for error, in addition to increasing the costs for consumers and secured creditors doing business intrastate, and even more so in transactions across state lines. The sometimes chaotic and confused reasoning of the case decisions (even when reaching the correct result) well illustrates these risks, and the potential for economic harm. These risks and problems are entirely unnecessary and self-inflicted, and reinforce the need for a uniform and modern CT law such as UCOTA.

270. *See* UCC § 9-612(a); *cf.* the ten days notice required if the collateral is not consumer goods, at *id.* §9-612(b).

271. 2011 WL 1755540 (E.D. Pa. May 9, 2011).

272. *See* the Pennsylvania Motor Vehicle Sale Financing Act (MVSFA).

273. For obvious reasons it would be a bad idea to provide this information to the debtor.

274. Note that such return is required but does not have to be provided in this notice. *See* UCC § 9-614.

275. *Hudson*, 2011 WL 1755540. *See also* Barclays Bank PLC v. Poynter, 2011 WL 3794890 (D. Mass. Aug. 25, 2011) (10 days or more notice was sufficient for $1,400,000 loan to purchase a luxury yacht).

276. 2011 WL 3799768 (Bankr. D. Utah Aug. 26, 2011).

277. 11 U.S.C. § 362. *See generally supra* Part II.B.

Chicago City Council Passes Compromise…

(Continued from page 405)

mortgage industry in response to the prior ordinance, which became effective September 18, 2011 and made mortgage holders responsible for maintaining vacant or abandoned properties even before the mortgagee obtains ownership or possession of the property through the foreclosure process.[1] The prior ordinance ensnared mortgagees by defining an "owner" to include "any person who alone, jointly or severally with others…is a mortgagee who holds a mortgage on the property or is an assignee or agent of the mortgagee."[2] Thus, regardless of the mortgagor's ownership, delinquency or foreclosure status, the prior ordinance defined the mortgagee as the owner and put mortgagees in the awkward position of having to secure and maintain vacant properties.

The amended ordinance deletes the definition of "owner" altogether and creates a separate section of the Chicago City Code that sets forth specific maintenance standards for vacant homes that servicers and mortgagees must comply with. The measure requires the mortgagee to determine, on a monthly basis, beginning forty-five days after default, whether a building is vacant. Once it is determined that a building is vacant, the mortgagee is required to secure and maintain the vacant building within the later of: (1) thirty days after the building becomes vacant and unregistered; or (2) sixty days after the default.

The amended ordinance appears to deal primarily with definitional problems in the prior ordinance, relating to characterization of a mortgagee as the owner of the property; it does not address concerns of the mortgage industry relating to the state law trespass issues that may arise in connection with a mortgagee securing and maintaining a vacant property where the mortgagee does not yet have ownership or possessory rights. Nor does the amended ordinance deal with a myriad of issues relating to determination of whether a property is "vacant" and abandoned by the owner, issues that otherwise might require a judicial determination in order to protect the owner's property rights.[3] As an illustration of the foregoing, a servicer, mortgagee or third party acting on their behalf could be deemed to be trespassing on the borrower's property if, in fact, the borrower had not abandoned the property or if the borrower decides to "reclaim" occupancy and possession of the property prior to a foreclosure. Further action from the courts or Illinois State Legislature may be needed in order to resolve these matters.

The amended ordinance became effective November 19, 2011, or ten days following the meeting of the City Council on November 9, 2011.

1. *See* Stephen F.J. Ornstein & Jennifer Maree, *City of Chicago Ordinance on Mortgagee Liability*, 65 Consumer Fin. L.Q. Rep. 185 (2011).

2. *Id.* The definition of owner also includes "any person who…has legal title to the property, with or without accompanying actual possession thereof." *Id.*

3. The prior and amended ordinances define "vacant" as a structure that is "empty or otherwise uninhabited" and "in need of maintenance, repair or securing." Chicago Mun. Code Ch. 13-12 § 13-12-126(e)(5).