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"Texas Legislature Passes Certificate of Title Bill Negating Effect of Clark Contracting Decision,"

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On June 19 of this year, Texas Governor Rick Perry signed into law Senate Bill 1592, S.B.1592, 81st Leg., Reg. Sess. (Tex. 2009) ("SB1592"), bringing an end to an intensive five-month effort to negate the broader effects of a decision handed down by a bankruptcy court in the Western District of Texas in late 2008 relating to the perfected status of a lender on a loan purportedly secured by six equipment trucks. *Clark Contracting Serv., Inc. v. Wells Fargo Equip. Fin. (In re Clark Contracting Serv., Inc.)* 399 B.R. 789 (Bankr. W.D. Tex. 2008). As reported in the August 2009 issue of *LJN's Equipment Leasing Newsletter* ("Secured Transactions: The Transfer of Security Interests," Alan M. Christenfeld and Barbara M. Goodstein; available online at [www.ljnonline.com/issues/ljn\\_equileasing/28\\_7/news/152458-1.html](http://www.ljnonline.com/issues/ljn_equileasing/28_7/news/152458-1.html)), the decision in *Clark Contracting* left many purchasers of motor vehicle loans questioning their status as secured lenders with respect to obligors in the underlying motor vehicles. Fortunately, the Texas Business Law Foundation and the American Securitization Forum were quick to react to the *Clark Contracting* decision when it was published in February 2009, promoting legislation to amend the Texas Certificate of Title Act ("TCTA") (Tex. Transp. Code Ann. §§501.001-501.159 (2007)) and other Texas statutes governing titled assets to clarify the meaning of the provisions of those statutes governing the assignment of liens in titled assets and the effect of that assignment on the perfected status of assignees.

As previously reported, the court in *Clark Contracting* found that Wells Fargo Equipment Finance ("Wells Fargo"), a purchaser of a secured loan made by CIT Group/Equipment Financing Inc. ("CIT") to Clark Contracting Services, Inc. ("Clark") for the purchase of six equipment trucks, did not have a perfected security interest in those trucks because CIT failed to apply with the county assessor-collector to have the certificates of titles for the trucks reissued to reflect Wells Fargo as the lienholder. As a result, Wells Fargo was relegated to the status of an unsecured creditor in the bankruptcy proceedings of Clark. The court's decision was inconsistent with what is believed to be the current state of the law in all of the other 49 states, many of which either have statutes that expressly provide that re-titling is unnecessary or have courts that have interpreted state law in a manner consistent with such statutes. The decision was also directly in conflict with the practice of many of the finance companies and banks that make motor vehicle loans in Texas, including lenders that financed their loans through structured warehouse facilities and securitizations.

**Other States**

Many states have statutes that clearly provide that assignee lienholders need not apply for re-titling in order to enjoy the perfected status of their assignors. See, Cal. Veh. Code §5908 (2000); Fla. Stat. §319.27(6)(d) (2009); Ga. Code Ann. §40-3-50(b) (2009); Mich. Comp. Laws §257.238(b)(2) (1979); Mo. Rev. Stat. §201.630 (2002); N.Y. Veh. & Traf. Law §2120(b) (2009). Other state statutes are silent as to assignments of certificates of title (see, Id. Code Ann. §49-501 to -530 (2008); Va. Code Ann. §§46.2-636 to -638 (2009)), have assignment provisions in their certificate of title statutes that do not appear to address the perfected status of assignee lien holders (see, Ark. Code Ann. §27-14-908 (2007); N.M. Stat. §66-3-111 (2008)) or are otherwise ambiguous as to the effect on the perfected status of an assignee that fails to re-title (see, Tenn. Code Ann. §55-3-124 (2007)). Some of these states that have ambiguous, non-applicable or silent statutes have resolved the assignee lienholder perfection issue through cases litigated in their state courts. In each case of which I am aware, the courts in these states have all ruled that re-titling is not required for an assignee lienholder to succeed to the perfected status of its assignor. See, *In re Johnson*, 2009 WL 1863219 (Bankr. E.D. Ark. 2009), *In re Field*, 263 B.R. 323 (Bankr. D. Idaho 2001), *Sec. Pac. Fin. Serv. v. Signfilled Corp.*, 956 P.2d 837 (N.M. Ct. App. 1998), *Bank of N. Y. v. Leake (In re Wuerzberger)*, 284 B.R. 814 (Bankr. W.D.Va. 2002). Other than Maine, whose motor vehicle certificate of title statute *does* require re-titling for perfection to continue in assignees except in those cases where the assignor continues to service the related loan on behalf of the assignee (a common occurrence in securitizations and other structured finance transactions), the *Clark Contracting* decision appears to have momentarily isolated Texas as the only state to interpret its certificate of title statute to require re-titling of assigned motor vehicle liens in order to continue the perfected status of assignors in their

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assignees.

### Industry Practice

Prior to *Clark Contracting*, finance companies and their Texas legal counsel generally interpreted the TCTA provisions regarding re-titling upon assignment of a lien as permissive. That is, assignees or assignors could re-title upon assignment if they chose to do so, but the TCTA did not require re-titling in order to continue perfection. In fact, the TCTA did not appear to address the perfected status of an assignee lienholder at all. As a result, matters governing perfection of assignee lienholders defaulted back to Chapter 9 of the Texas Business & Commerce Code (Tex. Bus. & Com. Code § 9 (2002)) (“Chapter 9”), the Texas version of Article 9 of the Uniform Commercial Code, where Section 9.310(c) governs the perfected status of a non-filing assignee. See, U.C.C. § 9.310(c) cmt. 4 (2008); see also, P.E.B. Commentary No. 12 (discussing this issue under former U.C.C. §9.302(3)). Section 9.310(c) provides that assignees enjoy the perfected status of their assignors as against creditors of and transferees from the debtor without the necessity of filing a new financing statement reflecting that assignment. While the practice of failing to re-title under a certificate of title statute or filing a new financing statement under Chapter 9 can be fraught with danger to an assignee, in many transactions the assignor services the motor vehicle loan on behalf of the ultimate assignee and may even repurchase the loan at some point (for instance, in connection with a clean-up call in a securitization), resulting in a seamless transaction to the debtor car owner. As in Chapter 9, the mere indication of a lien on the face of the title, whether or not that lienholder is the current lienholder, promotes the goals of the TCTA, which are to prevent: 1) the theft of motor vehicles; 2) the importation into this state of and traffic in motor vehicles that are stolen; and 3) *the sale of an encumbered motor vehicle without the enforced disclosure to the purchaser of a lien secured by the vehicle*. Tex. Transp. Code Ann. §§501.003 (2007). In almost all scenarios, the identification of the current, unnamed lienholder can be determined with a modest amount of due diligence on the part of the buyer of the vehicle or any prospective lender. In those states where re-titling is not required by an assignee lienholder to enjoy the perfected status of the assignor, while there is a modest amount of investigation that may need to be conducted by parties engaging in transactions with owners of motor vehicles encumbered by liens, the only party that has any realistic chance of exposure to economic harm by failing to re-title to reflect an assigned lien is the assignee lienholder.

### The Legislation

Upon learning of the *Clark Contracting* decision, the American Securitization Forum, the primary advocate for the securitization industry, joined with the Texas Business Law Foundation, a group comprised of businesses and law firms that promotes legislation intended to foster a favorable environment for Texas businesses, to draft legislation for consideration by members of the Texas House and Senate. The legislation originally covered all four certificate of title statutes referenced in Section 9.311(a)(2) of Chapter 9:

1. Chapter 501, Transportation Code, relating to motor vehicles;
2. Subchapter B-1, Chapter 31, Parks and Wildlife Code, relating to vessels (watercraft) and outboard motors;
3. Chapter 1201, Occupations Code, relating to manufactured homes; and
4. Chapter 261, Business & Commerce Code (former Subchapter A, Chapter 35 Business & Commerce Code), relating to utility security instruments).

At the request of the Texas Manufactured Housing Association, the legislation was amended to delete all references to Chapter 1201, Occupations Code, because participants in that industry preferred to maintain the lien registration system then in place, which promotes re-titling upon the assignment of a lien.

The goal of the drafters of the legislation was to amend the assignment provisions in the TCTA and the other certificate of title statutes to more clearly reflect the intent of the legislature to make re-titling upon assignment permissive. As industry participants and legislators believed that the *Clark Contracting* decision was an incorrect interpretation of the TCTA, the goal was not to make a change in the law, but merely to clarify what the law has been for years. In order to manifest that intent, language was added to the draft bill to express the nature of the legislation as a clarification of existing law. See, Tex. S.B.

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1592 §6. The desired effect of Section 6. is protection of the perfected lien status of assignee lienholders that took assignment prior to the effective date of the legislation and did not re-title. Without such language, the amended statutes might only operate prospectively to assignments made after the effective date of SB 1592, continuing to leave pre-effective date assignee lienholders unperfected until they make application to the state to reflect their status as lienholders on certificates of title. While Texas law generally frowns upon giving retroactive effect to amended statutes, there is persuasive recent case law indicating that amendments to statutes that reflect the legislature's intent to clarify, rather than change, existing law will be applied by the courts to claims that accrue prior to the effectiveness of the amendment, as if the law at the time of the accrual of the claim was the statute as amended. *See, Sw. Bell Tel. Co., L.P. v. Mitchell*, 276 S.W.3d 443 (Tex. 2008) and *In re Adams*, 307 B.R. 549 (Bankr. N.D. Tex. 2004).

To further harmonize the certificate of title statutes with Chapter 9, the amendments added language to clarify that recordation of a lien on a certificate of title in accordance with the statutes will give the lienholder priority over the rights of a lien creditor. Section 9.311(b) of Chapter 9 indicates that compliance with the requirements of a certificate of title statute for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under Chapter 9. Thus, clarifying that for purposes of Chapter 9, lienholders of record are the equivalent of perfected secured parties that have filed financing statements. *See, Tex. S.B. 1592 §1* (amending Tex. Bus. & Com. Code §261.004(a)(3) (2009)); *Tex. S.B. 1592 §3* (amending Tex. Parks & Wild. Code §31.052(a) (2002)); *Tex. S.B. 1592 §4* (amending Tex. Transp. Code §501.113(b) (2007)).

At the request of the Texas AutoDealers Association, additional language was added to Section 501.114 of the TCTA to clarify that the amended provisions concerning assignee lienholders have no effect on the procedures applicable to the foreclosure of a worker's liens under Chapter 70 of the Property Code and the mechanics set forth in Section 348.08 of the Finance Code regarding the tender of loan payoff amounts in connection with dealer trade-ins. *See, Tex. S.B. 1592 §5* (amending Tex. Transp. Code §501.114(h)-(i) (2007)).

### Conclusion

During the period between the publication of the *Clark Contracting* decision and the effective date of SB1592, many auto loan finance companies restarted their dormant securitization programs to take advantage of increased investor interest in buying newly issued asset-backed securities through the Term Asset-Backed Securities Loan Facility ("TALF"). The uncertain status of Texas law on assigned liens during that time resulted in at least one finance company withdrawing all Texas auto loans from its securitization. Another reduced the number of Texas auto loans to less than 10% of the pool (despite having nearly 50% more Texas loans available for securitization) and effected its securitization on less favorable terms as a result of inclusion of those loans. Since the effective date, I am unaware of any discriminatory action taken against Texas auto loans in securitizations or other structured financings. Quick action by interested parties appears to have limited the damage caused by *Clark Contracting*, but the potential remains for similar challenges to the perfected status of assignee lienholder that do not re-title in those states that don't have statutes that clearly protect the perfected status of assignees. Since the *Clark Contracting* decision, a bankrupt debtor in Arkansas has challenged that state's laws regarding this subject. *See, In re Johnson*, 2009 WL 1863219 (Bankr. E.D. Ark. 2009). Fortunately, the Arkansas court ruling on the matter recognized and dismissed the *Clark Contracting* decision and came to the conclusion that assignee lienholders in Arkansas do not need to re-title to enjoy the perfected status of their assignors. More attacks on assignee lienholders should be expected in other states with statutes that are silent or ambiguous on this issue.