MARKS &
WEINBERG, P.C.

DISPATCHES FROM THE TRENCHES

CERTIFICATES OF TITLE:
OWNERS, LIENHOLDERS AND COURTS OH MY!

Uniform Commercial Code Section 9-311(a)(2) provides that the filing of a UCC financing statement does not perfect a lien that is governed by the stateøs certificate of title law. Stepping out of the familiar and more-or-less uniform terrain of the UCC and into state title laws has proven perplexing, expensive and in some cases disastrous for motor vehicle lenders and lessors.

For example, should a lessor list itself as õOwnerö or õLienholderö on a motor vehicle certificate of title? On its face, the answer seems simple enough. A lessor under a true lease is the owner of the vehicle while the lessor under a financing arrangement, such as a dollar-purchase-option lease or an equipment finance agreement is a lender holding a lien against the vehicle. In practice, the issue is much more complex.

First, there is the potential for lessor liability. State vicarious liability laws have long imputed a driverøs negligence to the vehicle owner. Plaintiffsø counsel looking for the deep pocket at the end of the litigation rainbow routinely check titles and look for a corporate owner. Many lessors have therefore opted to be listed as lienholders in lieu of owners in true leases, hoping to avoid liability while retaining the benefit of putting the world on notice of their interests. Fortunately, recent federal legislation has overridden state vicarious liability statutes in most cases. 49 USC § 30106; Marks, õLessor Liability and the Federal Leased Vehicle Liability Actö, *Journal of Equipment Lease Financing*, Vol 24, No. 1 (Winter 2006).

However, case law is still evolving. In addition, the federal statute leaves room for findings of actual lessor negligence. For example, injured parties have argued that a lessor was liable for failing to inspect equipment and discover defects likely to cause injury; for failing to deliver operating manuals to the lessee; or for failing to warn a lessee of equipment defects of which the lessor knew or should have known. See e.g. *Indeck Power Equipment Co. v. Jefferson Smurfit Corp*, 881 F. Sup. 338(NV. Ill 1995); *Black v Gorman-Rupp*, 655 So. 2d 717(La. Ct. App. 1995).

There are other reasons why an owner might prefer not to have the title issued or re-issued in its name as owner. Some lessors prefer to be listed as lienholders in order to facilitate transfers of title to the lessee at the end of the lease term without the necessity of paying transfer or sales taxes, or even having the title reissued if the lessee/purchaser is comfortable relying on a power of attorney and acknowledgement of satisfaction from the lessor.

How would a court treat the lessorøs ownership interest when it was not disclosed as such, but was rather shown as a lien interest? There is little guidance from the cases, but where courts have encountered the reverse scenario of lienholders showing themselves as owners, the results have not always been clear or pretty.

The bankruptcy court deciding *In re National Welding of Michigan, Inc.,* 17 B.R. 354 (B.W.D. Mich. 1982) *rev'd* 61 B. R. 314 (B.W.D. Mich. 1986) held that the lessor under a lease which was determined to be a secured loan rather than a true lease was not perfected at all when it listed itself as owner rather than lienholder. The case was reversed four years later based on two cases coming out of the Sixth Circuit Court of Appeals. *See In re Paige,* 3 B. R. and *In re Angier,* 684 F. 2d 397 (6th Cir 1982); *See also In re Circus Time,* 641 F. 2d 39 (1st Cir. 1981). These cases focused on the fact that the listing gave subsequent creditors or purchasers notice of the lessorøs/lenderøs interest.

More than one Alabama case has held that, even when a pawnshop loan is made, the formalities of the stateøs certificate of title law must be observed. Mere possession of the title is not enough to perfect the interest and if the lender waits until after the debtor is in bankruptcy to have a new title issued showing its lien, the lender is unperfected and unprotected. *e.g., Patterson v. Spradlin,* 185 B. R. 354 (B.N.D. Ala. 1995); *In re Mattheiss,* 214 B.R. 20 (B.N.D. Ala. 1997).

In *In re Otasco, Inc.,* 11 B.R. 976 (B.N.D. Ok. 1990), the Court determined that a lease with a TRAC style end of term option was a secured loan. To make matters worse, the Court held that the lessor, who listed itself as owner on the title, was unperfected and the proceeds from the sale of the vehicles were therefore to be divided amongst all creditors on a pro-rata basis. That Court summarized its Certificate of Title provisions as follows:

> Under Oklahoma law, security interests in motor vehicles are perfected not by filing financing statements pursuant [under the UCC] but only by delivery of a lien entry form and payment of the required fee to the Oklahoma Tax Commission. The secured creditor must, in effect, identify itself as such by submitting a lien entry form designating the secured creditor as such; pay the prescribed fee therefor; release the security interest in due course, or owe certain penalties to the debtor; and provide such information in the lien entry form as will permit the Oklahoma Tax Commission to answer any request as to whether a particular vehicle is subject to a security interest. . . . The lien entry form is required in addition to any certificate of title or application therefor. It is the lien entry form which will cause the Oklahoma Tax Commission to note the lien as

> such on the certificate of title, to index it accordingly, and thus enable it to ascertain, on request, whether any particular vehicle is subject to a security interest. This method is exclusive--if it is not complied with, there is no perfection.

The Court emphatically rejected the lessors argument that it substantially complied with the statute and that any such errors were õminorö stating:

> The certificates of title misname the secured party as the "owner", do not contain the real owner's name or address at all, and do not disclose the existence, let alone the date, of any security agreement. These misstatements and omissions are not inadvertent but are deliberate and intentional, committed in furtherance of a scheme to misrepresent the true nature of the transaction between these parties and the role (and in that sense, at least, the "identity") of the secured party herein. . . . . [N]o lien entry form was ever delivered, or even attempted to be delivered, to the Oklahoma Tax Commission, and so of course the fee required therefor was never paid. . . . All things considered, the doubtful good faith of a secured creditor masquerading as a "lessor"; the complete omissions and misleading partial entries on the certificate of title; the total failure to deliver, or even attempt to deliver, a lien entry form as specifically required by statute; the intentional character of these acts and omissions; and the commercial unreasonableness of this attempt to turn a simple, forthright disclosure into a guessing game, [result in the holding that lessorøs non-compliance with the Certificate of Title Laws] is "seriously misleading," and does not rise to the dignity of "substantial compliance.ö

Whether wrongly decided or not, these cases show there is ample precedent to avoid playing fast and loose with titling statutes, particularly when the effect is to deny notice to a subsequent lender or purchaser.

Similar risks can be unexpectedly lurking, despite common sense and standard industry practice, in syndications where an originator makes an outright assignment to a funder/assignee of the originatorøs right, title and interest in the equipment lease and underlying vehicles being leased. It is a not-uncommon syndication practice for such transfers to occur without the title being reissued. Arguably, the original lessor may act as the purchaserøs agent, creating a sort of poor manøs titling trust.

This concept received much attention recently as a result of the case of *In re Clark Contracting*, 399 B. R. 789 (B.W.D. Texas 2008). In that case, Wells Fargo elected not to re-title vehicles securing loans it had acquired from CIT. The court ruled that, unlike the UCCøs Section 9-310(c), which allows assignees to stand in the shoes of the assignor without re-filing, the Texas motor vehicle title law required reissue of the titles showing the assignee/lienholderøs name. Fortunately, industry advocates and the Texas Legislature acted quickly and, on June 19, 2009, the Texas Governor signed a new law negating the bankruptcy court decision. *See* Senate Bill 1592, S.B. 1592, 81st Leg., Reg. Sess. (Texas

2009). Subsequently, the federal district court reviewing the *Clark Contracting* decision overturned the bankruptcy court decision and reinstated Wells Fargoøs perfected security interest. *See Clark Contracting Serv., Inc. v. Wells Fargo Equip. Fin.* (Ch. 7 Case No. 08-50046-LMC, Adv. No. 09-726-FB (W.D. Tex. Apr. 14, 2010).

Despite the reversal of fortunes in this case, it may still give pause vehicle lease portfolio purchasers and lenders. At the end the day, the interplay between the generally uniform provisions of the Uniform Commercial Code and the various state Certificate of Title laws resembles a complex dance which must be attempted with caution. Unfortunately, that dance looks much more like a street Crunking battle than a Smooth Waltz.

Kenneth P. Weinberg is a founding partner of Marks & Weinberg, PC. He and co-founder, Barry Marks, have significant experience in dealing with virtually every type of equipment and facility lease financing, have participated in leasing financings for more than a billion dollars of equipment and are recognized throughout the industry. Weinberg has written *Dispatches from the Trenches* since 2002, routinely writes articles in a variety of equipment leasing and financing journals, and has participated in numerous seminars on equipment leasing issues. If you would like more cases or articles on leasing, or have any questions or comments about this column or other leasing issues, please visit www.leaselawyer.com or contact Weinberg at 205-251-8307.

Article appeared in the October, 2010 issue of the *Monitor*.

For more articles/news regarding the equipment leasing and finance industry, visit

http://www.monitordaily.com/