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SECURED TRANSACTIONS

Texas Decision Raises Issues on Assignment Of Perfected Interests





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Much has been much written about the attachment and perfection of security interests. Less attention has been paid to how those liens, once perfected, can be transferred to other creditors. Transfers of security interests can occur, for example, in connection with the transfer of debt secured by liens or with the substitution of a secured party.[1] Ease of transferability of perfected security interests is critical to ensuring access to capital in financing transactions, especially in securitizations. The assignee of a security interest wants to succeed to both the assignor's perfected lien and the priority of that lien.[2] Failure of an assignment to achieve either of these goals could result in a forfeiture to junior secured parties or the debtor's bankruptcy estate.

Article 9 of the Uniform Commercial Code, recognizing the importance of facilitating transfers of liens, imposes minimal requirements on assignments of security interests perfected by the filing of financing statements, or possession or control. However, when it comes to Article 9 collateral subject to federal or other state laws, such as certain mobile goods and intellectual property, the UCC often defers to such federal or state regimes.[3] The intersection between the UCC and these other laws is not always seamless, as illustrated by the recent decision of a Texas bankruptcy court in *Clark Contracting Services Inc. v. Wells Fargo Equipment Finance (In Re: Clark Contracting Services Inc.)*.[4] That lack of seamlessness can disrupt commercial and consumer markets significantly.

Today we discuss the procedures for assigning Article 9 security interests, the issues highlighted in *Clark*, and the reaction to that decision.

To determine how to assign an Article 9 security interest and maintain its perfected status effectively, one must first ascertain how the lien was initially perfected. The general rule is articulated in UCC Section 9-310.

Perfection Under the UCC

Section 9-310(a) provides that liens on most types of collateral can be perfected by filing a UCC financing statement.[5] Section 9-310(c), in turn, states that no filing or other action is required to continue the perfected status of perfected security interest that is assigned. Thus, if an assignor secured party has properly filed a financing statement to perfect its lien, the assignee of such lien need not do anything further to maintain the perfected status of the assigned security interest against creditors of and transferees from the original debtor.[6]

The lack of any affirmative requirement for perfecting assignments of filed financing statements is consistent with the UCC's system of "notice filing."[7] Although the already-filed financing statement may not reveal the current secured party, it puts searchers on notice that someone may have a security interest in the collateral indicated. It is enough that, through further inquiry, they can learn about the assignment and the assignee's identity.

UCC Section 9-310(c) also applies to liens perfected by control or possession. There is accordingly no requirement under Article 9 that assignees take additional action to maintain perfection of the security interests for collateral perfected by control or possession. As long as the assignor secured party or the assignee maintains possession or control of the collateral, the security interest will remain perfected.[8]

Although the UCC does not require the assignee of a secured party to amend a financing statement to maintain perfection and priority of the assigned lien, filing an amendment that assigns the lien does have significant advantages. The assignor remains the "secured party of record"[9] under Article 9 unless and until the assignee is named in the financing statement, whether in the initial filing or by amendment.[10] By remaining the secured party of record, the assignor retains valuable rights in respect of such financing statement. The secured party of record is entitled to authorize the filing of an amendment to a financing statement (other than an amendment which adds collateral or a debtor).[11] It can partially release collateral from or terminate a financing statement and is solely entitled to continue the duration of the filing.[12] A secured party of record could assign its rights as such to a third party, enabling that party to become and exercise the rights of the secured party of record. In addition, a secured party who is not the secured party of record is statutorily obligated under certain circumstances to cause the secured party of

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record to terminate a financing statement.[13] By becoming the secured party of record, the assignee protects itself from such risks and obligations.

However, although there are clearly advantages to being the secured party of record, it can be quite burdensome to amend financing statements to reflect assignments, particularly in the realm of securitization transactions. The large number of titled assets that are liened in favor of assignee secured parties pursuant to securitizations makes filing amendments reflecting such assignments costly, time-consuming and therefore, in many cases, impractical.

Other Statutes

Although no action by the assignee is required to maintain the status of security interests perfected by filing a UCC financing statement, or by possession or control, some collateral may fall under alternative state or federal regimes for perfection. Railcars, vessels, civil aircraft, manufactured homes, motor vehicles and copyrights are examples of such assets.[14] Under UCC Section 9-311, a financing statement is not necessary or effective to perfect a lien on property where a federal statute, regulation or treaty contains requirements for the priority of a security interest over a lien creditor. The same rule applies to assets the perfection of which is subject to state certificate of title laws. Under Section 9-311, one can perfect a security interest in property subject to certificate of title statutes only by complying with the provisions of such statutes.

Official Comment 4 to Section 9-310 states that subsection (c) applies to assignments of security interests perfected by compliance with a certificate of title or other statute under Section 9-311. However, the comment goes on to say that the security interest will remain perfected even if the assignee takes no action to reflect the assignment on the certificate of title, "*unless the statute expressly provides to the contrary*."[15] In short, although the UCC adopts a strong policy in favor of continued perfection, applicable statutes to the contrary are respected.

Although the general rule is that no action need be taken, if, for example, a state certificate of title statute expressly requires an assignee to take additional steps to maintain the perfected status of its security interest following assignment, the assignee is obliged affirmatively to undertake such steps.[16] It is accordingly prudent to "ascertain whether the certificate of title statute applicable to the particular transaction contains provisions concerning an assignment of a security interest and, if so, whether such provisions relate to perfection."[17] Practitioners dealing with assignments of liens perfected under certificate of title regimes need to determine both whether the security interests were properly perfected and whether the regimes require action to continue perfection following the assignments.

'Clark Contracting'

The *Clark* case[18] highlights the impact state certificate of title laws can have on the perfection of security interests following an assignment. In *Clark*, a bankruptcy court in Texas held that for an assigned lien on a motor vehicle governed by the Texas Certificate of Title Act (TCTA)[19] to be effective against judgment lien creditors and other third parties, including a debtor or trustee in bankruptcy, the assignee of the lien must comply with the TCTA by having its identity as lienholder reflected on the vehicle's title.[20]

Although the UCC makes it relatively simple to assign perfected security interests; 'Clark' demonstrates that practitioners need to be familiar with state and federal statutes that may impose additional requirements on such assignments.

The facts of the case are straightforward. Clark Contracting Services Inc. financed several trucks with CIT Group/Equipment Financing Inc. CIT perfected its security interest in the vehicles by noting its lien on the certificates of title for such vehicles in accordance with the requirements of the UCC and the TCTA. Subsequently, Wells Fargo Equipment Finance purchased from CIT the loans that were secured by these trucks. Wells Fargo did not record the assignments in accordance with the TCTA, i.e., it did not reflect its status as the assignee lienholder on the vehicles' titles. It was not disputed that CIT was noted on the certificates of title as lienholder and that Wells Fargo was not.

Following the transfer of the liens to Wells Fargo, Clark Contracting commenced a Chapter 11 case under the federal Bankruptcy Code in which it challenged the perfection of such liens and, under Bankruptcy Code Section 544(a),[21] sought to avoid them. The debtor argued that "the UCC defers to the Texas Certificate of Title Act on matters such as perfection, and the latter enactment requires an affirmative act by an assignee to maintain lien perfection."[22] Wells Fargo countered that although it acknowledged the liens were covered by the TCTA, the act had no express requirement that assignments be recorded on certificates of title. Wells Fargo pointed instead to UCC Section 9-310's general rule that assignees need take no action to enjoy the perfected status of their assignors. Additionally, it asserted that recording assignments under the TCTA was merely optional, not required.

The court had to determine how the UCC and TCTA interacted regarding assignments of motor vehicles liens and whether the TCTA expressly required lienholder assignments to be recorded on certificates of title. It held that Texas' UCC Section 9-311(a) requires that security interests in motor vehicles be perfected in accordance with the TCTA and that the TCTA expressly mandated noting the assignment on the certificate of title to maintain the perfection of the assigned liens. The court determined that the TCTA established a scheme that was "quite unlike the general perfection rules under the UCC" and that "[r]ather than relying on a generally searchable database [as does the UCC]…relies on physical notation of security interests on the very document required to legally transfer a motor vehicle."[23] It concluded that, just as original perfection of the security interest depends on a notation on the certificate of title, "assignments too must be notated on the certificate of title if the lienholder's claim is to be effective against innocent third parties."[24] Accordingly, assignees of liens on certificated Texas motor vehicles who want assurance that their liens will "relate back" to the recordation date of the original liens by the assignors are obliged to record their liens on the titles pursuant to the TCTA.

The court found that the TCTA set forth a specific procedure for handling the

assignment of interests in motor vehicles. At particular issue was the meaning of the word "may" used in the statute. The TCTA provided that a lienholder "may" assign a lien recorded under the statute by applying to the county assessor-collector for the assignment of the lien and then notifying the debtor of the assignment.[25] Wells Fargo argued that the word "may" applies to the assignee and implies optionality, i.e., that such procedure can be used, but is not required. As construed in the decision, however, "may" applied only to the assignor, not the assignee, and presented no option for an assignment not to comply with the statute's recordation requirement—in other words, according to *Clark*, lienholders "may" assign their liens provided they follow the procedures set forth in the TCTA.

Fallout From 'Clark'

Although the authors are not unpersuaded by *Clark's* statutory analysis, the legal consequences of the decision are troubling. As a result of the case, perfected liens on certificated Texas motor vehicles become unperfected the instant they are assigned and remain so until the assignment is recorded on the certificate, even though the debtor and its creditors are aware that the vehicles in question have been encumbered. If the debtor files a bankruptcy petition after the assignment is made but before issuance of an amended certificate of title, the automatic stay in bankruptcy[26] may prevent the assignment from ever being noted and enable the debtor to avoid the lien as being unperfected. Such situation will effect a forfeiture by the assignee and generate a windfall to the debtor's bankruptcy estate or junior secured creditors.

Various industry associations have asserted that *Clark* is having a negative impact on the availability and cost of secured credit to Texas borrowers. In testimony before the Texas Senate Business and Commerce Committee, for example, a representative of the American Securitization Forum recently noted that *Clark* "had already forced auto finance companies doing business in Texas to rethink their strategy with respect to receivables originated in Texas."[27]

As a consequence, industry groups immediately launched a legislative effort to reverse *Clark*. Bills were introduced and approved in both houses of the Texas Legislature, but, at deadline for submission of this article, the proposed legislation has not become law. The proposed statute would authorize the holder of a security interest in a vessel, outboard motor or motor vehicle to assign a recorded security interest without making any filing or giving any notice, and specifies that the security interest assigned remains valid and perfected and retains its priority.

Other States

The certificate of title regimes in New York and many other states expressly state that although recording assignments of liens on certificated motor vehicles is permissible, the failure to do so does not affect the validity or perfected status of the security interests.[28] In several states, however, the certificate of title laws lack such savings language.[29] Even if Texas amends the TCTA to overrule *Clark* legislatively, therefore, the issues raised by the case may emerge again in other states whose certificate of title laws are similar to the TCTA as in effect at the time of the decision. Practitioners representing buyers of debts secured by vehicles titled in other states thus ought to become, or engage local counsel that is, familiar with the certificate of title laws in the applicable states, ascertain whether noting the assignment on the titles is optional or mandatory under such laws and, together with their clients, make informed decisions whether or not to record the assignments.

Conclusion

Although the UCC makes it relatively simple to assign perfected security interests, *Clark* demonstrates that practitioners need to be familiar with state and federal statutes that may impose additional requirements on such assignments.

1. A substitution of secured parties may occur, for example, when one collateral agent is succeeded by another. U.C.C. §9-207(c)(3) also permits secured parties to repledge collateral separate from the debt, but discussion of such procedures is beyond the scope of this article.
2. Technically, the rules discussed herein apply with respect to assignments by the assignor's predecessors in interest, in the case of multiple assignments. For the sake of clarity, however, we refer only to the immediate assignor, not its predecessors in interest.
3. U.C.C. §9-311(a).
4. 299 B.R. 789 (Bankr. W.D. Tex 2008).
5. U.C.C. §9-310(a).
6. U.C.C. §9-310(c).
7. U.C.C. §9-502, Official Cmt. 2.
8. U.C.C §9-310, Official Cmt. 4.
9. U.C.C. §9-511.
10. U.C.C. §9-514.
11. U.C.C. §9-513.
12. U.C.C. 9-514 §, Official Cmt 2.
13. U.C.C. §9-311.
14. See e.g., 49 U.S.C. §44107-11 (aircraft); 49 U.S.C. §11301 (railcars), 17 U.S.C. §§204-205 (copyrights).
15. U.C.C. §9-310, Official Cmt. 4. (Emphasis added.)
16. U.C.C. §9-311.
17. PEB Commentary on the Uniform Commercial Code, Commentary No. 12 (American Law Institute 1994) 6.
18. Supra, note 2.
19. Tex. Transp. Code §§501.001, et seq.
20. Id., §501.113.
21. 11 U.S.C. §544(a). This section gives bankruptcy debtors and their trustees the so-called "strong-arm" power to avoid any liens that would not prevail against a hypothetical lien creditor (e.g., liens not perfected under the UCC or other applicable law).
22. *Clark*, 299 B.R. 789, 793.
23. Id. at 796.
24. Id. at 798.
25. Tex. Transp. Code §501.114(a).
26. See 11 U.SC. §362.
27. Tom Deutsch, Executive Deputy Director, American Securitization Forum, Presentation to Texas Legislature (March 31, 2009).
28. N.Y. Veh. & Traf. Law §2120(b) ("The assignee may, but need not, to perfect the assignment, have the certificate of title endorsed or issued with the assignee named as lienholder…"). See also Fla. Stat. Ann. §319.27(6)(d) ("If the original lienholder sells and assigns his or her lien to some other person and if such assignee desires to have his or her name substituted on the certificate of title as the holder of the lien, the assignee may, after delivering the original certificate of title to the department and providing a sworn statement of the assignment, have his or her name substituted as the lienholder…"); Ga. Code Ann. §40-3-55(b) ("The assignee may, but need not, to perfect the assignment, have the certificate of title endorsed or issued with the assignee named as holder of a security interest or lien…"); Mich. Comp. Laws Ann. §257.238(b)(2); Mo. Ann. Stat. §700.365(2).
29. Me. Rev. Stat. Ann. 29A; §704; Md. Code Ann. Transp. §13-202; Tenn. Code Ann. §55-3-124.

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