

By Michael D. Jewesson

Lone Star State *Wrestles with* Car Loan Fate

A decision by a bankruptcy court in San Antonio could have closed down the auto loans securitization market in Texas. A timely joint effort by the ASF and the State's Business Law Foundation appears to have engineered a narrow escape.



Who would have thought that five of these could cause an ABS crisis?

Securitization doesn't always require a nationwide catastrophe to shake the market to its core. Most market commentators have in recent times devoted their attention, understandably, to the trillions of dollars involved in the fallout from the housing collapse and liquidity crisis.

But while everyone was busy dealing with the larger meltdown, a bankruptcy court in San Antonio caught and held the attention of the securitization world when it issued a decision concerning the fate of five Ford F750 water trucks and one asphalt truck belonging to a modestly sized construction company. What appeared to many to be no more than a simple ruling against a purported secured creditor in a bankruptcy case quickly developed the potential to close off the securitization market for Texas auto loans. Thankfully, a concerted effort by both the American Securitization Forum (ASF) and the Texas Business Law Foundation appears to have averted a crisis.

It all began innocuously enough. San Antonio-based Clark Contracting Services bought the vehicles between the end of 2005 and early 2007 with money borrowed from its lender, CIT Equipment Finance. CIT then sold the loans to Wells Fargo Equipment Finance — a pretty routine set of transactions. Then, on January 9, 2008, Clark filed for Chapter 11. While no secured lender is pleased to find one of its debtors in bankruptcy, a properly perfected security interest in collateral usually provides the lender some comfort that it will recover a significant portion of its loan.

Unfortunately for Wells Fargo, Clark argued that the bank did not have a properly perfected security interest in the six vehicles

under Texas' certificate of title statute because CIT had not applied for new certificates of title reflecting that it had sold the loans and the associated liens on to Wells. In a memorandum opinion dated November 28 of last year, the bankruptcy court granted a partial summary judgment in Clark's favor (*In re Clark Contracting Services, Inc v Wells Fargo Equipment Finance; Adv. No. 08-5045-LMC*), thus relegating Wells Fargo's status to that of an unsecured creditor.

The court's decision rendering Wells Fargo unperfected shocked the securitization industry: Texas law was commonly interpreted by attorneys engaged by auto loan securitization issuers to be the diametric opposite of the court's interpretation. Whether a finance company or a bank, any lender that has been granted a security interest in a motor vehicle



Now imagine this virtually traffic-free road in Houston if auto securitization disappeared

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registered in the State of Texas perfects that security interest by applying to the State for a certificate of title reflecting the lender as the lienholder of record. When a lender that is a lienholder of record assigns its security interest in a motor vehicle, the prevailing interpretation of Texas law among those in the securitization and finance industry was that re-titling was not necessary in order for the assignee to enjoy the perfected status of the assignor.

The assignment of motor vehicle loans and the related underlying liens is fundamental to the securitization process. Lenders using securitizations originate or purchase these loans and transfer them to one or more special purpose entities which then pledge the loans and motor vehicle liens as security to trustees or collateral agents in connection with the issuance of securities. These loans may be transferred to multiple different entities over the course of their existence. As a result, it is administratively burdensome and costly to make an application with the State to record each new lienholder as the loan is assigned from one party to another. Applying for multiple certificates of titles for each Texas motor vehicle destined for securitization — and managing the administration of that process — would likely add millions of dollars annually to the cost of financing loans in Texas.

Prior to Clark Contracting, parties to these transactions had avoided re-titling and associated costs by relying on interpretations of the Texas Certificate of Title Act and Chapter 9 of the Texas Business and Commerce Code — Texas' version of

Article 9 of the Uniform Commercial Code. This indicates that re-titling is not necessary in order for a perfected security interest to reside in assignees of lenders or future assignees in the chain of assignment. The bankruptcy court decision put that in jeopardy.

While Chapter 9 governs the creation of a security interest in a motor vehicle in Texas, it does not govern its perfection.

That is governed by the Texas Act. A security interest in a motor vehicle created under Chapter 9 is perfected pursuant to Section 501.113 of the Texas Act when application is made to the proper filing office reflecting the lienholder's interest in the vehicle. According to section 501.114(a) of the Texas Act, a lienholder may assign a properly perfected lien recorded under Section 501.113 by applying to the county

assessor-collector for the assignment of the lien and notifying the debtor of the assignment.

No interpretations published

Prior to Clark Contracting, lenders and counsel had interpreted Section 501.114(a) of the Texas Act to be permissive: the use of the word "may" indicated that the statute did not require an assignor or assignee to comply with its provisions in order to effect an assignment of a lien or for perfection in that lien to

continue in an assignee. There had been no published judicial interpretations of Section 501.114(a) of the Texas Act until Clark Contracting, so assignees relied on two issues.

First, the fact that if the legislature had intended the procedures set forth in Section 501.114 to be the sole method of making a valid assignment of a perfected lien, it would have used more precise language indicating that to be the case.

Second, on the official comments to Section 9.310 of Article 9 of the Uniform Commercial Code and that of the UCC Permanent Editorial Board (PEB) in PEB Commentary No. 12 on Section 9-302 — the section of pre-Revised Article 9 that addressed matters now covered by Section 9.310 of Revised Article 9.

The PEB Commentary states that while Article 9 provides that matters of perfection of motor vehicles are governed by a state's certificate of title statute, matters of assignment of that perfected security interest may be governed by Article 9 if the

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assignment provisions in the certificate of title statute do not relate to perfection. Some states, including Florida, Georgia and New York, have made it explicit in their motor vehicle certificate of title statutes that re-titling is not necessary to perfect an assignment of a security interest in an assignee. Therefore, such assignment provisions do not relate to perfection and are instead governed by Article 9 provisions relating to assignment and the effect of assignment on perfection.

In many states, including Texas, assignment provisions in the certificate of title statutes do not address perfection of an assigned lien in the assignee — or are ambiguous as to whether they address it. In such cases, the PEB Commentary notes that judicial interpretation has been that certificate of title statutes should be construed in harmony with the general UCC scheme for perfection of security interests, which in the case of assignment of security interests can be found in Section 9.310(c) of the Texas UCC.

The PEB Commentary concludes that unless otherwise expressly required by a certificate of title statute, assignment provisions in certificate of title statutes should be not interpreted to require re-titling by assignees in order to maintain perfection in security interests assigned them by assignors.¹ Section

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9.310(c) of the Texas UCC provides that a secured party that assigns a perfected security interest need not make any filing under Chapter 9 of the Texas UCC in order to continue the perfected status of the assignor in the assignee against creditors of and transferees from the original debtor, including any judgment lien debtors. In addition, Section 501.005 of the Texas Act states that conflicts between provisions found in the Texas Act and the Texas UCC are to be resolved in favor of the provisions set forth in the Texas UCC.

In Clark Contracting, the bankruptcy court concluded that Section 501.114 unambiguously requires that application for re-titling must be made in order for an assignee of a lienholder to perfect its interest in a titled vehicle. By concluding that there was no ambiguity or conflict with the Texas UCC, the court avoided application of Section 501.005 and the rationale set forth in the PEB Commentary.

The bankruptcy court noted that the Texas Act provides notice to third parties of a prior lien on a motor vehicle by notating a lienholder on the title certificate. It also claims that the Texas Act must have a procedure in place to make sure that assignees are reflected on the face of the certificate of title in order to be consistent with “the larger scheme of perfection” adopted in the Texas Act, and that Section 501.114 provides that procedure by mandating recordation of the assignee’s lien on the certificate of title. However, the bankruptcy court fails to recon-

cile why Section 9.310(c) of the Texas UCC provides that no such recordation procedure is necessary for assignments with respect to all other asset types. Much like the existence of a financing statement filed against a debtor under Chapter 9, the indication on a title of the existence of a lien on a motor vehicle serves to put the world on notice the vehicle is subject to a lien and furthers the underlying purpose of the perfection scheme of the Texas Act without requiring the identification of the assignee lienholder.

Consequences and solution

Since the Clark Contracting decision, assignees of loans secured by Texas autos and other collateral governed by certificate of title statutes have questioned whether other Texas judges would follow the bankruptcy court’s decision and effectively render their liens unperfected. We know of no other Texas court that has since been confronted with this issue. And we understand that securitization participants have not begun the laborious and costly process of applying for new certificates of title for each of their Texas loans, instead hoping that the decision will be overturned upon appeal or eviscerated through legislation.

Despite the wait-and-see stance, there have been some noticeable and adverse changes. At least one sponsor withdrew 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 including those loans.

This is where the work of the ASF and Texas Business Law Foundation comes into play. After the court’s decision, the two organizations jointly lobbied the Texas Legislature. They drafted and supported legislation designed to ensure that both current and future assignee lienholders in motor vehicles and other titled assets need not apply for new certificates of title to be issued reflecting their names in order to enjoy the perfected status of their assignors.

Governor Rick Perry signed the legislation — Senate Bill Number 1592 — on June 19th and it went into immediate effect. As drafted, it reflects that the legislation is a “clarification” of existing Texas law, thus ensuring that liens assigned prior to the Bill’s effective date will be considered perfected. Its enactment should reassure securitization market participants that millions of Texas title certificates need not be re-titled in order to provide comfort that secured parties are properly perfected and should avert further securitization market disruptions on this issue. ▼

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