

Lien Priority between Motor Vehicle Floor Plan Lenders and Retail Lenders

Why Bank One v. Arcadia Financial is No Longer Good Law

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Introduction

In *Bank One v. Arcadia Financial*¹, the Fifth Circuit applied Texas law to give a floor plan lender priority over a retail purchaser's secured lender. The Court, in what many viewed as standing Article 9 of the Uniform Commercial Code ("UCC") on its head, ruled that the Texas Certificate of Title Act ("COTA") trumped the UCC.

Revised Article 9 exists in all states as do COTAs. Interpretation, and the language of the COTAs, however, can vary.

Bank One concerned whether the retail purchase of an automobile severed the security interest of the dealer's floor plan lender and gave priority to the retail lender's lien. Bank One argued that its security interest remained valid because the buyer did not receive the certificate of title (which it held) as required under COTA. Arcadia, the retail lender, argued that the buyer was a "buyer in the ordinary course of business" who took free and clear of Bank One's security interest. Accordingly, under the UCC, Arcadia's purchase money security interest took priority.

The Fifth Circuit held COTA controlled. Because the certificate of title was not transferred at the time of sale, the sale as between the dealer and buyer was void. Without a "sale" under COTA, the buyer's retail lender could not use the "buyer in ordinary course"

defense, and the floor plan lender's lien remained in effect.

Though the Texas Supreme Court hasn't decided the issue, statutory analysis and recent case law suggest that *Bank One* is not, and perhaps never was, good law. This article analyzes the relationship between COTA and the UCC and reviews the case law of Texas and three other states.

I. Statutory Analysis

1. COTA Does Not Govern Completion of Dealer's Sale

Under COTA, a vehicle can be sold at a *subsequent* sale only when the *owner* transfers the certificate of title. COTA defines a "dealer" as "a person who purchases motor vehicles for sale at retail." "Owner" is "a person, *other than a . . . dealer*, claiming title to or having a right to operate under a lien a motor vehicle." Thus, a "dealer" is not an "owner" that must transfer a certificate of title to complete the sale of a motor vehicle. A dealer's failure to "deliver" or "transfer" a certificate of title to the purchaser does not affect the validity of the sale under COTA.

2. The UCC Controls

When there is conflict between COTA and the Texas UCC, COTA expressly defers to the UCC. Thus, Article 2 of the UCC determines when the sale is complete and Article 9 determines priority of security interests.

Under Article 2, a "sale" consists of the "passing of title from the seller to the buyer for a price." This occurs when the dealer has been paid and delivers the vehicle to the buyer. A buyer in the ordinary course takes free of a perfected security interest even though the buyer knows of the security interest, unless the buyer knows that the sale violates an agreement with the secured party.

If the secured party authorized the sale by express agreement or otherwise, then the buyer takes free of a security interest. Under UCC § 2.403(b), by entrusting its collateral to the dealer, the lender authorizes the dealer to transfer all rights the lender has in the vehicle to a buyer in the ordinary course. Because a sale from a dealer to a purchaser is authorized, the lender's security interest in the vehicle is extinguished.

Under UCC § 9.315, a perfected security interest in inventory purchased does not follow the collateral after it is sold in the ordinary course of business. It attaches to sale proceeds.

Neither COTA nor the UCC allows a lender to perfect a security interest in inventory by retaining the certificates of title. Under COTA, lien-holders whose liens are properly perfected by recordation on the certificate of title have the right to retain the original certificates in their possession until the lien is retired. COTA does not provide the same right to lien-holders in inventory.

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¹ 219 F.3d 494 (5th Cir. 2000).

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3. Retail Lender Trumps Floor Plan Lender

Under the UCC, the retail lender's security interest attaches and becomes enforceable against the debtor and third parties when (1) value has been given, (2) the debtor has rights in the collateral, and (3) the debtor has authenticated a security agreement with a description of the property. As a buyer in the ordinary course, the purchaser severs the floor plan lender's interest in the vehicle as inventory and enables the retail lender's security interest to attach and be perfected as a first priority lien.

II. Texas Case Law Since *Bank One*

In *In re Dota*, the Southern District of Texas addressed a suit between a bank as floor plan

lender and the consumer purchaser. The buyer purchased two vehicles, but only received title to one. The seller did not pay the proceeds of the sale to the bank and the buyer filed bankruptcy. The bank demanded return of the untitled vehicle, arguing that the buyer was not a "buyer in the ordinary course of business" because he did not receive title.

The court found that the dealer was not covered under the specific terms of COTA because its definition of "owner" specifically excludes a "dealer." Because the buyer was a "buyer in the ordinary course ..." the buyer took free of any security interest in inventory.

Further, neither the UCC nor COTA permits perfection of security interests in inventory by possession of certificates of title. The bank had no right to keep title once the buyer purchased the vehicle and the dealer had a legal obligation to transfer title to the buyer.

In *First National Bank of El Campo v. Buss*, the Corpus Christi Court of Appeals held that the UCC preempted COTA in the event of conflicts. Under facts similar to *Dota*, the court held that "buyers in the ordinary course of business" cut off the lender's security interest in inventory. The court held that because there was a conflict between COTA and the "buyer in the ordinary course" provision of the UCC, the UCC controls.

In *Vibbert v. Par, Inc.*, the El Paso Court of Appeals held that failure to transfer a certificate of title to a dealership as part of a trade-in did not void a sale. The vehicle's owner traded it in on the purchase of a new car but title was never taken out of the owner's name. Because the original contract on the trade-in was never paid, the prior seller sued the subsequent retail lender for conversion of the automobile.

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The court found that it was not the purpose of COTA to impede vehicle transfers. Under the UCC, title to a purchased vehicle passes upon its delivery, regardless of whether the seller transfers the certificate of title. Thus, the sale of a vehicle without transfer of a certificate of title is valid between the parties when the purposes of COTA are not defeated.

III. Inter-Jurisdictional Analysis

Ohio

In *First Merit Bank v. Angelini*, the Ohio Court of Appeals found that the Ohio COTA trumped the UCC, specifically relying on a recent Ohio Supreme Court decision. However, Ohio's COTA provides that it prevails over the UCC in the event of conflicts. Without a transfer of the certificate of title to the purchaser, dealer's floor plan lender took priority over subsequent purchasers and their lenders. The court refused to find the retail lender's interest superior to the floor plan lender's interest where title had not been transferred.

California

In *Brasher's Cascade Auto Auction v. Valley Auto*, the court held that California's COTA could not be used to void a sale between a middleman and a dealer. The middleman financed the purchase of 32 vehicles from an auction house and then sold them to a vehicle dealer. The auction house possessed a secured interest in the middleman's 32 vehicles and held the certificates of title. The auction house's lien would remain against the vehicles until the middleman sold the vehicles and paid the auctioneer. When the middleman escaped with the money, the auction house sued the dealer. The auction house argued that no sale had occurred because the dealer never received the certificates of title.

The court determined that if the dealer could show it adhered to reasonable commercial standards sufficient to qualify as a "buyer in the ordinary course," the dealer's

purchase severed the auction house's liens on the vehicles. Under California law, the transfer of a vehicle is effective even if the parties have not complied with the COTA.

Colorado

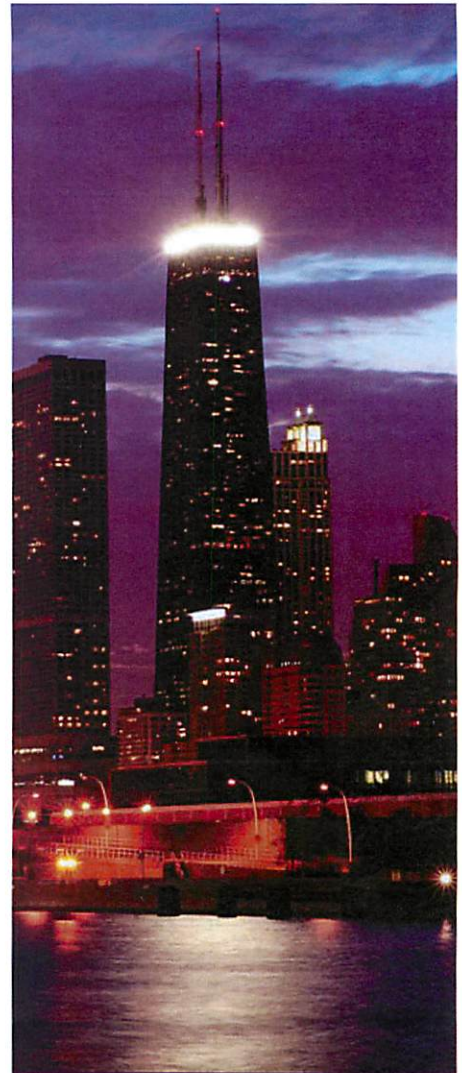
In *Valley Bank & Trust Company v. Holyoke Community Federal Credit Union*, the floor plan lender sued the consumer's lender when the proceeds of the sale were not paid to the floor plan lender. The floor plan lender maintained control over the certificates of title.

The court found that after the vehicle was sold, the floor plan lender's security interest was extinguished and transformed into a security interest in the proceeds. Since the floor plan lender authorized the dealer to sell the vehicles without informing the buyers that it reserved its rights in the collateral, the floor plan lender did not maintain a security interest in the sold vehicles. The retail lender's lien prevailed.

IV. Conclusion

The Texas Certificate of Title Act does not control on the issue of priority between a floor plan lender and a retail lender. COTA does not apply to dealers, nor is its purpose to impede the transfer of vehicles. *Bank One's* interpretation of COTA would impede the purchase of vehicles because retail lenders would not provide financing without a first priority lien. Lastly, in any potential conflict, Texas' COTA specifically defers to the UCC.

In states in which the UCC trumps the COTA, buyers in the ordinary course of business take free and clear of liens created by the seller. (In Ohio, the floor plan lender will prevail, since the Ohio COTA expressly trumps the UCC.) Because a dealer is authorized to sell inventory, a buyer's purchase will sever the floor plan lender's security interest, even when a certificate of title is not transferred. The floor plan lender will be left with a security interest in proceeds. The retail lender's purchase money security interest can then attach and be perfected as a first priority lien. ■



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