

SPOTLIGHT

The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code to be published after the previous edition of the Newsletter. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is shine a spotlight on major errors of analysis, and thereby provide practitioners and judges with reason to disregard the opinion as precedent.

The last column focused on judicial opinions containing one or more patent analytical errors. In contrast, the decisions noted here might not be wrong; reasonable readers might well conclude that both courts' analysis is correct. To that extent, then the cases present valuable lessons for litigators and legislatures.

Manufacturers and Traders Trust v. Wyoming Sand and Stone,
[2007 WL 397377](#) (3d Cir. 2007)

In the case, the debtor wished to sell several collateralized motor vehicles by auction. To facilitate the sale, the debtor's president asked the secured party to execute lien releases on the vehicles, with the understanding that the loan proceeds would be used to pay down the secured obligation. The secured party signed a release of lien on the back of the certificates of title and delivered the certificates to the auctioneer. Several of the vehicles were sold and the proceeds transferred to the secured party. The debtor then filed for Chapter 11 bankruptcy protection.

At the secured party's request, the state department of motor vehicles issued new certificates of title for the unsold vehicles. These certificates noted the secured party's lien. Thereafter, the debtor again hired the auctioneer to sell the remaining vehicles and the secured party again signed and delivered a release of lien to facilitate the sale and maximize the sale proceeds. The auctioneer sold the vehicles and the proceeds were placed in an escrow account maintained by the secured party. One of the debtor's unsecured creditor's then challenged the secured party's right to the auction sale proceeds.¹

The bankruptcy court and district court both ruled that by executing the release of lien on the certificates of title, the secured party released its security interest and was therefore not entitled to the sale proceeds. On appeal, the Third Circuit affirmed. The secured party tried to distinguish a 1992 bankruptcy court decision involving a mistakenly executed lien released by arguing that in that case, *In re Cavalieri*, [142 B.R. 710](#) (Bankr. E.D. Pa. 1992), the creditor has also mistakenly marked the loan agreement as "paid." The Third Circuit was unpersuaded. It ruled that the secured party had released its lien prior to the sale and thus was simply not entitled to the sale proceeds.

¹ It is unclear from the opinion whether the challenge applied to both auction sales or only to the postpetition sale.

There are several aspects of this decision that are disturbing. First, in some places the court seems to confuse the concepts of attachment and perfection. For example, near the end of the brief opinion, the court stated, “[t]he crucial factor is whether the lien is noted on the certificates. . . . Because M & T Bank released the lien, no lien was noted on the certificates.” Nevertheless, the court does correctly treat the issue as an attachment question, not a perfection question, and any confusion or ambiguity in the court’s language is of minor consequence.

Second, the opinion contains no discussion of the potentially conditional nature of the secured party’s execution of the lien releases. There appears to be no dispute that the creditor executed the lien releases to facilitate the sale (*i.e.*, to maximize the sale proceeds) *and with the express understanding that it was to receive the sale proceeds*. The court expressly ruled that the secured party’s motive to facilitate the sale “was not determinative,” by which it apparently meant not relevant. However, it never discussed whether the secured party’s act was conditional. Perhaps the secured party never advanced such an argument. It should have. Just as the execution and delivery of any single document at a closing is normally conditioned on the execution and delivery of all the other closing documents, perhaps the secured party’s execution of the lien release was conditional on receipt of the sale proceeds.

Perhaps related to this, there was also a disturbing inattention to agency principles. The secured party delivered the executed lien releases not to the debtor, but to the hired auctioneer. While the debtor may have been the one who initially selected and hired the auctioneer, it was apparently the auctioneer – not the debtor – who decided to seek the lien releases before conducting the sale. It seems plausible, then, the at least for this purpose, the auctioneer became the secured party’s agent, not merely the debtor’s agent. After all, the debtor and the secured party had compatible interests in facilitating the auction, and there is thus no reason to think that the auctioneer could not be the agent of both parties. *See, e.g.*, Restatement (Third) of Agency § 3.16 (2006). If so, there arguably was no effective delivery of the lien releases prior to the sale, thus preventing the lien releases from having effect until then.

Regardless of whether the deficiencies in the court’s opinion are traceable to omissions from the creditor’s brief, the lesson for secured parties are clear. Do not execute and deliver a bare release of lien prior to a sale of the collateral. Instead sign an authorization for the debtor to sell the property free of the security interest. *See* § 9-315(a)(1).

In re Villa,
2007 WL 397373 (Bankr. D. Kan. 2007)

The interaction of state certificate of title laws with revised Article 9 of the Uniform Commercial Code is not always smooth. The newly proposed Uniform Certificate of Title Act should remove all or almost all of the problems and confusion, but unless and until states enact it, creditors, lawyers, and judges are left trying to harmonize two different pieces of legislation that do not always seem to be speaking the same language. This case is illustrative.

Under Kansas law, a security interest in a mobile home may normally be perfected only by having the lien noted on the certificate of title. It is not enough to send the appropriate

documentation to the Division of Vehicles. Instead, the lien must be noted on the certificate.² However, a purchase-money security interest (“PMSI”) in a mobile home may be perfected merely by completing and sending a notice of security interest to the Division, along with the applicable fee. Specifically, the statute provides that:

The dealer or secured party may, within 10 days of the sale and delivery, mail or deliver the notice of security interest, together with a fee of \$2.50, to the division. . . . The proper completion and timely mailing or delivery of a notice of security interest . . . shall perfect a security interest in the . . . mobile home described on the date of such mailing or delivery.”³

In the case at hand, the debtor purchased a mobile home from a dealer on June 17, 2003. She granted the dealer a PMSI to secure a portion of the purchase price. The dealer immediately assigned its paper to Home Pride Finance Corp. and mailed the existing certificate of title to Home Pride. However, no certificate of title listing the debtor as owners was ever issued. The mobile home was delivered to debtor before August 1, 2003.

On August 15, 2003, Home Pride filed a properly completed notice of security interest, along with the requisite fee. Two years later, the debtor filed for bankruptcy protection and the trustee eventually sought to avoid Home Pride’s lien, claiming it was unperfected because the notice of security interest was not filed within the applicable 10-day period. The court agreed. It ruled that because notice was sent 14 days after delivery, it was not “timely” mailed within the meaning of the statute.

The case is a bit troubling because the delay in mailing is invisible to any subsequent searcher. In other words, the purpose of statute’s perfection rules is to provide a method of giving public notice of a security interest to others interested in acquiring an interest in the property. Anyone searching after the notice was filed would learn precisely the same thing, regardless of whether the notice was filed within the 10-day period or after it. Thus, there is simply no reason for perfection to depend on when the notice was filed, merely on the fact that it had been filed.

Home Pride appears to have made this point to the court, arguing that the 10-day rule was simply a relation-back provision. In other words, a creditor who mails the notice within the 10-day is deemed perfected on the date of mailing, whereas one who mails it later is deemed perfected on when the Division files it. While the court found merit in Home Pride’s argument, it felt constrained by the plain wording of the statute. It also noted that its interpretation promotes prompt filing.

One might well disagree with the court’s conclusion and its almost cavalier disregard of the basic principles underlying Article 9. Nevertheless, the court had a difficult task. The state’s certificate of title statute simply does not mesh well with Article 9 and the language or policy of one was going to have to yield to the other. Perhaps the lesson here is for state legislatures and state bar UCC Committees to closely scrutinize any state law or proposed state legislation that supplants

² Cf. Uniform Certificate of Title Act §§ 25, 26(a), making perfection effective upon delivery of the security-interest statement to the appropriate state agency and payment of the applicable fee, regardless of whether the interest is ever noted on the certificate. See also U.C.C. § 9-516(a) (providing a similar rule for perfection by filing a financing statement).

³ Kan. Stat. Ann. § 58-4204(g).

Article 9's filing system,⁴ and make sure the two work together properly. The UCC Committee of the ABA stands by to assist in this endeavor. It can provide experts willing to assist in the analysis involved.

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⁴ See U.C.C. § 9-311(a).