

**PERFECTING LIENS IN VEHICLE INVENTORY:
A COURT SHEDS SOME LIGHT ON A CLOUDY TOPIC**

In our November 2004 *ALERT* entitled *Financing Vehicle Lessors & Dealers: Is it inventory?*, we provided you with a brief analysis of the cloud hanging over a secured party's perfection of its lien when financing vehicle lessors. The issue was whether a secured lender would "perfect" its security interest by identification of the lien on the Certificate of Title or by filing a UCC-1 Financing Statement. The analysis focused on UCC §9-311(d) which contains an "exception" to the general rule that a lender must identify its lien on the Certificate of Title by stating that when the collateral is inventory of the debtor, a lender must file a UCC financing statement. Specifically, UCC §9-311(d) provides that if the collateral is vehicle inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind, the secured party must perfect its security interest by filing a financing statement. As we identified in our November Alert, the phrase "selling goods of that kind" created ambiguity as to when this exception applied (in which case a UCC-1 financing statement would be required to perfect the security interest) and when it did not (in which case perfection would occur by denoting the lien on the Certificate of Title). However, in a recent Florida Court of Appeals case entitled *Union Planters Bank, N.A. v. Peninsula Bank*, 897 So.2d 499, 56 UCC Rep. 2d 356 (Fla. CT. App. 2005), the Appellate Court provided us with some guidance as to its interpretation of the phrase "selling goods of that kind". This is significant since most vehicle lessors do "sell" vehicles either after repossession or upon expiration of the lease term.

By way of background, the official comment to UCC §9-311(d) makes it clear that if the debtor eventually sold the goods, it does not necessarily mean that the debtor is in the business of selling goods of that kind. Commentators have stated that factors relevant to making the determination of whether or not the debtor is selling goods of that kind includes *the total value of the used fleet sales, the percentage of the debtor's income or profits* which are attributable to the sales, the residual value left in the vehicles at the time of sale, *how the debtor holds itself out to third persons in its advertising* and financing statements and *the method of selling the used vehicles* at the end of their useful life. This, unfortunately, created a potentially complex analysis to determine how a lender should perfect its security interest in vehicle inventory and, obviously, falls far short of the preferred "bright line" distinction necessary to set up proper perfection procedures.

In the *Union Planters* case, the Florida Appellate Court provides us with some insight. The facts in *Union Planters* are straightforward. The debtor, InterAmerican Car Rental Inc., defaulted on its secured loans. Two of its secured creditors (Peninsula Bank and Ocean Bank) perfected their security interests on InterAmerican's rental vehicles by identifying their liens on the Certificate of Titles. Union Planters (a competing secured lender) was also provided a security interest in InterAmerican's fleet of rental cars but chose to file only UCC-1 financing statements on the vehicle inventory. Union Planters did not identify its security interest on the Certificates of Title. Union Planters' financing statement was the first financing statement filed against InterAmerican's vehicle inventory. As a result, the battle lines were drawn as Union Planters argued that the exception in UCC §9-311(d) was applicable to this case and, therefore, it maintained a first position security interest on the rental cars (by the earlier filing of its UCC-1). In contrast, Peninsula Bank and Ocean Bank argued that that section did not apply and, therefore, they maintained a first position security interest on the rental fleet due to their identification of their liens on the Certificates of Title.

There was no dispute that InterAmerican was a traditional rental car company that sold a portion of its rental fleet each year. Union Planters argued that InterAmerican is in the business of selling goods of that kind by putting forth evidence that InterAmerican sold approximately 4,000 used vehicles per year, earning 60% to 70% of its revenue from these sales.

The Florida Court was not convinced and rejected Union Planters' position, holding that InterAmerican was not "in the business of selling used cars". The Court explained its decision by stating that InterAmerican is in the business of renting motor vehicles. InterAmerican only sold its used vehicles when they had lost their usefulness in its rental business (approximately 9 months) and all of the vehicles were sold direct to

dealers and wholesalers or through wholesale auctions. InterAmerican never advertised the sale of these vehicles to the public and never sold the vehicles directly to the public. The Court then supported its position by citing that portion of the Official Comment to UCC §9-311(d) that states that the "fact that the debtor eventually sells the goods does not, *of itself*, mean the debtor is in the business of selling goods of that kind".

Moreover, the Court stated that InterAmerican held itself out "exclusively" as a short term rental car company and never possessed a dealer's license. The Court further analyzed the Florida statute which stated that a "motor vehicle dealer" does not include a person engaged in the purchase or sale of motor vehicles as a business who are disposing of vehicles acquired for their own use or the use of their business. The Court reasoned that since InterAmerican was simply "disposing" of the vehicles after their useful life in their business, it was not a "motor vehicle dealer" under Florida law and thereby concluded that InterAmerican was not in the "business of selling used cars". The Court went further and stated:

[t]o conclude otherwise would require tortured logic and lead to an absurd result. InterAmerican sells gasoline and automobile insurance to those who rent their vehicles, and yet no one would argue that it is in the insurance or gasoline sales business. It is axiomatic that in order to operate a car rental company, one by necessity must constantly phase out (sell) its older inventory and restock its fleet with new or newer vehicles.

The significance of the *Union Planters* case is the Court's focus on the true business of the company rather than all the components that are part and parcel to its business. Clearly there was no dispute that this was a "rental company." Although Union Planters argued that the debtor generated 60% to 70% of its revenue from the sale of 4,000 vehicles per year, despite its appearance to the general public, the Florida Court was not persuaded and looked purely to the advertised portion of the business - that is, a short term rental car company. *Query*: Would the result would have been different had InterAmerican sold a portion of its fleet to the public at large?

It is interesting to note that although Peninsula Bank and Ocean Bank won this battle, they had also filed UCC-1 financing statements (albeit, after Union Planters) to cover either requirement - a prudent approach in dealing with this issue.

As set forth in our November Alert, the manner in which a funding source perfects its security interest in vehicle inventory also has an affect on the "notice of sale" that must be provided by the secured party to other lienors prior to the disposition of that collateral. Clearly, if the perfection must be accomplished by the UCC filing, the lender can only identify other lienors by performing a UCC lien search. However, to the extent perfection is only by identification on the Certificate of Title, no such UCC search would be required. As we stated in the past, a sensible approach is to always file a UCC financing statement and identify the lien on the Certificate of Title and it is similarly prudent to perform a UCC lien search before providing a notice of sale to other lienors. While the *Union Planters* case is instructive, it also highlights the precarious nature of perfection of liens in vehicle inventory.

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