No. F076205

Court of Appeal

OF THE

State of California

Fifth Appellate District

RON MILLER ENTERPRISES, INC.,
dba **FRESNO COMMERCIAL LENDERS,**

Plaintiff and Appellant,

vs.

LOBEL FINANCIAL CORPORATION, INC.,

Defendant and Respondent.

Amicus Brief of AFSA in Support of Petition for Rehearing

Appeal from a Judgment of the Fresno County Superior Court
Case No. 15CECG02661, Honorable Donald Black, Judge

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I.

INTEREST OF AMICUS CURIAE

The American Financial Services Association ("AFSA") is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance. AFSA's broad membership, ranges from large international financial services firms to single-office, independently owned consumer finance companies.

For over 100 years, AFSA has represented financial services companies that hold leadership positions in their markets and conform to the highest standards of customer service and ethical business practices. AFSA advocates before legislative, executive and judicial bodies on issues affecting its members' interests. (See, e.g., *American Financial Services Assn. v. City of Oakland* (2005) 34 Cal.4th 1239, 1245.)

AFSA has often appeared in court as a party or amicus in cases affecting its members' interests. In the regular course of their business, AFSA members finance many new and used automobiles sold to California consumers. As purchasers of conditional sales contracts from automobile dealers, AFSA's members have a direct interest in the priority dispute and issues raised on this appeal.

II.

INTRODUCTION

The Court's opinion in this case addresses a priority issue of great and growing concern to AFSA members. Unfortunately, the prior briefing on this appeal did not guide the Court to the express statutory resolution of that

priority issue. Likely for that reason, the Court's opinion also fails to mention the controlling statute, Commercial Code section 9330. Because it overlooks that statute, the opinion also reaches an incorrect result.

As the Court's opinion has now been published, it will adversely affect the entire automobile finance industry in California. The opinion also conflicts with an otherwise unanimous line of out-of-state authority interpreting section 9330 and its predecessor, thus establishing a California-only exception to the Uniform Commercial Code's ("UCC's") otherwise uniform priority rules.

The Court should grant rehearing to correct its opinion, or in the alternative, vacate its order for publication of the opinion.

III.

THE PRIORITY ISSUE IN THIS CASE IS OF GREAT AND GROWING CONCERN TO THE AUTOMOBILE FINANCE INDUSTRY

The priority issue that lies at the heart of this appeal is of great and increasing concern to the automobile finance industry in California.

Particularly after the decision in *Quartz of Southern California, Inc. v. Mullen Bros., Inc.* (2007) 151 Cal.App.4th 901 ("*Quartz*"), lenders financing automobile dealers' used car inventory have taken possession of the financed cars' certificates of title as a means of achieving, in effect, a non-statutory lien priority over purchasers of the dealers' chattel paper.

This increasingly frequent practice harms the innocent consumers who buy the financed cars. Though the Commercial Code provides that these consumer purchasers take ownership of the cars free of any security interest in the dealer's inventory (Com. Code, §§ 2403(2), (3), 9320(a)), inventory lenders,

like Ron Miller Enterprises, Inc. ("Ron Miller") in this case, have refused to release the certificates of title to the car buyers until the amounts advanced on the sold cars have been repaid. (See Opn., 4.) As a result, the consumer car buyers are deprived of clear title to their cars, often for years, or are forced to apply to the Department of Motor Vehicles for issuance of duplicate certificates of title. Lack of a certificate of title will prevent the buyer from reselling the car. If the car is involved in an accident, the buyer may have difficulty collecting on insurance due an inability to prove that he or she has an insurable interest in the car. (See *Tyler v. Emplrs. Mut. Cas. Co.* (2002) 274 Kan. 227, 235, 49 P.3d 511, 516; *Aetna Casualty & Sur. Co. v. A.L.J.A., Inc*. (D. Mass. 1995) 905 F. Supp. 36.)

The practice has also resulted in a spate of litigation between inventory lenders and chattel paper purchasers raising the same priority issue involved in this appeal.[1] The eight cases cited in the footnote are but a small sample of the many instances in which this priority issue has been raised in litigation. In addition, the issue has been the key bone of contention in many other matters that have settled short of litigation.

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[1] See, e.g., *Gateway One Lending & Finance LLC v. ABS Finance Co*., Orange County Superior Court, No. 30-2018-00980148; *Westlake Flooring Co., LLC v. Gateway One Lending & Finance, LLC*, Orange County Superior Court, No. 30-2018-00975564; *Auto Finance Solutions, LLC v. Credit Acceptance Corp.*, Orange County Superior Court, No. 30-2017-00913248; *Floorit Financial, Inc. v. Gateway One Lending & Finance, LLC*, Orange County Superior Court, No. 30-2016-00863874; *ABS Finance Co., etc., et al., v. Juno Equipment Rentals, Inc*., Orange County Superior Court, No. 30-2015-00823448; *ABS Finance Co. v. Fire & Ice, Inc*., San Bernardino County Superior Court, No. CIVDS1407864; *Gateway One Lending & Finance, LLC v. ABS Finance Co*., San Bernardino County Superior Court Nos. CIVDS1314467 & CIVDS1314476.

As the priority issue in this case is of great importance to the automobile finance industry in California, the Court should grant a rehearing to consider Commercial Code section 9330 and its impact on the opinion's reasoning and result. If the Court is unwilling to do so because the parties failed to call the Court's attention to section 9330 in their prior briefing of this appeal, it should at least vacate the order for publication of its opinion. A single party's procedural error should not cause an entire industry to be shackled by a published decision that fails to discuss the relevant statute and reaches an incorrect result.[2]

IV.

COMMERCIAL CODE SECTION 9330 GRANTS A CHATTEL PAPER PURCHASER PRIORITY OVER AN INVENTORY LENDER

The UCC answers the priority issue raised by this suit, expressly giving priority to the chattel paper purchaser, not the inventory lender.

As the opinion correctly states, Ron Miller's security interest in the cars at issue in this case is governed by the UCC, not the Vehicle Code, because the dealers held the cars that Ron Miller financed as inventory. (Opn., 9; Com. Code, § 9311(a)(2)(A), (d); Veh. Code, § 5907.)

When the dealers sold the financed cars in the ordinary course of business to consumers, the consumers took the cars free of Ron Miller's security interest. (Opn. 14-15; Com. Code, §§ 2403(2), (3); 9320(a).) Ron Miller's security interest then attached to the proceeds of those car sales, which were

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[2] The Court's opinion has already drawn a commentator's criticism as ill-reasoned and "bad law." (See Schechter, 2019-12 Comm. Fin. News. NL 23, Purchaser of Conditional Sales Contracts is Liable for Debts of Defaulting Dealerships Because Senior Inventory Lender Retained Vehicles' Title Certificates.)

the conditional sales contracts the consumers signed. (Com. Code, §§ 9102(a)(64)(A), 9315(a)(2).)

When the dealers sold the conditional sales contracts to Lobel Financial Corporation ("Lobel"), Commercial Code section 9330(a) governed the conflict between Lobel's and Ron Miller's security interests in those contracts. So long as Lobel bought in good faith and in the ordinary course of its business[3] and met section 9330(a)(1)'s other requirements, section 9330(a) granted Lobel's interest in the conditional sale contracts priority over Ron Miller's, as the contracts did not bear a legend stating they had been assigned to Ron Miller.[4]

In other words, under the UCC's express provisions, the consumers bought the cars free of Ron Miller's security interest, and Lobel took the conditional sales contracts free of Ron Miller's security interest as well. Ron Miller's security interest then reattached to the proceeds of the sale of the conditional sales contracts; namely, the cash proceeds that Lobel paid the dealers for the contracts. (Com. Code, §§ 9102(a)(64)(A), 9315(a)(2).) If Ron Miller's agreements with the dealers so provided or if the dealers were in

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[3] To qualify as a buyer in good faith and the ordinary course of business, a chattel paper purchaser need not determine whether the dealer holds the certificate of title. "This approach, under which the chattel paper purchaser who gives new value in ordinary course can rely on possession of unlegended, tangible chattel paper ***without any concern for other facts that it may know***, comports with the expectations of both inventory and chattel paper financers." (Com. Code, § 9330, UCC cmt. 5; emphasis added.)

[4] Section 9330 is the latest codification of a priority rule that has a long history that goes back at least to the Uniform Trust Receipts Act, adopted in California in 1935. (See *Security-First Nat. Bank v. Taylor* (1954) 123 Cal. App.2d 380, 381, 385-388.) In the original version of Article 9, the same rule was codified in the second sentence of former section 9308. (See 2 Gilmore, Security Interests in Personal Property (1965) §§ 27.2, 27.3, pp. 727-730.)

default, Ron Miller was entitled to take those cash proceeds and apply them in payment of its loans to the dealers. (Com. Code, § 9607(a)(2).)

V.

THE INVENTORY LENDER DID NOT GAIN ANY GREATER RIGHTS BY RETAINING POSSESSION OF THE CERTIFICATES OF TITLE

Ron Miller, the inventory lender in this case, did not enhance its rights as against the consumer buyers of the cars or as against Lobel, the purchaser of their conditional sales contracts, by retaining possession of the cars' certificates of title.

Under the Vehicle Code, a lender like Ron Miller cannot gain an ownership and security interest in a motor vehicle by taking physical possession of its certificate of title. Instead, a transfer of any interest in a car is perfected only by proper endorsement of the certificate of title and delivery of the endorsed certificate to the Department of Motor Vehicles. (Veh. Code, §§ 5600(a), 5750, 5751, 5909.) Moreover, as the opinion correctly states, the Vehicle Code is completely inapplicable to Ron Miller's interest in the cars at issue in this case because they were held as inventory by the dealers. (Opn., 9; Com. Code, § 9311(a)(2)(A), (d); Veh. Code, § 5907.) For both reasons, Ron Miller gained no greater interest in the cars or their proceeds under the Vehicle Code by retaining possession of the cars' certificates of title.

Ron Miller also gained no greater rights under the UCC by retaining possession of the certificates of title. A certificate of title is not one of the types of property in which a security interest may be perfected by possession under the UCC. (See Com. Code, § 9313.) Indeed, a certificate of title is not property in itself but simply evidence of ownership, or of a security interest, in a motor vehicle.

Possession of the certificates of title did not confer any additional rights on Ron Miller as against buyers of the cars or purchasers of the buyers' conditional sales contracts under any other statute either. Neither car buyers nor chattel paper purchasers were party to or bound by Ron Miller's agreements with the dealers. So even if Ron Miller acquired additional rights against the dealers by retaining possession of the certificates of title, it did not thereby enhance its position vis-à-vis the car buyers or chattel paper purchasers.

Instead, by retaining physical possession of the certificates of title, Ron Miller attempted to exercise a non-statutory, secret lien on cars it entrusted to the dealers for sale as their inventory. Since well before the Declaration of Independence, such secret non-possessory liens have been condemned as transfers to defraud creditors.[5] (*Twyne's Case*, Case (Star Chamber 1601) 3 Coke Rep. 806, 76 Eng. Rep. 809.) Non-possessory liens on personal property became permissible only on enactment of statutes that required public notice of the liens. (See *Robinson v. Elliott* (1874) 89 U.S. 513, 520-526; Gilmore, Article 9: What It Does for the Past (1966) 26 La.L.Rev. 285, 289, 298.)

California's certificate of title law and Commercial Code, article 9 are the modern day successors of the earlier statutes allowing non-possessory liens but only upon public notification, either through the Department of Motor Vehicle's records of ownership of cars, or through the Secretary of State's records of UCC-1 financing statements. Ron Miller's attempt to gain rights by

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[5] Though Ron Miller had possession of the certificates of title, its lien was still non-possessory since the dealers had possession of the goods, the cars. And, as the opinion notes, Ron Miller's agreements with the dealers "clearly reflected the parties' understanding that the dealerships would be selling the vehicles … [and] the sales contemplated by the parties necessarily included sales to consumers." (Opn., 15.)

retaining physical possession of certificates of title complies with neither of these statutes. Its physical possession is not reflected in any public record. It is the very type of secret lien that Anglo-American law has always condemned as a fraud on creditors.

Though the question may be new in California, other states' courts have long held that an inventory lender cannot overcome a chattel paper purchaser's UCC-granted priority by retaining possession of car titles. (See, e.g., *Duke Wholesale, Inc. v. Pitchford* (2001) 75 Ark. App. 223, 229-230, 56 S.W.3d 399, 403-404; *American Clipper Corp. v. Howerton* (1984) 311 N.C. 151, 158, 166-168, 316 S.E.2d 186, 190, 194-195; *Commercial Credit Corp. v. National Credit Corp.* (1971) 251 Ark. 541, 549-550, 473 S.W.2d 876, 880-881; *Associates Discount Corp. v. Old Freeport Bank* (1966) 421 Pa. 609, 613, 220 A.2d 621, 623-624.

The Court should grant rehearing to align California with this unanimous line of out-of-state authority rather than create a needless disuniformity in application of the UCC to this common fact pattern.

VI.

QUARTZ DOES NOT SUPPORT THE OPINION'S REVERSAL OF SECTION 9330's RULE OF PRIORITY

Quartz does not support the opinion's conclusion that the inventory lender, Ron Miller, held rights superior to those of the chattel paper purchaser, Lobel, in this case. As Mr. McMillen said in his letter requesting publication of the opinion in this case, this case involves "a set of facts significantly different tha[n] those presented previously."

In *Quartz*, the auction house plaintiff owned the cars in question. It had perfected its title to those cars under the Vehicle Code. It did not hold any

security interest in the cars. (*Quartz*, 151 Cal.App.4th at pp. 907-908.) Here, by contrast, Ron Miller never owned the cars. It never perfected any title under the Vehicle Code. It held only a security interest in cars in the dealers' inventory. (Opn., 3-4.) As Mr. McMillen put it, "[t]his is significantly different tha[n] the facts in *Quartz*."

The "significantly different" facts make a critical legal difference for several reasons. First, the Commercial Code does not provide an express priority rule to govern a conflict of the type at issue in *Quartz*—that is, between a perfected ownership interest under the Vehicle Code and a perfected interest in chattel paper under the Commercial Code. In the absence of express statutory language governing the facts, the *Quartz* court could and did resort to statutory policy to reach its conclusion. (*Quartz*, 151 Cal.App.4th at pp. 910-911.)

By contrast, in this case, both Ron Miller's and Lobel's security interests are governed solely by the Commercial Code. And that Code contains an express priority rule governing the type of conflict between the interests of an inventory lender and a chattel paper purchaser that is at issue in this case. (Com. Code, § 9330(a).) When a statute prescribes a rule fitting the circumstances of the case, the Court is not free to reach a different conclusion based on its view of statutory policy. (See *Cassel v. Superior Court* (2011) 51 Cal.4th 113, 125; *Pacific Hills Homeowners Assn. v. Prun* (2008) 160 Cal. App.4th 1557, 1564.)

Second, Quartz held title—that is ownership of the cars, not just the certificates of title. "Quartz holds title to the vehicles unimpaired by any security interests." (*Quartz*, 151 Cal.App.4th at p. 906.) Ron Miller, by contrast, never held title. It held only certificates of title which listed others as the registered and legal owners of the cars. Quartz's title to the cars could be

easily verified by consulting the Department of Motor Vehicles' public records. Ron Miller's retention of the certificates of title, by contrast, was not reflected in any public record. It was an attempt to secure a secret non-possessory lien.

Third, as owner of the cars, Quartz was entitled to retain possession of its certificates of titles until it was paid. Ron Miller, by contrast, had no legal right to retain the certificates of title. It was unlawful for Ron Miller to refuse to release those certificates to the consumer buyers who were lawfully entitled to a transfer of registration after purchasing the cars free of Ron Miller's security interest. (Veh. Code, § 5753(a); Com. Code, § 2403(2), (3), 9320(a).)

Ron Miller's agreements with the dealers created no rights binding on either the car buyers or Lobel, who were not parties to those agreements. As assignee of the conditional sales contracts, Lobel may have stepped into the dealers' shoes and assumed the dealers' obligations under those contracts, but it did not thereby agree to be bound by the dealers' separate agreements with Ron Miller.

Thus, *Quartz* is inapposite and does not support the opinion's conclusion.

VII.

CONCLUSION

For the reasons stated above, the Court should grant rehearing and amend its opinion or depublish the opinion to avoid making bad law for the automobile finance industry.

DATED: March 28, 2019

SEVERSON & WERSON
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By: */s/ Jan T. Chilton*
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PROOF OF SERVICE

At the time of service, I was over 18 years of age and not a party to this action. I am employed in the County of San Francisco, State of California. My business address is One Embarcadero Center, Suite 2600, San Francisco, CA 94111.

On March 29, 2019, I served true copies of the following document(s):

AMICUS BRIEF OF AFSA IN SUPPORT OF PETITION FOR REHEARING

on the interested parties in this action as follows:

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BY CM/ECF NOTICE OF ELECTRONIC FILING: I electronically filed the document(s) with the Clerk of the Court by using the CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the CM/ECF system. Participants in the case who are not registered CM/ECF users will be served by mail or by other means permitted by the court rules.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on March 29, 2019, at San Francisco, California.

/s/ Chilaren L. Kada
Chilaren L. Kada