



Gould



Sharensen

Avoiding Avoidance: Perfecting Security Interests and Bankruptcy

By Donald W. Gould, II and Andrew Sharensen
Johnson DeLuca Kurisky & Gould

In this Issue:

Feature Articles	1, 7, 8
Executive Director's Message ...	4
New Members	6
Advertising Opportunity	13
Board of Directors.....	14

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If you ask the average title clerk what is the deadline to perfect a security interest on a vehicle, more often than not the answer would be that the lenders give the dealership sixty days to record their lien on the vehicle's title. A sharp title clerk might note that they are required by the state to submit the title application within a shorter period of time, usually twenty to thirty days from the date of the sale. But while the concerns of late filing fees and repurchase demands from lenders are significant, most dealerships are completely unaware that the most important deadline is thirty days from the date of delivery. That is the period of time the United States Bankruptcy Code gives a purchase money lender to perfect a security interest in order to not be subject to the bankruptcy trustee's avoidance powers.¹

There are generally two main variations on how state law approaches the perfection of security interests on financed motor vehicle sales. Some states allow perfection to relate back to the time of creation of the security interest if the required application and fee is submitted within the deadline set forth by the statute.² Otherwise, the security interest is perfected upon delivery to the relevant title office. Other states have no provision to allow

Most dealerships are completely unaware that the most important deadline is thirty days from the date of delivery.

a security interest to relate back to the time of creation. However, these states generally have two variations on how the security interest is perfected. In some states, the security interest is perfected upon filing or delivery of the application and required fee to the title office.³ In other states, the security interest is perfected upon the recordation of the lien on the title or the notation by the clerk in the title processing system.⁴ Finally, in most jurisdictions, dealerships have thirty days to file an application for certificate of title.⁵

Under the Bankruptcy Code, a creditor has thirty days after the debtor receives possession of the property to perfect a security interest in order to escape the trustee's ninety day avoidance powers.⁶ Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the deadline was only twenty days. This raised the issue of whether a state's relation back statute could save a creditor from failing to perfect within the time required under the bankruptcy code. This issue

Disclaimer: The *Defender* articles do not constitute legal advice and are not independently verified. Any opinions or statements contained in articles do not reflect the views of NADC. Cases cited in articles should be researched and analyzed before use.

came before the U.S. Supreme Court, which held that the perfection period under the Bankruptcy Code could not be modified by any state relation back statute.⁷

If a dealership fails to timely perfect a security interest, the trustee has the power to avoid the lien and sell the vehicle to satisfy other creditors. The dealership, after presumably having to repurchase the retail installment contract from the lender, is then an unsecured creditor and may only recover pennies on the dollar in the bankruptcy proceeding. The only option at that point is to initiate an adversary proceeding to see whether the trustee will agree to release the vehicle to the dealership in lieu of further litigation.

It is probably a universal practice for dealerships to put used vehicles on the front line before the dealership obtains the certificate of title from the prior lien holder. Dealerships seem to be willing to risk penalties from the state and a repurchase demand from a lender in order to get a used vehicle on the market as fast as possible. Dealerships must understand that the real risk behind marketing a vehicle prior to obtaining the certificate of title is losing the vehicle to a bankruptcy trustee in exchange for pennies on the dollar as an unsecured creditor. ■

References

1. 11 U.S.C. § 547(c)(3)(B).
2. *See, e.g.*, VA. CODE ANN. § 46.2-639 (security interest relates back if filed within thirty days of the date of purchase); N.C. GEN. STAT. ANN. § 20-58.2 (twenty days); FLA. STAT. ANN. § 319.27 (fifteen days of the date of delivery and execution of security agreement); S.C. CODE ANN. § 56-19-630 (ten days).
3. *See, e.g.* MD. CODE ANN., TRANSP. § 13-202; TENN. CODE ANN. § 55-3-126; COLO. REV. STAT. ANN. § 42-6-121; CAL. VEH. CODE § 6301.
4. *See* OHIO REV. CODE ANN. § 4505.13 (security interest perfected upon notation on the certificate of title or recordation by the clerk into the automated title processing system if a physical certificate of title has not been issued); TEX. TRANSP. CODE ANN. § 501.113 (security interest is perfected when titling system is updated or when application for title is accepted by the tax assessor).

5. *See, e.g.* OHIO REV. CODE ANN. § 4505.06; MD. CODE ANN., TRANSP. § 13-113(c); COLO. REV. STAT. ANN. § 42-6-112; VA. CODE ANN. § 46.2-600; FLA. STAT. ANN. § 319.23; GA. CODE ANN. § 40-3-33; *but see* S.C. CODE ANN. §§ 56-3-210 & 56-19-370 (forty-five days); N.C. GEN. STAT. ANN. § 20-73 (twenty-eight days); N.C. GEN. STAT. ANN. § 20-79.1(c) (ten days if dealer issues a temporary tag); CAL. VEH. CODE § 4456 (twenty days if new; thirty if used); TEX. TRANSP. CODE ANN. § 501.0234; 43 TEX. ADMIN CODE § 215.144 (twenty business days).

6. 11 U.S.C.A. § 547(c)(3).

7. *Fid. Fin. Servs., Inc. v. Fink*, 522 U.S. 211 (1998).

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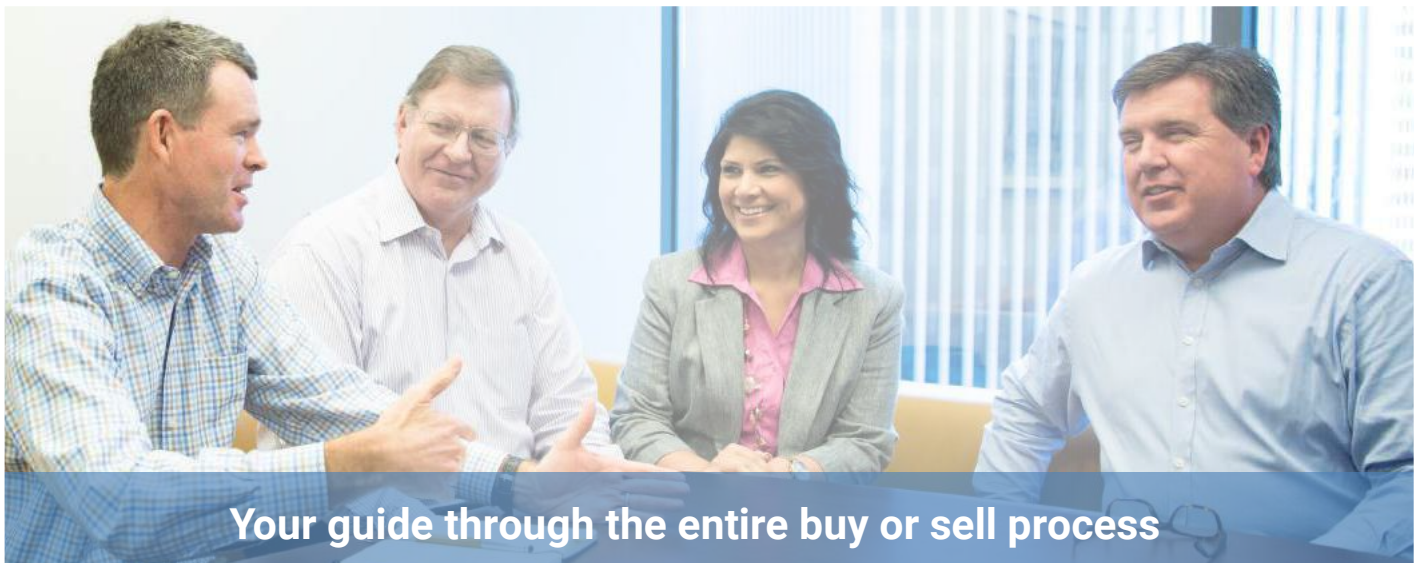
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Executive Director's Message



Erin H. Murphy
NADC Executive Director

The NADC Fall Conference held October 23-25 in Chicago was by all accounts a great success! Attendees of the Fall Conference enjoyed a change in venue at the Radisson Blu Aqua Hotel and **eight** informative, timely educational sessions. For the first time this year, the conference piggybacked the ATAE Conference in an effort to accommodate folks attending both meetings. There were an outstanding 210 members in attendance . . . record breaking numbers for the Fall Conference!

NADC members who were not in attendance can benefit from the conference materials that have been uploaded to our website at www.dealercounsel.com. Please look under the Conference, Workshop, and Webinar Handouts section in the eLibrary (2016 NADC Fall Conference) section of the website. Please don't forget that you can upload any documents that you wish to share with the membership in

the eLibrary. If you have questions, please contact Christina McGrath at cmcgrath@dealercounsel.com.

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Additionally, we hope you will join us at the 13th Annual NADC Member Conference being held April 23-25, 2017 at the Ritz-Carlton, Laguna Niguel in Dana Point, CA. The conference will be a two-day program designed to provide you with updates, best practices, lessons learned and other useful information. If you are interested in submitting a session proposal for the conference, please send the following information to emurphy@dealercounsel.com:

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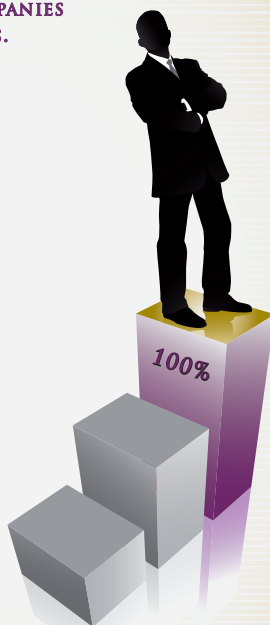
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Used Car Rule Compliance 101

By Bruce Anderson, *Iowa Automobile Dealers Association*

Feature Article

The standard and oft-repeated advice regarding compliance with the FTC's Used Car Rule generally relates to the manner of displaying the Used Car Buyers Guide form and to the wording of the information relating to warranties offered. Dealer audits and spot inspections reveal that more detailed guidance to dealers is needed. Too many dealership personnel are unfamiliar with some of the core requirements, because posting of the guide has become a routine practice in place since the rule's enactment in 1985. Following are some common mistakes dealers make even when they are consistently posting the guide.

Modification or embellishment of the Used Car Buyers Guide is not permitted. The rule provides that "the capitalization, punctuation and wording of all items, heading and text on the form must be exactly as required by this Rule." 16 C.F.R. § 455.2(a)(2). The FTC publication, *Dealer's Guide to the Used Car Rule* further specifies that dealers "are not allowed to place any other wording or symbols (including logos) on the Buyers Guide." Creative dealers should be strongly warned against "enhancing" the form with marketing or branding materials. The rule even specifies that the form must be printed in black ink on white stock, although the guidance does permit the use of colored ink to fill the blanks. The prohibition on including "other wording" should also be explained to well-meaning dealers who are using the "systems covered" and "duration" lines within the "WARRANTY" section of the form for any purpose other than the intended description of any available warranty.

Many dealers are concerned about safety issues associated with operating a used vehicle for purposes of a test drive while a properly displayed Used Car Buyers Guide is blocking the driver's view. Accordingly, some dealers have posted reduced versions of the guide to minimize the space occupied on the window. This change in size violates the rule, which requires that the posted form be at least 11 inches high by 7¼ inches wide. However, the guide may be temporarily removed during a test drive but must be returned as soon as the test drive is over. 16 C.F.R. § 455.2(a).

Sometimes both a Monroney sticker and a Used Car Buyers Guide are required. The common assumption is that the inventory on the new vehicle lot needs only Monroney stickers attached and that the stock on the pre-owned lot need to only have Used Car Buyers Guides displayed. But there is an overlap in the definitions that often results in dealerships unintentionally violating the Used Car Rule by failing to display both forms.

The Automobile Information Disclosure Act of 1958 prohibits the

removal or alteration of the "Monroney" sticker from a new automobile until the vehicle is "delivered to the actual custody and possession of the ultimate purchaser." 15 U.S.C. § 1233(c). "New automobile" is a statutorily defined term meaning any automobile "the equitable or legal title to which has never been transferred by a manufacturer, distributor, or dealer to an ultimate purchaser." 15 U.S.C. 1231(d). Naturally, "ultimate purchaser" is also a defined term and means "the first person, other than a dealer purchasing in his capacity as a dealer, who in good faith purchases such new automobile for purposes other than resale." 15 U.S.C. § 1231(g).

The Used Car Rule mandates that dealers display a Used Car Buyers Guide in all used vehicles. The regulation defines a used vehicle as any "motorized vehicle, other than a motorcycle, with a gross vehicle weight rating (GVWR) of less than 85 pounds, a curb weight of less than 6,000 pounds, and frontal weight of less than 46 square feet" which has been "driven more than the limited use necessary in moving or road testing a new vehicle prior to delivery to a consumer" 16 C.F.R. § 455.1(d).

A single vehicle can meet the definition of both a "new automobile" for Monroney purposes and the definition of "used vehicle" for Used Car Buyers Guide purposes – and therefore the dealer has to display both stickers. For additional information, consult: <https://www.ftc.gov/tips-advice/business-center/guidance/dealers-guide-used-car-rule>. ■

Bruce Anderson is President and General Counsel of the Iowa Automobile Dealers Association.

NADC Member Announcements



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The Dealership of Tomorrow

Technology Is Reshaping the World, and Dealers Must Adapt

By Jason Bennick, CEO & Co-Founder, *Dealer Market Exchange*

From ride-sharing and online shopping to booking travel and mobile banking, the last ten years have seen technology change business more than the previous one hundred years. Dealerships slow to embrace technology are not only losing business but also are less likely to even stay relevant. How does a dealer understand and adapt to macro shifts in the marketplace and emerge with longevity and profitability? Why do dealerships need to keep up anyway?

We live in a world where the average person can get through an entire day with using only a smart phone. Communication tools, mobile payments, digital retail, productivity apps, and even entertainment have gone mobile. Cloud-based technology ensures 24/7 access to vital business data. By using sophisticated algorithms and artificial intelligence, the technology in our pockets is getting smarter—requiring less action through the purchase funnel. In many cases, technology anticipates our needs and requires only a click or voice command to take action.

With such tremendous computing power in our hands, it is no wonder a rapidly shrinking number of car buyers enjoy walking into a dealership to hear a sales pitch and spend hours on paperwork. Purchasing a car is a huge decision for consumers, and, as an industry, we should be making every possible effort to reduce consumer time, effort, and energy in the car buying experience, and bring—dare I say—joy, to the process.

Change is already forcing itself across the auto industry. Dealerships are fighting to recapture customer attention being taken by online retail startups such as Beepi, Carvana, and Shift, among others. Consumers are showing they are fed up with the traditional sales experience because technology has spoiled users with seamless digital experiences in all other aspects of their lives.

What then can dealerships do to provide seamless customer service? What tools and technologies can they leverage to improve the customer experience?

Leverage the Cloud. Joining the cloud means migrating all dealer data management services into a remotely accessed shared secure environment, and not relying on physical site server equipment. Shared data services from the cloud solves equipment costs, personnel overhead, and power outages, as well as provides 24/7 access to data on multiple platforms, including web and mobile. It also opens dealers to hundreds of third party vendor services to bid for business by not being held hostage to a single source provider,

which in turn controls pricing, data access, and quality of customer engagement.

And that is just the beginning of the power of the cloud.

Crowdsourcing. Breaking away from the routine takes some work, but it is how we change habits and usher in improved conditions. It is upon this premise Uber rose to a \$60 billion valuation in less than five years. That same successful methodology is available to every dealership to help them vastly improve their economic positions. Dealers have to break away from single-source local vendors for recon, parts, and other services, and tap into aggregated wholesale, retail, and trade value sources to lower costs and improve quality of delivery. Innovation is driving improvement. Pricing, suppliers, and vitally needed dealer services backed by peer-contributed data provide dealers a solid choice for change. Using aggregated and crowdsourced data and services solutions fosters a competitive marketplace that lowers prices to dealerships and collectively drives market demand in improving transactional volume for users.

Go Mobile. In less than ten years, the primary car buying consumer will be today's millennials. According to recent industry surveys, over 40% of millennials have stated they would buy a car online and would use multiple devices to shop for one.¹ Dealerships must make every possible effort to migrate their marketing, engagement, and retention services to a fully integrated mobile and web platform, just to keep up with vehicle owners and future buyer's shopping habits. This means the back-end of a dealership business preceding digital retail needs to also include digital wholesale. And all of this must be done with an entire process that is accessible, functional, and operational in a fully mobile experience. Dealers that can manage inventory on a mobile device just as easily as they can engage their customers have a far better chance of faring in today's cutthroat car business when it comes to getting the customers the exact vehicles they want in a timely manner.

The dealership of tomorrow is truly a cloud-based, crowdsourced, and mobile platform. Nearly 65,000 franchise and independent dealers

¹ Sources: AutoScout 24 (2015); Autotrader, "Car Buyer of the Future Study" (2015); Capgemini, "Cars Online" (2014); Microsoft/Wakefield Research, "Automotive Industry Survey - Millennials' Technology Preferences".

can leverage dozens of new and advanced mobile and cloud-based tools to bridge retail and wholesale into the full inventory management process, building a complete digital ecosystem. Providing fresh, seamless, and smart service is how the dealership of yesterday becomes the consumer experience of tomorrow, placing dealers squarely in the driver's seat on this train of change and not getting left behind at the station. ■

As the CEO and Co-Founder of Dealer Market Exchange, Jason is responsible for leading a team of automotive experts and technologists in reinventing the automotive industry. Prior to DMX, Jason served as a startup advisor as CEO and Founder at Stonetrust Consulting. He also served as COO for AutoLoop, an automotive SaaS. Before immersion in the automotive space, Jason spent over 25 years as a producer/distributor of film and digital content. Jason is passionate about startups, technology, and sharing his vision for the automotive industry. When he is not riding his Ducati, Jason can be found scuba diving, absorbing a book, or penning his next article. Questions? Reach out. Find Jason on twitter at: @jasonbennick.

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Please make sure to notify NADC Staff (info@dealercounsel.com) if your contact information has changed so that your records can be updated accordingly. We will begin to list updated contact information in *The Defender* so all members can be aware of the change.



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