In re SCHWALB
347 B.R. 726 (Bankr. D. Nev. 2006)

BRUCE A. MARKELL, Bankruptcy Judge.

I. Introduction

> "Then the bird does not belong to any of you?" Spade asked, "but to a General Kemidov?"
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> "Belong?" the fat man said jovially, "Well, sir, you might say it belonged to the King of Spain, but I don't see how you can honestly grant anybody else clear title to it – except by right of possession." He clucked. "An article of that value that has passed from hand to hand by such means is clearly the property of whoever can get hold of it."[1]

Possession is the central theme in this case. Pioneer Loan & Jewelry, a pawnbroker, possesses two certificates of title that list it as the owner of two motor vehicles. Michelle Schwalb, the debtor, possesses those vehicles. Pioneer claims exclusive ownership, and that Ms. Schwalb has no legal or equitable interest in the vehicles beyond mere possession. Schwalb counters that Pioneer has no interest in the vehicles because she never transferred title or granted any other interest in them to Pioneer.

Pioneer seeks possession of the vehicles, and has asked this court to force Ms. Schwalb to turn them over to it. Ms. Schwalb seeks to keep the vehicles and pay Pioneer nothing under her chapter 13 plan, the confirmation of which is the subject of this opinion.

Both parties' fallback position is that Pioneer's interest is that of a secured creditor, as it is not disputed that Pioneer originally lent money to Ms. Schwalb on the strength of the vehicles as collateral. But this presents a different problem: the documents under which Pioneer lent Ms. Schwalb money provided for an annual interest rate of approximately 120%. As a result, by the time Ms. Schwalb filed her bankruptcy, Pioneer's claim had grown to more than double the original loan. Pioneer thus believes that Ms. Schwalb has insufficient resources to pay this claim over the life of her chapter 13 plan. Ms. Schwalb responds that Pioneer's secured claim is less than Pioneer alleges. She offered evidence that she can afford plan payments at the current plan value. She also asserts, and Pioneer does not dispute, that Pioneer's failure to file a proof of claim prevents Pioneer from asserting any unsecured claim related to its loans.

.... After hearing the testimony, and reviewing all the evidence and the pleadings, the court finds that Pioneer is a secured creditor ....

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[1] Dashiell Hammett, *The Maltese Falcon, reprinted in* THE NOVELS OF DASHIELL HAMMETT 397 (1965).

II. Relevant Facts

Michelle Schwalb is not a typical chapter 13 debtor. She holds no job, because she can't hold one. Seven years ago she had a brain tumor removed, leaving her unsteady and unable to concentrate for extended periods of time. Social Security disability payments are her only regular income. She is 34 years old, diabetic, has a non-working pituitary gland, and has initial symptoms of Grave's disease. She must take steroids to live. Ms. Schwalb lives with a man who fathered her only child, and they have been together as a family for thirteen or fourteen years. He works outside the home, and pays most of the household expenses.

Ms. Schwalb's chapter 13 plan is being funded entirely from her monthly disability payments, which are currently $580, and from contributions by her father. Her father's current monthly contribution is $640....

Ms. Schwalb's father gave her the two vehicles at issue, a 1997 Infiniti QX4 Sport Utility Vehicle and a 2002 Cadillac Escalade. Before dealing with Pioneer, Ms. Schwalb had clean title to both vehicles. Then, sometime during 2004, the debtor, her father and her partner decided they needed to contribute funds to a business that Ms. Schwalb's partner ran. They went to Pioneer and obtained two loans totaling $20,000.

The business, however, failed. Ms. Schwalb had no way to repay Pioneer. At this point, Pioneer began to take action to obtain the vehicles. To understand the actions Pioneer took, however, it is necessary to review the transactions by which Ms. Schwalb obtained the $20,000.

Ms. Schwalb and her father initially approached Pioneer in June of 2004. Mr. Schwalb had done business with Pioneer and, at that time, enjoyed some goodwill with it. Ms. Schwalb's Infiniti QX4 Sport Utility Vehicle was offered as collateral, and Pioneer advanced $4,000 against possession of the certificate of title for the vehicle. The parties testified that Ms. Schwalb gave Pioneer her certificate of title after she signed it as seller. The buyer's name was left blank.

When she received the $4,000 in loan proceeds, Ms. Schwalb signed a document referred to by the parties as a pawn ticket. The pawn ticket is a preprinted form used by Pioneer in its pawnbroker business. It is a simple 5-inch-by-8-inch form, with text front and back. Among other things, the front has blanks for describing the property pawned, for the amount of the loan and for the repayment date.

On Ms. Schwalb's pawn ticket, the parties designated the property pawned as an Infiniti QX4 Sport Utility Vehicle, and included its Vehicle Identification Number (VIN). The ticket also contained the loan terms. Ms. Schwalb was to repay the $4,000 in 120 days, plus $1,605 interest. The disclosed annual interest rate was 122.04%.[2] If Ms. Schwalb did not "redeem" the pawn and pay the loan within the 120 days, the pawn ticket indicated that "you shall ... forfeit all right and interest in the pawned property to the pawnbroker who shall hereby acquire an absolute

[2] Interest was payable at 10% per month, or 120% per year, but Pioneer added a $5 charge at the initiation of the transaction, which increased the effective interest rate for the first year of the loan to 122.04%.

title to the same." Just before the blank on the pawn ticket in which the parties inserted the description of the Infiniti and its VIN, the pawn ticket indicated, in very small five-point type, "You are giving a security interest in the following property: "Pioneer did not retain possession of the vehicle. Ms. Schwalb drove off in it with her $4,000. Pioneer put the signed certificate of title in a safe on its premises.

The transaction with the Cadillac was essentially the same, except Pioneer advanced $16,000 against possession of the signed certificate of title, and the interest rate was 121.76%. This transaction occurred on August 19, 2004. In each case, Pioneer's representative testified that the amount Pioneer lent against the certificates of title was within Pioneer's general practice of lending no more than 30% to 40% of the retail value of the vehicle offered as collateral.

Approximately $1,605 in interest on the Infiniti loan was paid on or around November 6, 2004, thus extending the redemption period to March 6, 2005. No interest was ever paid on the Cadillac loan. The final 120-day term expired on the Infiniti loan on March 6, 2005, and on December 17, 2004, for the Cadillac loan.

When Ms. Schwalb did not repay either loan, Pioneer took both certificates of title to the Nevada Department of Motor Vehicles ("DMV") where, sometime in April 2005, Pioneer requested that the DMV reissue the certificates showing Ms. Schwalb as the owner and Pioneer as the "lienholder." The DMV complied. After Pioneer's initial efforts to obtain the vehicles were unsuccessful, Pioneer then presented the newly reissued certificates of title to the DMV, this time requesting that the DMV reissue the certificates of title without any mention of Ms Schwalb, and listing Pioneer as the sole owner. Again the DMV complied. Pioneer then filed a state court lawsuit apparently alleging conversion and seeking recovery of both vehicles....

Ms. Schwalb filed her chapter 13 case on August 9, 2005....

Ms. Schwalb's plan, filed with her chapter 13 petition, proposes to pay her creditors over 36 months. Her monthly payment is $555 for the first 12 months of her plan, and $709 per month for the remaining 24 months of her plan.

Initially, Ms. Schwalb contends that Pioneer is not a secured creditor, and is barred from participating in her case as an unsecured creditor. Her initial proposal is thus to pay Pioneer nothing under her plan. If Pioneer is found to be a secured creditor despite her objection, she proposes to value the collateral for the secured claims at $16,000 for the Cadillac loan and $4,000 for the Infiniti loan. The plan would then pay these two secured claims full over the life of the plan, together with 10% simple interest.

III. Pioneer's Property Interests

The parties have focused on the nature of Pioneer's property interest, if any, in the two vehicles. Relying on its pawn ticket and the laws of other states, Pioneer contends that it owns both vehicles, and that Ms. Schwalb has no legal or equitable interest in them. Ms. Schwalb counters that Pioneer is not a pawnbroker with respect to the vehicles since it did not retain possession of them after making the loans. Ms. Schwalb further argues that the language of the

pawn ticket is insufficient to create an Article 9 security interest under Nevada's version of the Uniform Commercial Code (UCC).

Pioneer, if forced to yield on its ownership claims, contends that the language in the pawn ticket is sufficient under Nevada's version of Article 9 to create a security interest, and that it has not violated any of Article 9's requirements or restrictions....

A. Pawnbrokers and the Pawning of Goods Generally

All around the cobbler's bench
The monkey chased the weasel
The monkey thought that all was fun
Pop! Goes the weasel!

A penny for a spool of thread
A penny for a needle
That's the way the money goes
Pop! Goes the weasel![6]

Under Nevada law, a pawnbroker is a "person engaged, in whole or in part, in the business of loaning money on the security of pledges, deposits or other secured transactions in personal property." NEV. REV. STAT. § 646.010. The parties agree that Pioneer is a licensed pawnbroker under this law. They disagree, however, on the significance of Pioneer's status, and to resolve those differences the court must investigate the history and current status of pawnbrokers, and the impact of pawnbroker status with respect to a nonpossessory vehicle loan.

1. Short History of Pawnbroking

Pawnbrokers engage in transactions in which a debtor pawns goods in return for a short-term loan. Pawnbroking has a significant and positive place in the history of lending. According to some accounts, Queen Isabella of Spain pawned her jewels to finance Columbus' trip of discovery. At various times in our history, pawning one's clothes and other possessions was an ordinary and common occurrence.

Pawning one's goods differs from lending against them; in a typical pawn, a debtor deposits goods with the pawnbroker, and receives money in return. If the customer does not "redeem" his pawn within a specified time, tradition has it that the power to sell the goods deposited automatically passes to the pawnbroker. If the pawnbroker's subsequent sale of the goods does not cover the loan, the pawnbroker takes the loss; conversely, if the pawnbroker sells the goods for more than the money lent, custom allows the pawnbroker to keep the surplus.

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[6] Nursery rhyme it may be, but its origins are in pawnbroking. In English slang (and the English version of the rhyme is printed above), to "pop" something is to pawn it; and a "weasel" was slang for a hatter's tool. WILLIAM MORRIS & MARY MORRIS, MORRIS DICTIONARY OF WORD AND PHRASE ORIGINS 457-58 (1977); BREWER'S DICTIONARY OF PHRASE AND FABLE 929 (16th ed., Adrian Room, rev. 1999).

Another way to characterize the transaction is as a nonrecourse loan by the pawnbroker to the customer, with agreed strict foreclosure on the redemption date.

2. Recent History and the Advent of "Title Pawns"

Despite its venerable history, pawnbroking has lately experienced something of a public relations crisis. Pawnbrokers are regulated in a manner designed to deter personal property theft, and often are found in low-income neighborhoods on the fringe of respectability. Despite efforts to improve this image, "the negative portrait lingers; pawnshops continue to be cast as 'nuisance businesses,' in the company of tattoo shops and massage parlors, and somewhere in rank between liquor stores and houses of prostitution."

This negative perception has not been helped by the type of loans present here. As noted in a recent report sponsored in part by the Consumer Federation of America, "car title loans are marketed as small emergency loans, but in reality these loans trap borrowers in a cycle of debt. Car title loans put at high risk an asset that is essential to the well-being of working families – their vehicle." AMANDA QUESTER & JEAN ANN FOX, CAR TITLE LENDING: DRIVING BORROWERS TO FINANCIAL RUIN 2 (2005).... [S]ome states have passed laws favorable to the title loan industry, while others have specifically prohibited pawnbrokers from engaging in "title pawn" transactions ....

3. Nevada's Regulation of Pawnbrokers and Title Pawn Transactions

Nevada has not directly enacted legislation regarding the relationship between traditional pawnbroking and title lending. As a consequence, Pioneer attempts to support its position with extrapolations of existing state and local regulations, as well as of recent Nevada Attorney General opinions. As will be seen, however, these arguments are unavailing.

a. State

Nevada regulates pawnbrokers through a series of provisions found in Chapter 646 of the Nevada Revised Statutes. NEV. REV. STAT. §§ 646.002 to 646.060. Most of these provisions regulate the business and accounting side of pawnbroking; for example, pawnbrokers are required to keep detailed records of their transactions and are required each day to turn over records of the previous day's transactions to law enforcement officials.

Of all the sections in Chapter 646, only ... Section 646.050 provides substantive restrictions on the terms of a loan made by pawnbrokers. It requires that pawnbrokers cannot charge more than 10% per month on their loans, and must offer a redemption period of at least 120 days to their customers....

Chapter 646 also covers "motor vehicles received in pledge," and permits the storage of such vehicles at a location apart from the pawnbroker's principal place of business. In the late 1990s, when title pawns began to expand in Nevada, the state attorney general was asked to opine on the appropriate classification of such activity. In two opinions cited by counsel, the attorney general found that nonpossessory lending against the strength of a vehicle's title fit within the definition of "pawnbroker" for regulatory purposes because, although it was not the

typical possessory lending historically associated with pawnbrokers, it did fit the statutory definition of someone in the business of "loaning money on the security of pledges, deposits or *other secured transactions in personal property*." NEV. REV. STAT. § 646.010 (emphasis supplied).... The attorney general apparently assumed that such nonpossessory lending was subject to Article 9 of Nevada's version of the UCC,... but opined that when practiced with the traditional pledge of personal property, it was within the business of pawnbroking, at least for purposes of exempting pawnbrokers from regulation under the installment lending provisions of Chapter 675 of the Nevada Revised Statutes.

b. City

Nevada pawnbrokers are also regulated by municipal governments, and Pioneer was (and is) subject to regulation by the City of Las Vegas. Chapter 6.60 of the Las Vegas Municipal Code in most parts copies and expands on Chapter 646 of the Nevada Revised Statutes. It also requires a pawnbroker to be licensed, and requires a separate license if the person "accepts a motor vehicle as pledged property or in any other matter allows the use of a motor vehicle as collateral or security for a loan." LAS VEGAS MUNICIPAL CODE §§ 6.6.020 (definition of "auto-pawnbroker"); 6.60.035 (requirement of a separate license for auto-pawnbroker).

The municipal provisions applicable to Pioneer are also primarily related to law enforcement, and not to consumer protection. The municipal code, however, does contain certain disclosure requirements for borrowers, and also makes it unlawful for the pawnbroker to charge or receive more than 10% interest per month.

B. Application of Article 9

Neither the state nor the local regulation specifically refers to the applicability of the primary statute related to personal property collateral – Article 9 of the UCC. Conversely, Nevada has not explicitly excluded pawnbroking from the scope of Article 9. The initial question is thus easily stated: Does Article 9 apply to Pioneer's two transactions with Ms. Schwalb?

1. Does Article 9 Apply to Traditional Pawnbroking Activities?

Pioneer contends (and often assumes without argument) that pawnbroking is excluded from Article 9. That contention is false as a matter of statutory construction. Article 9 is intended to be the primary statute regarding the consensual personal property security. It is a marvel of drafting that consolidates and resolves many issues into one single statute. And it is intentionally broad; as noted in the comments, "all consensual security interests in personal property and fixtures are covered by this Article .... When a security interest is created, this Article applies regardless of the form of the transaction or the name that parties have given to it." UCC § 9-109 cmt. 2.

To achieve this breadth of coverage, Article 9 looks to substance over form. This is confirmed by its text: Article 9 states that it applies to any "transaction, *regardless of its form,* that creates a security interest in personal property or fixtures by contract." NEV. REV. STAT. § 104.9109.1(a) (emphasis supplied).

Given this broad scope, some states have altered the breadth of Article 9 by either expanding the list of exclusions to Section 9-109 as adopted, or by restricting the effect Article 9 gives to security interests in Section 9-201. *Compare* NEV. REV. STAT. § 104.9109.4(n) (excluding "[a] transfer by a government or governmental unit" from scope of Nevada's Article 9) *and id.* § 104.9201.2 (excluding consumer transactions under Chapters 97 and 97A from Article 9's section validating security agreements) *with* UCC § 9-109(d) (containing no exclusion for governmental transfers) *and* UCC § 9-201(b) (containing generic exclusion for consumer protection laws from Article 9's section validating security agreements generally); *see also* UCC § 9-109(c)(2) (permitting exception for categories of transactions expressly provided by another state statute).

In the area of pawnbroking, however, Nevada has not adopted other states' practice of excluding some or all of pawnbroking's practices from Article 9....

Given this lack of express exclusion, the court believes that Nevada would join the other states and commentators who have examined the issue, and concluded that pawnbroking is an activity governed by Article 9 of the UCC that neither the parties' contrary language nor an industry's contrary practice can alter. ... 4 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 30-1(b), at 4 (5th ed. 2002) ("When a pawnshop takes possession of a debtor's clarinet, the parties are entering into a perfected secured transaction."); 8A LAWRENCE'S ANDERSON ON THE UNIFORM COMMERCIAL CODE § 9-102:152 (3d ed. Lary Lawrence ed. 2005) ("Pawn transactions are Article 9 secured transactions.") [hereinafter "ANDERSON"].

2. Pioneer's Transactions Are Not Traditional Pawn Transactions

Even if the court held that pawnbroking's practices are impliedly exempt from Article 9, Pioneer would not prevail for the simple reason that the transactions at issue are not those of a traditional pawnbroker. Pawnbrokers are bailees of personal property held as collateral for loans. If the loan is not paid – or, in the argot of pawnbroking, if the pawn is not redeemed – then the pawnbroker sells the goods held, and keeps the proceeds; the debtor is not liable for any deficiency, and the pawnbroker is not accountable for any surplus. *See* [Jarret C. Oeltjen, *Florida Pawnbroking: An Industry in Transition*, 23 FLA. ST. U.L. REV. 995, 996-97 (1996)].

As a result, a true pawn requires a pledge, and a pledge requires delivery of the collateral to the pawnbroker...

Here, of course, Pioneer did not possess the vehicles (although state law permitted it to do so); at best, it was a bailee of the certificates of title, for whatever good holding on to pieces of officially issued paper did it. As such, the issue as to the exempt status of traditional pawnbroking activities is not directly raised by this case.

Pioneer argues that actual possession was not necessary. Since it had possession of the certificates of title, it has "constructive" possession of the vehicles, and that this constructive possession was sufficient to bring it under the protective reach of pawnbroking status. Nothing in the Nevada statutory scheme authorizes this view, and pre-UCC cases rejected it.

C. Applicability of Article 9 to Pioneer's Loans

As indicated above, Section 9-109 makes Pioneer's transactions with Ms. Schwalb subject to Nevada's version of Article 9. This was not unexpected. Pioneer's form of pawnbroking ticket expressly states that Ms. Schwalb was "giving a security interest" in the two vehicles to Pioneer. Although more will be said about this language below, it is a clear indication that Pioneer was both aware of the term "security interest," and wanted to use it in the two transactions. And if a "security interest" is involved, the default statute of applicability is Article 9 of the UCC.

Beyond that, however, as the courts and commentators cited above have found, each transaction here fits within the text of Section 9-109 – that it be a "transaction ... that creates a security interest in personal property or fixtures by contract." NEV. REV. STAT. § 104.9109.1(a). This can be seen from an analysis of the components of Section 9-109.

The component most obviously present is a contract – a provision that requires that transaction to be consensual. "Contract," as defined in the UCC is "the total legal obligation that results from the parties' agreement ..." NEV. REV. STAT. § 104.1201.2(*l*).[12] The UCC defines the term "agreement" as "the bargain of the parties in fact, as found in their language or inferred from other circumstances ...." *Id.* § 104.1201.2(c).

Here, Ms. Schwalb and Pioneer had an "agreement" – Pioneer would lend money to her on the security of her two vehicles. That was their bargain in fact. This agreement gave rise to legal obligations – that is, rights that courts would vindicate – some supplied by Nevada's common law of contracts, and others by Nevada's version of Article 9. This consensual agreement combined with the attendant legal consequences form the necessary contract; or, put another way, the transaction was consensual, and breach of it implied various legal consequences.

Was it a contract to create or provide for a security interest? "Security interest" is defined in Article 1 as "an interest in personal property ... which secures payment or performance of an obligation." NEV. REV. STAT. § 104.1201.2(ii). Here, Ms. Schwalb gave Pioneer an interest in her vehicles as a condition of obtaining the two loans, and Pioneer held onto the title to ensure repayment. When Ms. Schwalb did not repay the loans within the 120-day redemption period, Pioneer's position is that exclusive ownership of the vehicles passed to it. This type of arrangement – in which rights to possession of personal property arise upon failure to repay debt or honor some other obligation – is a classic security interest and fits the definition of "an interest in personal property [that] secure[d] payment ... of an obligation." NEV. REV. STAT. § 104.9201.2(ii).

As a result, the transactions here were covered by Article 9 of the UCC....

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[12] Article 9 expressly provides that the definitions from Article 1 apply when interpreting Article 9's provisions. NEV. REV. STAT. § 104.9102.3.