

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

BRUCE A. MARKELL, Bankruptcy Judge.

I. Introduction

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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

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%.¹ 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 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

¹ 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%.

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

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C. Applicability of Article 9 to Pioneer's Loans

... 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. This conclusion has serious repercussions for the parties.

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

1. Attachment Generally

The initial consequence of Article 9's applicability is that the creation and status of Pioneer's interest is governed by a combination of the common law of contract law and the statutory provisions of Article 9. For an Article 9 security interest to be enforceable, it must "attach." NEV. REV. STAT. § 104.9203.

Attachment, in turn, has three requirements: (1) value has to have been given; (2) the debtor must have rights in the collateral; and (3) either (a) the debtor has authenticated a security agreement that provides a description of the collateral, or (b) the secured party possesses the collateral pursuant to a security agreement. NEV. REV. STAT. § 104.9203.2(a)-(c).

Value is present in the form of the loans extended by Pioneer to Ms. Schwalb. NEV. REV. STAT. § 104.1204. Similarly, there is no doubt that, at the time of each transaction, Ms. Schwalb's ownership rights in the vehicles were sufficient "rights in the collateral" for a security interest to attach. *Foothill Capital Corp. v. Clare's Food Market, Inc. (In re Coupon Clearing Service, Inc.)*, 113 F.3d 1091, 1103 (9th Cir. 1997) ("Where a debtor has rights to collateral beyond naked possession, a security interest may attach to such rights.") (citing *Morton Booth Co. v. Tiara Furniture, Inc.*, 564 P.2d 210, 214 (Okla. 1977)).

The issue thus boils down to whether the "debtor authenticated a security agreement that provides a description of the collateral," or whether the collateral was "in the possession of the secured party under NRS 104.9313 pursuant to the debtor's security agreement." NEV. REV. STAT. § 104.9203.2(c)(1)-(2).

a. Authenticated Agreement

Ms. Schwalb contends that the pawn ticket is legally insufficient as a security agreement. At trial, she testified that she did not know what she was signing¹⁵ at the time she received each of the two loans. Each pawn ticket used, however, contained the following preprinted language just before a description of the automobile involved as well as its VIN: "You are giving a security interest in the following property ..."

Under Article 9, a "security agreement" is "an agreement that creates or provides for a security interest." NEV. REV. STAT. § 104.9102.1(ttt). The pawn ticket was clearly an "agreement" as the UCC uses that term. It contained "the bargain of the parties in fact," as expressed in "their language or [as could be] inferred from other circumstances ..." *Id.* § 104.1201.2(c). The bargain was simple and standard: Ms. Schwalb borrowed money at interest, and agreed to repay it within 120 days.

Thus, the only question is whether the agreement also included collateral as security for repayment of the loan. Each pawn ticket definitively described the vehicle at issue, by make,

¹⁵ Her signing each of the pawn tickets was sufficient authentication, as signing is a form of authentication under Article 9. NEV. REV. STAT. § 104.9102.1(g)(1).

model and VIN. The issue is thus whether the words “[y]ou are giving” adequately “create[] or provide[]” for a security interest in the vehicles. The safest and traditional words to accomplish this task are words of grant or assignment, such as “I hereby grant a security interest in X to secure repayment of my debt to you” or “I assign this property to you to secure what I owe you.”

* * *

... Ms. Schwalb signed each pawn ticket Her signatures ... signaled her assent to the contract and her agreement to be bound by its terms As “signing” is “authentication” under UCC § 9-102(a)(7)(A), Ms. Schwalb’s signatures effectively authenticated each pawn ticket within the meaning of Section 9-203. Because each pawn ticket adequately described the collateral covered by listing its VIN number, *see* UCC § 9-108(b), Ms. Schwalb’s signature thus completed the requirements of Section 9-203(b)(3)(A). ... Pioneer’s interest attached upon such authentication.

b. Attachment Based on “Constructive Possession” of the Certificates of Title

Pioneer argues in the alternative that its security interest attached through constructive possession of the vehicles, which was accomplished by possession of the certificates of title....

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... [A]lthough Article 9 brings certificates of title into its system, it is only to provide a proxy for the financing statement, not the vehicle. In most states, the only way to perfect an interest in a car or other vehicle is to note the secured party’s interest on the certificate of title. Except in rare circumstances, possession of the car will not perfect the already-attached secured party’s security interest. NEV. REV. STAT. § 104.9313.2.²⁵ The upshot of this is that mere possession of the certificate of title is of little legal significance under Article 9; that possession neither creates a security interest nor perfects one otherwise granted in the vehicles. *See, e.g., Lee v. Cox*, 18 U.C.C. Rep. Serv. 807 (M.D. Tenn. 1976) (possession of registration certificates for eight Arabian horses did not perfect interest in horses). At best, Pioneer possessed the certificates of title for what they were worth – which is not much, as it turns out; their possession facilitated Pioneer’s perfection of its interests as will be seen, but it did not assist Pioneer in divesting Ms. Schwalb of her interests.

Pioneer’s interests were thus attached, but that alone is insufficient in this case. While attachment may make the security interest enforceable against the debtor, more is needed when the debtor is a debtor in bankruptcy. What is required in the later case is that the security interest be good against the world. The process by which such validity is obtained is referred to in Article 9 as perfection.

²⁵ That rare circumstance is when a secured party initially perfects correctly by noting its interest on the certificate of title, and the debtor moves to another state and does not submit the paperwork during the time required by the destination state’s law, or four months, whichever is sooner. NEV. REV. STAT. § 104.9316.5. Only then may a secured party perfect by taking possession of the car. *See* 4 WHITE & SUMMERS, *supra*, § 31-8(c).

2. Perfection

A security agreement “is effective according to its terms between the parties, against purchasers of the collateral, and against creditors,” so long as a contrary result is not specified elsewhere in the UCC. NEV. REV. STAT. § 104.9201.1. Although not immediately obvious, one of the key restrictions on this provision is that, to be effective against lien creditors and purchasers, the security interest must be perfected. *Id.* §§ 104.9317.1; 104.9317.2. The UCC tells us that the default method of perfection is by filing a financing statement. *Id.* § 104.9310.1.

An exception exists for items such as the vehicles involved here. If, as here, the collateral is subject to a certificate of title statute, Article 9 requires compliance with the state certificate of title statute for perfection. *Id.* § 104.9311.1(b). In Nevada, that requires reference to Chapter 482 of the *Nevada Revised Statutes*, which indicates that perfection occurs when there is “[c]ompliance with the applicable provisions of NEV. REV. STAT. 482.423 to 482.431,” NEV. REV. STAT. § 482.432, which includes delivery of information regarding any secured party, and issuance of a certificate of title showing the secured party as a lienholder. *Id.*

Here, the manner in which Ms. Schwalb delivered the certificates of title to Pioneer facilitated perfection. Although the exact date when it occurred is in dispute, Ms. Schwalb testified that at some point she signed the certificates of title in blank, and then gave them to Pioneer. Pioneer held the certificates until default (thus adopting the risky strategy of being secured but unperfected during this time). It then exchanged them at the DMV, initially for certificates showing Pioneer as lienholder, and then ultimately for certificates showing Pioneer as owner.

As a result, ... Pioneer ... became perfected no later than the time when it received the new certificates of title showing it as a lienholder.²⁶

* * *

²⁶ This opinion takes no position on whether, under Nevada law, an interest in a vehicle covered by Chapter 482 is perfected upon presentation of the appropriate paperwork to the DMV, upon issuance of the revised certificate by the DMV, or upon the secured party’s receipt of the reissued certificate.