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M&P In Brief

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Perfection of Security Interests in All Terrain Vehicles

By memorandum effective August 1, 2006, the Kentucky Transportation Cabinet, Division of Motor Vehicle Licensing, stopped issuing titles for All Terrain Vehicles. The policy change included any other "off-road" vehicles such as mini trucks, smart cars, gators and golf carts.

After lenders with security interests in titled ATVs raised concerns about the new policy, the Division of Motor Vehicle Licensing issued a second memorandum on September 8, 2006, indicating that it would continue to issue titles on ATVs and other off-road vehicles pending further review. Regardless, noting a lien on the title of an ATV or other such vehicle is likely insufficient to properly perfect a security interest therein.

Until the courts or the Legislature finally resolves the issue, we are advising clients to always file a financing statement and, if a title is issued, additionally perfect on the title.

The Division of Motor Vehicle Licensing's policy changes raise three questions for lenders: 1) how to properly perfect a security interest in off-road vehicles; 2) do title liens perfect the security interest; and 3) what should a secured party do if it is not properly perfected?

The issue has arisen as a result of the treatment of ATVs in Kentucky's motor vehicle law. "Vehicle" is defined by KRS 186.010(8)(a) as "all agencies for the transportation of persons or property over or upon the public highways of this Commonwealth and all vehicles passing over or upon said highways". However, KRS 189.515 specifically prohibits ATVs from use on a public highway, thus effectively removing them from the definition of "vehicle". Since Chapter 186A on vehicle titles adopts the above definition of "vehicle", ATVs do not qualify as "vehicles" for titling purposes.

Confusion on the issue arose because ATVs are not included in the list of vehicles exempted from title and registration requirements in KRS 186A.080. This led some county clerks to issue titles for ATVs and to allow secured parties to attempt to perfect their security interest by placing a lien on the title.

Nevertheless, without the authority of Chapter 186A, a title should not be issued for an ATV. It is likely that an improperly issued title for an ATV is of no effect and that a lien noted on that title does ***not*** perfect a security interest in the ATV.

Based on this analysis of Kentucky's motor vehicle law, in *In re Skeans*, 2003 Bankr. LEXIS 693, the United States Bankruptcy Court for the Eastern District of Kentucky held that a secured party did not need to perfect its security interest on the titles to ATVs. The Skeans owned two ATVs at the time of their bankruptcy. Certificates of title had been issued for both. Classic Bank held a security interest in the ATVs, which was perfected by filing a financing statement. It did not have its liens noted on the certificates of title.

The Bankruptcy Trustee argued that Classic Bank's security interest was unperfected because it was not noted on the titles. Finding the ATVs exempt from the title and registration requirements under Kentucky law, the Court held the fact that certificates of title were issued was not dispositive. The Court further held that Classic Bank had properly perfected its security interest by filing a UCC financing statement covering the ATVs.

The *Skeans* Court cited to *Manies v. Croan*, 977 S.W.2d 22 (Ky. App. 1998) as authority for its holding. *Manies* concerned a personal injury claim arising out of an ATV accident. In that case, the Court of Appeals held that an ATV was

Continued on page three.

601 West Main Street • Louisville, KY 40202 • Telephone (502) 589-2780 • Fax (502) 585-3498
133 West Short Street • Lexington, KY 40507 • Telephone (859) 253-1900 • Fax (859) 255-2038
5543 Edmondson Pike, #25 • Nashville, TN 37211 • Telephone (615) 831-9554 • Fax (615) 831-9557
9801 Fall Creek Road, #33 • Indianapolis, IN 46256 • Telephone (317) 287-3961 • Fax (317) 536-3687
P.O. Box 14328 • Cincinnati, OH 45250 • Telephone: (513) 769-3174 • Fax (513) 769-3639

Automobile Dealer Found to be Owner of Vehicle at Time of Accident for Insurance Purposes

The Supreme Court of Kentucky recently issued a decision in the case of *Gainsco Companies, et al. vs. Gentry, et al.*, 2004-SC-0276-DG, which may have a significant impact on automobile dealerships that sell vehicles without providing a properly signed certificate of title to the buyer.

In this case, a dealer, H&H Auto & Trailer Sales, Inc. ("H&H") purchased an automobile from another dealer in Alabama. Though the selling dealership was unable to immediately transfer the certificate of title, H&H took the automobile for resale. Approximately a week later, H&H, still without a certificate of title, sold the vehicle to Joe Booth ("Booth"). As part of the transaction, Booth traded in a 1995 Dodge Pickup truck that he had previously purchased from H&H. Booth additionally signed the application for a Kentucky certificate of title and registration for his new automobile, a credit application, a vehicle transaction record, and a bill of sale. However, H&H was unable to assign the certificate of title because it had not yet received it. Despite this, Booth drove off with the new automobile.

Insurance coverage was not discussed at the time of sale. However, H&H knew that Booth had insurance through Kentucky Farm Bureau ("KFB") because of previous sales to Booth and because the trade-in was covered by insurance. Because the sale occurred on a Saturday, H&H waited until Monday to confirm insurance coverage. At that time the dealer and president of H&H, spoke to one of the "secretaries" at KFB who confirmed coverage. Though there was no evidence of any additional confirmation, it was not disputed that Booth's policy automatically covered the newly purchased automobile.

Several days after the sale of the automobile, Booth's son was driving the automobile and lost control of the vehicle. Joshua Gentry, a passenger, sustained serious injuries and was permanently disabled as a result of the accident. Later that day, H&H received the certificate of title. The documents assigning title to Booth were not signed until four days later. They were then sent to the county clerk for filing.

Gentry's father filed an action for damages naming Booth, KFB, H&H, H&H's president, and Gainsco Companies, H&H's insurance company. The trial court held that H&H was the owner for insurance purposes. This was affirmed by the Court of Appeals, and then reviewed by the Supreme Court of Kentucky.

The only issue considered by the Court was the identity of the owner of the vehicle at the time of the accident, so that it then could be determined

Continued on page four.

Kentucky Revises Its Partnership Laws

During its 2006 Session, the Kentucky General Assembly enacted House Bill 234 for the purpose of modernizing Kentucky partnership law. House Bill 234, sponsored by Rep. Scott Brinkman (R-Louisville), will align Kentucky law with the Revised Uniform Partnership Act ("RUPA"), the most recent version of uniform partnership law as approved by the National Conference of Commissioners on Uniform State Laws. Approximately 37 other states have adopted the legislation since the latest update of the Act in 1997.

The bill is massive, consisting of 322 pages. It principally affects the partnership law provisions of KRS Chapter 362. RUPA clarifies the relations among general partners and between the partners and the partnerships by expressing the primacy of the partnership agreement. This is a fundamental concept to RUPA because it is the default statute for anything not covered in the partnership agreement.

Another important shift is that RUPA moves away from the aggregate approach to general partnership law to an entity approach. Under RUPA, the partnership is an entity distinct from its partners. A partnership can take legal action and can acquire property the way other entities are able to do. The partners have separate rights and liabilities from the partnership. For example, under Section 45 of the bill, creditors of a partner may attach the interest of a partner in the partnership, but may not attach specific partnership property. Furthermore, the debtor partner has a statutory right of redemption as does the partnership and other partners.

RUPA also provides greater protection to general partners of a registered limited liability partnership than is the case under most of the existing state limited liability partnership statutes. Furthermore, under Section 117 of the bill, a limited partner is not personally liable for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership.

There are some important transition rules concerning when and how the new law will apply to partnerships created before enactment of the new law. Partnerships created before enactment of the new law generally remain governed by prior law, but they have the ability to elect to be governed by the new law. Other transition rules are beyond the scope of this brief summary.

Section 236 also makes changes to KRS 365.015 relating to the "real

Continued on page three.

All Terrain Vehicles

Continued from page one.

not a motor vehicle as that term is defined in the Motor Vehicle Reparations Act because it could not be legally operated on the highways.

The decision of the Bankruptcy Court is not binding on Kentucky's state courts; however, its reasoning, based on a state appellate court decision, would likely be followed.

The Division of Motor Vehicle Licensing's memorandums to county clerks demonstrate the confusion surrounding this issue. Nevertheless, there is no statutory authority for issuing titles on ATVs. As recognized in the *Skeans* decision, the proper method of perfection is through the UCC system.

A secured party that has not filed a financing statement to perfect its security interest in an ATV should file now. If a financing statement is not filed, the secured party will most likely lose priority to a properly perfected secured party and to lien creditors, including trustees in bankruptcy. It is important to file a financing statement even though a secured party may be outside the period in which to perfect a purchase money security interest, and the new perfection will be subject to the preference period in bankruptcy.

Many existing transactions may be protected under the consumer goods safe harbor in KRS 355.9-309. If the lender secured by an ATV extended purchase money credit and the ATV constituted "consumer goods" when the loan was made, the security interest was perfected the moment it attached to the ATV without additional action by the lender.

"Consumer goods" are goods bought primarily for personal, family, or household purposes. Unless the consumer goods are subject to a state title law, or federal statute relating to security interests, filing is not required for perfection.

Though filing may not be required to perfect purchase money security interests in consumer goods, a simple five dollar electronic financing statement can save headaches in the future. Without a financing statement, it's possible that a buyer of the ATV from the consumer could take the ATV free of the security interest. Filing also avoids arguments about the primary purpose of the ATV at the time of purchase. An example is an ATV purchased for hunting but also used on a farm; is it a consumer good or equipment.

Security interests in ATVs that do not qualify as consumer goods must always be perfected by filing. If not a consumer good, and unless held by a dealer for sale, the ATV would almost always be classified as equipment. To achieve purchase money priority status, the financing statement must be filed within twenty days of the day the debtor first takes possession of the vehicle.

When filing a financing statement, a secured party should treat the ATV, or other type of off-road vehicle, similar to a filing on a specific piece of equipment. The collateral description should include the make, model number or name, year and vehicle identification number, if any, of the ATV. It is not necessary to attach the manufacturer's certificate of origin, or any other document, to the financing statement. The easiest way to file is through the Secretary of State's on-line electronic filing system.

An important difference to remember between title liens and financing statements is the shorter effective period of a financing statement. Title liens are good for seven years while financing statements must be continued every five years. Continuation should occur during the last six months of the effective period. A financing statement that is not continued will cease to be effective. Once lapsed, the law treats the financing statement as though it was never filed.

The above policy changes do not apply to manufactured homes. Manufactured homes are specifically included in Kentucky's vehicle titling system, even though most are not operated on the highways.

John T. McGarvey
Melinda T. Sunderland

Partnership Laws

Continued from page two.

name" of domestic and foreign partnerships. Generally, if there has been a formal filing with the Secretary of State, the name on the filed document is the "real name." On the other hand, if a general partnership has not filed a statement of partnership authority, the name is "that name which includes the real name of each of the partners." Knowing the correct name of a partnership is important for purposes of filing financing statements under Revised Article 9 of the Uniform Commercial Code. Of course, the practical response to a "real name" question is to file a financing statement under all possible names.

Section 236 also amends KRS 365.015 to change the county for filing certificates of assumed name not only for partnerships but also for individuals and other entities. Previously, business entities filed assumed name certificates with the Secretary of State and the County Clerk of the county where they were deemed a resident under KRS 186A.190 relating to motor vehicle registration. An individual filed an assumed name certificate with the County Clerk of the individual's county of residence under KRS 186A.190.

Under the new law, an individual now files in the county where the individual "maintains his or her principal place of business." A business entity now files with the Secretary of State and in the county where it maintains its registered agent for service of process. If no registered agent for service of process is required, the certificate of assumed name is filed in the county of the principal office. If there is no registered agent or principal office in Kentucky, a certificate of assumed name for a business entity is filed

Continued on page four.

Dealer Ruled to Be Owner

Continued from page two.

which insurance carrier was primarily responsible for paying damages. The general rule is that the party holding the certificate of title is the owner of the vehicle for insurance purposes. However, under KRS 186A.220(5), a dealer may still effectively transfer ownership without simultaneously transferring possession of the certificate of title if he both obtains the purchaser's consent to file the certificate of title and other documents on behalf of the purchaser, and he verifies that the purchaser has obtained insurance on the vehicle before relinquishing possession.

Although it was undisputed that KFB's policy did in fact cover the newly purchased automobile at the time of the accident, the Court held that it was insufficient to simply be insured at the time of the purchase. Rather, the statute requires that the dealer actually obtain proof of insurance. If the dealer fails to obtain proof of insurance, then it takes the risk that its own insurer will be held liable if the purchaser causes an accident prior to the transfer of the certificate of title. Although the Court did not clarify what is considered proof of insurance, and it would not go as far as to say it had to be written proof, it did clarify that the statute requires verification beyond mere assumption or knowledge.

Because Booth had not verified insurance coverage until days after the automobile was driven off the lot, it was held H&H did not strictly satisfy the statute's requirements. Accordingly, it was held that H&H had not validly transferred ownership, and its carrier was held to be primarily responsible for payment for Gentry's damages.

Although this may appear to be a harsh decision against automobile dealerships, the benefits from complying with the simple requirements of the statute far outweigh the consequences and costs of having the dealership's insurance carrier making large payouts. It is encouraged that all Kentucky dealerships make sure their internal policies comply with this decision.

Molly E. Rose

Partnership Laws

Continued from page three.

only with the Secretary of State.

If you are making loans to, or otherwise doing business with, a general partnership, a limited partnership, or an entity using an assumed name, make sure you or your attorney understands this new law and how it affects the transaction.

M. Thurman Senn

Firm News

- We are pleased to announce that after a two year absence as general counsel to one of our corporate clients, Thurman Senn has rejoined the firm as Of Counsel.
- We are pleased to announce that Larry Powell and Molly Rose have been named senior associates.
- Diane Moore, an administrative legal assistant and Morgan & Pottinger employee for over 15 years, retired in August. We would like to thank Diane for all of her years of valuable service to the firm.
- On June 7, 2006, John McGarvey and Mindy Sunderland conducted an on-line seminar entitled "Common Mistakes in UCC Filings". The seminar was sponsored by BankersOnline Learning Connect and was webcast to over 100 locations across the nation.
- On August 16, 2006, John McGarvey and Mindy Sunderland conducted an on-line seminar entitled "Default, Remedies and Enforcement Under Revised Article 9". The seminar was sponsored by BankersOnline Learning Connect and was webcast to over 40 locations across the nation.
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