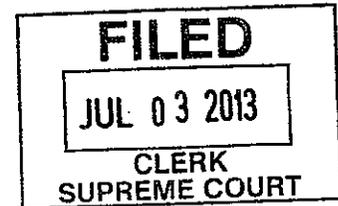


SUPREME COURT OF KENTUCKY  
NO. 2012-SC-000249-D



DELPHI AUTOMOTIVE SYSTEMS, LLC

APPELLANT

v. APPEAL FROM KENTUCKY COURT OF APPEALS  
NOS. 2010-CA-002303 AND 2010-CA-002332

CAPITAL COMMUNITY ECONOMIC/  
INDUSTRIAL DEVELOPMENT  
CORPORATION, INC.

APPELLEE

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**REPLY BRIEF FOR APPELLANT  
DELPHI AUTOMOTIVE SYSTEMS, LLC**

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**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a true and correct copy of this Reply Brief for Appellant was served on this the 2nd day of July, 2013, by U.S. Mail upon: Samuel Givens, Jr., Clerk, Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601; Hon. Thomas Dawson Wingate, Circuit Judge, Franklin Circuit Court, Judicial Building, 669 Chamberlin Avenue, Frankfort, Kentucky 40601; Robert W. Kellerman, Esq., Stoll Keenon Ogden PLLC, 201 West Main Street, P.O. Box 5130, Frankfort, Kentucky 40602.

  
Virginia Hamilton Snell

**STATEMENT OF POINTS AND AUTHORITIES**

**No Transfer “By” A Government Unit**.....1

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**May It Please The Court:**

Appellee Capital Community, labeled “CCEIDA” in its Brief, opens with a broad assertion: “No court to consider the matter has found that Appellee’s interest is unperfected” (Appellee’s “Introduction”). To the contrary, while no Kentucky case so holds one way or the other, other jurisdictions apply Article 9 to government units and deem security interests unperfected when the government, as here, is acting as a creditor and fails to file a financing statement to provide constructive notice of its interest to future creditors. Whether the loan concerns “public funds,” “economic development” or “job creation,” as Appellee trumpets, the government as lender must comply with Article 9 and file financing statements, just as even the smallest private business lenders must do. It is a rule of simple fairness. As taxpayers subject to Article 9, private lenders are entitled to rely on its requirements, which provide at least constructive notice of any priority in interest the government may assert.

**No Transfer “By” A Government Unit.** Capital Community’s Agreement with Certified Tool was not a “transfer *by* a government or governmental unit” within the meaning of KRS 355.9-109(4). Capital Community asks the Court to ignore the plain language of KRS 355.9-109(4) in favor of the Court of Appeals’ misinterpretation of legislative intent that violates the express statutory words. The Court should enforce the plain words of the statute (Appellant’s Brief, pgs. 20-21). Capital Community cites *MPM Fin. Group, Inc. v. Morton*, 289 S.W.3d 193, 197 (Ky. 2009), for a “cardinal rule of statutory construction” and then omits the part of its proffered “cardinal rule” that precludes courts from ignoring the express language in a statute: “We also bear in mind that where the language of a statute is clear and unambiguous on its face, we are not free

to construe it otherwise even though such construction might be more in keeping with the statute's apparent purpose." *Id.* at 197.

Capital Community "believes" that the word "transfer by" in KRS 355.9-109(4)(q) "necessarily includes transfers of assets and debt" (Brief, p. 9). But KRS 355.9-109 defines the "scope" and "applicability" of Article 9 and it exists to govern security interests. The very context of Article 9 instructs that any exemption in KRS 355.9-109(4)(q) can only refer to the transfer "by" the government of a security interest. The word "debtor" need not be added to understanding what "transfer by" means in KRS 355.9-109(4)(q) because Article 9 governs transfers of security interests; a "transfer by a government unit" necessarily means the transfer of a security interest by the government. Here, Capital Community did not transfer a security interest. It received and accepted a security interest, which was transferred to it. And, KRS 355.9-109(4)(q) does *not* say transfers "to and by." It does not exempt all transfers. It only exempts transfers "by" a government unit, namely when a government unit is a borrower/debtor transferring a security interest.

Curiously, Capital Community relies on *MP Star Financial v. Cleveland State University*, 837 N.E.2d 758, 760-761 (Ohio, 2005), even though the first paragraph of this opinion defines the issue as whether the Ohio version of the UCC "applies to payments made by an *account debtor* that is a governmental unit." *Id.* at 760 (emphasis added). *MP Star* should have no bearing on Capital Community because it was not acting as a debtor in loaning money to Certified Tool. *MP Star* also rejects Capital Community's narrow view of statutory construction. Rather than consider legislative intent, when faced with "clear and unambiguous" statutory terms, the Ohio Court

explained: “We will not attempt to ascertain a meaning different from that on the face of the statute by examining the comments.” *Id.* at 761.

Similarly, Capital Community relies on *Hawkland*, even though this UCC treatise overwhelmingly supports Delphi’s position. Capital Community quotes *Hawkland* for a justification underlying the original government unit exclusion (Appellee Brief, p. 10), but the full quote is more telling, however, in clarifying that Article 9 exempts transfers only when they are “specifically governed by other state law.”

Certainly, some local laws govern borrowing transactions by governmental debtors. Often times, however, these laws stop short of declaring how private lenders may perfect security interests in governmental property or how disputes will be resolved between competing interests in governmental collateral. It therefore would perhaps have been wiser to exempt transfers by governmental entities only to the extent that they were specifically governed by other state law. *That is what revised 9-109(c)(2) and (3) [Rev] does* (emphasis added).

The *Hawkland* treatise recognizes that many non-UCC state laws do not address the issue of government transfers, just as the Economic Development Act is totally silent on the creation, perfection, and priority of a security interest.

**No Public Policy Exemption.** Capital Community argues that *Hawkland* recognizes “public policy” exceptions to Article 9. This is incorrect. Nowhere does *Hawkland* support public policy exclusions. At most, it merely interprets *In Re City of Moran*, 713 P.2d 451 (Kan. 1986), as being decided on those grounds, which runs contrary to every other jurisdiction on the issue and notably was decided prior to revised Article 9 Amendments. And, Article 9 contains no public policy exclusion (Appellants’ Brief, pgs. 18-23). Capital Community relies on the trial court’s perspective that public policy favors exemptions that “stimulate local economics and develop jobs” (Appellees’ Brief, p. 19). But Article 9 contains no such exemption. And, having to file a financing statement to perfect a security interest is hardly an impediment to economic stimulation

and job growth. The private sector is critical to a strong economy and private lenders are entitled to know whether their loans are secured in first position or not.

**No Other Statute Governs Creation, Perfection and Priority.** Capital Community argues that it has no obligation to comply with Article 9 because “Kentucky’s economic development statutes” control and do not allow it to “enter into a secured lending transaction with Certified Tool, as it only had statutory authority to enter into a lease” (Appellee’s Brief, p. 14). This assertion is simply wrong under the statutes, as the courts below ruled. First, Capital Community relies on KRS 154.50-343 for the idea that “title to all property acquired by the authority shall rest with the authority.” This provision concerns “**Title to property – authority’s property, revenues are tax exempt.**” KRS 154.50-343 does not relate to granting or perfecting security interests. In fact, the Agreement with Certified Tool provides that it “agrees to pay when due” all taxes under Section 15 on “Taxes and Encumbrances” (Appellant’s Brief, App. 4, p. 6). Moreover, while KRS 154.50-343 says nothing about whether a development authority can sell property that it owns, KRS 154.50-320(d) expressly allows the sale of property. Capital Community cannot credibly maintain that it must retain title only when the express language of KRS 154.50-320 authorizes sale of the property as Capital Community sees fit.

In addition, although the Agreement with Certified Tool states that Capital Community retains title to the Press until the agreement expires and title passes to Certified Tool, Capital Community never acquired the Komatsu Press under KRS 154.50-343. Capital Community provided grant funds to Certified Tool to assist in its purchase of equipment. According to the Affidavit of Phillip Kerrick, former Executive Director of Capital Community, the grant funds totaled \$335,000.00, of which

\$320,000.00 was earmarked for equipment purchases (TR 222, 246). Komatsu America Industries, LLC, seller of the Komatsu Press, sent its purchase invoice to Certified Tool, not Capital Community. The invoice states that the total purchase price of the Komatsu Press was \$519,000.00 and seeks full payment from Certified Tool (Invoice TR 184, App. 1). Similarly, the March 21, 2001 invoice from Bailey Machinery Movers & Fabricators, Inc. for transportation and installation of the Komatsu Press seeks payment of \$24,687.27 from the owner, Certified Tool (TR 183, App. 1). The record proves that Certified Tool was the “purchaser” and the loan from Capital Community did not cover the full cost and maintenance of the Press, which remained in Certified Tool’s possession before it ceased doing business.

Second, it is wrong to suggest that Certified Tool could not grant a security interest. KRS 355.9-202, entitled “**Title to collateral is immaterial**” states, in relevant part, “the provisions in this part with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.” Under Article 9, a security interest attaches regardless of title – the debtor need only have “rights,” which Certified Tool certainly had in its Agreement with Capital Community. KRS 355.9-203 provides:

(1) A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral. . .

(2) . . . a security interest is enforceable against the debtor and third parties with respect to collateral only if:

(a) Value has been given;

(b) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

(c) One (1) of the following conditions is met:

1. The debtor has authenticated a security agreement that provides a description of the collateral . . . ;

KRS 355.9-203.

Here, the requirements of KRS 355.9-203 were satisfied:

- Delphi provided value – a \$275,000 line of credit (TR 10-11)
- Certified Tool had rights in the Press and executed a security interest in Delphi's favor (TR 12-18)
- The security interest covered the Komatsu Press because its blanket lien included "equipment" and "machinery"

As long as an agreement meets this criteria, a security interest is enforceable regardless of who actually owns the collateral or the terms of any agreement between the debtor and a third party. This makes sense because creditors would have no way of knowing the terms of an unrecorded agreement that the debtor may have with someone else.

Capital Community points to a "plaque" on the Komatsu Press "Property of Franklin County," suggesting that Delphi should have performed "at least rudimentary due diligence" by visiting the site and looking for a plaque (Appellee's Brief, p. 19). It suggests lenders would be "well served by investigating collateral," but nothing in Article 9 requires Delphi or any other company, in or out of state, to look for labels that may or may not exist. To perfect their interests, secured parties file financing statements and rely on others to do so as Article 9 requires.

Delphi filed its financing statements to perfect its interests. Capital Community repeatedly questions the description of the collateral without citing any authority for its criticism. And, the description was unquestionably adequate as a matter of law. Under KRS 355.9-108, a description of collateral is sufficient when it reasonably identifies the collateral by category or type. KRS 355.9-108(2). Delphi's security agreements list all "machinery" and "equipment" of Certified Tool as being subject to its lien,<sup>1</sup> a clearly sufficient description of its lien interest under Article 9.

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<sup>1</sup> Similarly, Capital Community's Agreement with Certified Tool describes the Komatsu Press as "Equipment" (TR 167, 176-184).

**The Agreement Was Not a Lease.** Capital Community reiterates its argument below that its Agreement with Certified Tool was a lease. Capital Community should not be allowed to raise this issue because it did not believe in the position enough to raise an objection on cross-motion for discretionary review. Capital Community contends no cross-motion was necessary, relying on *Fischer v. Fischer*, 348 S.W.3d 582 (2011), which overruled earlier case law that required a cross-motion when the Court of Appeals never decided or reached an issue. Here, the lower courts ruled against Capital Community in holding its Agreement to constitute a security interest for compelling reasons.

KRS 355.1-203(2) identifies certain contractual provisions, which if present, are final and conclusive in determining whether a transaction created a security interest (See Appellant's Brief, pgs. 8-9). The Agreement between Capital Community and Certified Tool satisfies the statutory criteria. It established the consideration that Certified Tool had to pay Capital Community for the right to possess and use the equipment (\$3,394.10 per month), which was an obligation for the term of the Agreement (84 months) that Certified Tool could not terminate (TR 167-168). It provided that Certified Tool "shall" become sole owner of the equipment upon completion of the Agreement, thereby satisfying KRS 355.1-203(2) (TR 168, 311-312). Finally, no additional consideration of any kind was required for Certified Tool to become the owner of the Press, thereby meeting the requirements of KRS 355.1-201(37)(d) (TR 168, 312).

Capital Community refuses to acknowledge the conclusive effect of KRS 355.1-203(2) in determining whether a security interest or true lease exists. Instead, it quotes at length KRS 355.1-203(3) (Appellee Brief, p. 25), which simply sets forth some general considerations in determining whether a security interest or true lease agreement exists.

KRS 355.1-203(3) provides that a transaction in the form of a lease does not necessarily create a security interest simply because certain factors may be present, such as a lessee assuming risk of loss, or a lessee having an option to renew the lease. What Capital Community fails to recognize is that the considerations set forth in KRS 355.1-203(3) only become applicable if KRS 355.1-203(2) does not apply. The factors set forth in KRS 355.1-203(2), if present, are conclusively deemed to create a security interest and are completely independent of the considerations set forth in KRS 355.1-203(3) in determining whether a security interest or true lease agreement exists. KRS 355.1-203(2) would be stripped of its meaning altogether if courts were allowed to ignore the same and look solely to KRS 355.1-203(3) in determining whether a security interest or true lease agreement exists.

Capital Community relies on *In Re Yost*, 54 B.R. 818 (Bank.R.W.D. Ky. 1985), but those factors should not trump the Kentucky UCC and do not support Capital Community. *Yost* considers whether (1) there is an option to purchase for a nominal sum at the end of the term; (2) the agreement grants the alleged lessee an equity or property interest; (3) the alleged lessor's business is that of a financing agency; (4) the alleged lessee pays sales tax incident to the acquisition, or pays all other taxes normally associated with ownership; (5) the alleged lessee is responsible for comprehensive insurance; (6) the alleged lessee is required to maintain the equipment at its expense; (7) the agreement places the risk of loss on the alleged lessee; (8) the agreement permits the alleged lessor to accelerate the payment of rent upon default, or provides the lessor with other remedies similar to those of a mortgagee; (9) the alleged lessee is required to pay a substantial security deposit; (10) a financing statement is executed by the alleged lessee in connection with the agreement; (11) there are default provisions inordinately favorable

to the alleged lessor; (12) the agreement provides for liquidated damages; (13) a provision of the agreement disclaims warranties; and (14) the aggregate rentals approximate the value of the subject matter. *Id.* at 818.

The Agreement between Capital Community and Certified Tool requires no payment whatsoever, let alone a nominal payment, for Certified Tool to acquire the Komatsu Press at the end of the term. To the contrary, Certified Tool automatically becomes the sole owner of the Press (TR 168, Appellant's Brief, App. 4, p. 2). Certified Tool also must pay all sales, use, property, excise, license and registration, *ad valorem* and assessment taxes incident to the Komatsu Press (TR 171). Certified Tool was responsible for maintaining the equipment at its own expense (TR 168-169) and paying for insurance against loss or theft of or damage to the Komatsu Press, and public liability and property damage insurance in the amount of at least One Million Dollars (\$1,000,000.00) (TR 169). The Agreement placed the risk of loss entirely on Certified Tool, for any damage or loss of use of the Komatsu Press (TR 169 and disclaims any warranties on the part of Capital Community (TR 169).

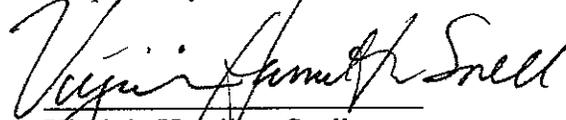
Similarly, the Agreement gives Capital Community remedies similar to those of a mortgagee upon default. In the event of any default, Capital Community has the option of, among other things, declaring the entire amount of unpaid rent, including rent which has not yet become due and owing, to be immediately due and payable (i.e. acceleration), and taking possession of the Komatsu Press and liquidating it (TR 173). These are the rights a secured creditor holds in relation to a security interest. Capital Community was engaged in the business of acting as a financing agency in relation to the Komatsu Press.

Although the Bankruptcy Court in *Yost* ultimately found the contract at issue to be a lease, it relied on the "unequivocal retention of control and ownership over the

equipment, and the absence of any purchase option...” as determinative. *Id.* at 821. Here, by contrast, Certified Tool retained exclusive control over the equipment and ownership automatically transferred to it upon expiration of the term without any additional consideration being paid (TR 168). Capital Community cannot reasonably rely on *Yost*.

In sum, Capital Community had a security interest in the Komatsu Press that Certified Tool purchased, and it never perfected its interest to give notice to subsequent lenders as Article 9 commands. When Delphi loaned Certified Tool \$275,000, believing it was secure, Delphi was entitled to rely on Article 9’s protection. No exemption saves Capital Community. We urge the Court to reverse and order that Delphi has priority over Capital Community to the liquidation sale proceeds.

Respectfully submitted,



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