



SO ORDERED.

SIGNED this 23 day of February, 2005.

Dale L. Somers

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In Re:

**DANIEL EUGENE FLOWERS,
BROOKE ANN FLOWERS,**

DEBTORS.

STEVEN L. SPETH, Trustee,

PLAINTIFF,

v.

**ELIE FARAH,
RANIA FARAH,
DANIEL EUGENE FLOWERS,
BROOKE ANN FLOWERS,**

DEFENDANTS.

**CASE NO. 04-10858-7
CHAPTER 7**

ADV. NO. 04-5102

MEMORANDUM OF DECISION

This proceeding is before the Court on the plaintiff's complaint under 11 U.S.C.A.

§ 544(a) to avoid an alleged security interest in a vehicle. Plaintiff Steven L. Speth, the

trustee for the debtors' bankruptcy estate ("Trustee"), appears as the Trustee and, with co-counsel Timothy J. King, as attorney for the Trustee. Defendants Elie and Rania Farah appear by counsel William B. Sorenson, Jr. Defendant-debtors Daniel Eugene and Brooke Ann Flowers ("Debtors") filed an answer and asserted an exemption in the vehicle except to the extent they owed a debt on it when they filed for bankruptcy. They are no longer participating in the proceeding. The Court has reviewed the relevant materials and is now ready to rule.

The Trustee seeks, as authorized by § 544(a), to avoid the lien the Farahs' claim in the vehicle, to preserve the lien under § 550 for the benefit of the bankruptcy estate, and to recover the lien or its value from the Farahs under § 550(a)(1). After considering the circumstances here, the Court concludes that the Farahs' have a valid lien in the vehicle that has been properly perfected. Consequently, the relief sought in the Trustee's complaint must be denied.

FACTS

On September 19, 2003, in Sedgwick County, Kansas, Elie Farah sold a 1995 Nissan Pathfinder to debtor Daniel Eugene Flowers. With no help from attorneys, they produced a one-page, homemade agreement that they both signed. The agreement does not expressly state that it concerns the sale of the vehicle, but in it, the Debtor promised to pay Elie or Rania Farah \$300 per month for 20 months for a total of \$6,000, with payments due on the 20th of each month. If the Debtor paid in full by October 20, 2004, though, the total "loan" would be reduced to \$5,500. The Debtor was required to carry insurance and

provide Farah with pertinent information about the coverage, though what was to be insured is not stated. Quoted exactly as it appears in the agreement, the final paragraph reads:

If at any time that Mr. Danny Eugene Flowers does not make his payment on time then he will be allowed 7 days grace period to make his payment, if payment is not made by the 27th of that month, then Elie Farah or Rania Farah has the right to reposes the 1995 Nissan Pathfinder with the VIN number of JN8HD17Y5SW045030 and Mr. Danny Eugene flowers will lose vehicle and all money invested.

Five days later, as shown by a title and registration receipt, the vehicle identified in this paragraph was titled and registered in both the Debtors' names, and Elie Farah was identified as the holder of a lien on it. Although the receipt does not clearly indicate who applied for the title and registration and paid the taxes and fees itemized on it, the applicable Kansas statute indicates "the owner or the owner's agent" was to do so.¹ Here, that means one of the Debtors probably made the application.

The Debtors made the payments called for by the agreement until they filed a joint Chapter 7 bankruptcy petition on February 27, 2004. They reported their monthly prepetition payments to Elie Farah on their Statement of Financial Affairs, and listed him in their schedules as their only secured creditor. Sometime after filing for bankruptcy, they paid Farah \$4,000, the amount still due on the agreement.

On May 6, 2004, the Trustee filed the complaint that commenced this proceeding, seeking to avoid any lien the Farahs might have in the vehicle and to recover any postpetition payments made to them. The Trustee named both Farahs and both Debtors as

¹K.S.A. 2003 Supp. 8-135(c)(1) & 8-135d.

defendants, but only the Farahs are currently defending against his claims. The Trustee and the Farahs have stipulated to the facts, and agreed that the issues the Court must decide are: (1) whether Elie Farah's transaction with Daniel Flowers effectively gave Farah a lien on the vehicle as security for the payments owed under the agreement, and (2) if no lien was created, whether the Trustee is entitled to recover the Debtors' \$4,000 postpetition payment from Farah. Because only Elie Farah and Daniel Flowers were involved in all aspects of the transaction and their spouses' interests are not alleged to have any impact on the dispute, the Court will simplify its discussion by using "Farah" and "the Debtor" to refer to all the interests involved in the transaction.

DISCUSSION

The Trustee is not disputing that any lien Farah obtained was properly perfected under Kansas law by being listed on the title and registration receipt.² Instead, he contends Farah's agreement with the Debtor did not give Farah any security interest in the vehicle because it contained no language granting one. To support this claim, he relies on two Tenth Circuit decisions, *Mitchell v. Shepherd Mall State Bank*³ and *Transport Equipment Co. v. Guaranty State Bank*.⁴ The Trustee notes that it might be argued the "right to

²See K.S.A. 2003 Supp. 8-135(c)(1) & 8-135d (after Jan. 1, 2003, when assignment of title shows lien, or division of motor vehicles has received notice of security interest, division shall create and retain electronic certificate of title); K.S.A. 2003 Supp. 84-9-311(a)(2) & (b) (security interests in property covered by certificate of title law to be perfected in accordance with that law, not Article 9 of UCC).

³458 F.2d 700 (10th Cir. 1972).

⁴518 F.2d 377 (10th Cir. 1975).

reposes [sic]” language in the agreement grants a security interest, but asserts the language should be considered to grant only a remedy that goes along with a security interest and not to grant the security interest itself. The Court cannot accept the Trustee’s contentions.

Under Revised Article 9 of the Kansas version of the Uniform Commercial Code, Farah’s alleged security interest is enforceable against the Debtor only if Farah gave him value, the Debtor has rights in the vehicle, and the Debtor signed a security agreement.⁵ Farah gave the Debtor the vehicle, obvious value, and the fact the vehicle is titled in the Debtor’s name shows he has rights in it. The question is whether the Debtor signed a security agreement. Under the UCC, a security agreement is “an agreement that creates or provides for a security interest.”⁶ As relevant here, a “security interest” is “an interest in personal property . . . which secures payment or performance of an obligation.”⁷

Under these definitions, the parties’ homemade agreement seems clearly to create or provide for Farah to have an interest in the vehicle to secure the Debtor’s obligation to make the payments specified. The right to repossess is tied to the Debtor’s failure to pay by the end of a grace period, and the Debtor agreed that repossession would cost him the vehicle and all the money he had paid on it. The requirement that the Debtor carry insurance and give Farah information about the coverage further suggests that Farah was

⁵K.S.A. 2003 Supp. 84-9-203(b) (specifying requirements for enforceability of security interests); K.S.A. 2003 Supp. 84-9-102(7)(A) (one meaning of “authenticate” is “to sign”).

⁶K.S.A. 2003 Supp. 84-9-102(a)(72).

⁷K.S.A. 2003 Supp. 84-1-201(37).

getting a security interest in the vehicle. While the agreement is not expressed as clearly as lawyers might wish, the parties' intent that Farah would have the right to recover the vehicle if the Debtor failed to pay is made clear enough.

But the Trustee's claim that no security interest was created is not so easily rejected. Although Article 9 of the Kansas UCC was extensively revised effective July 1, 2001,⁸ the definitions of "security agreement" and "security interest" were not changed in any way that is relevant in this case.⁹ The Tenth Circuit decisions the Trustee cites, issued in the 1970's, suggested a more stringent test for the sufficiency of a security agreement than the statutory definitions seem to require.

The first of these cases, *Mitchell*, arose under the Oklahoma version of the UCC, and involved a security agreement prepared by a bank using a form supplied by the federal Small Business Administration.¹⁰ The court explained that the agreement had one section that said a security interest was granted in collateral specified on an attached equipment list, and a second section that had boxes checked "to classify goods" as equipment, inventory, accounts receivable, and contract rights; a financing statement filed a few days after the agreement was signed said it covered all those categories.¹¹ The court declared

⁸See 2000 Kan. Sess. L., ch. 142, eff. July 1, 2001.

⁹See K.S.A. 84-9-105(l) (defining "security agreement") & 84-1-201(37) (defining "security interest") (Furse 1996) (repealed 2000 Kan. Sess. L., ch. 142, § 155, eff. July 1, 2001).

¹⁰458 F.2d at 702 & 704.

¹¹458 F.2d at 702.

that a security agreement must contain language specifically creating or granting a security interest in the described collateral.¹² The only reasonable reading of the agreement, the court said, was that the “words of grant” were limited to the equipment mentioned in the first section, and that the second section could not expand the security interest because it contained no granting language.¹³ The financing statement did not improve the creditor’s position because its function was to provide notice to third parties, and it contained no language that “would constitute the debtor’s grant of a security interest.”¹⁴ Consequently, the court declared that the creditor’s security interest extended only to the listed equipment, and could not reach the debtor’s inventory, accounts receivable, and contract rights, despite the creditor’s testimony that it had intended to take a security interest in those items, too.¹⁵ The second case, *Transport*, arose under the Kansas UCC, and the relevant portion of the decision involved a bank’s argument that a financing statement alone qualified as a security agreement.¹⁶ The court disposed of this argument by quoting statements in *Mitchell* that had expressed the view that a security agreement must contain a grant of a security interest, and declaring, “Our review of the financing statements filed by

¹²*Id.* at 703.

¹³*Id.*

¹⁴*Id.* at 703-04.

¹⁵*Id.* at 702-04.

¹⁶518 F.2d at 380.

the Bank in the instant case reveals no such ‘granting’ language.’¹⁷ Later, in *Pontchartrain State Bank v. Poulson*,¹⁸ another case involving the Oklahoma UCC, the Tenth Circuit read *Mitchell* and *Transport* to mandate the conclusion that a promissory note given to a bank that said it was “secured by pledge and delivery of the securities or property mentioned on the reverse” did not qualify as a security agreement because that language did not specifically grant a security interest.¹⁹

While these Tenth Circuit decisions have made resolving this case more difficult than the Kansas UCC’s definitions of “security agreement” and “security interest” indicated it would be, the Court is nevertheless convinced that Kansas state courts would conclude the transaction between Farah and the Debtor did give Farah a valid security interest in the vehicle. First, the Kansas Supreme Court has declared: “The primary rule in construction of any contract is to ascertain the intent of the parties, and such intent may best be determined by looking at the language employed and taking into consideration all the circumstances and conditions which confronted the parties when they made the contract.”²⁰ Any rule requiring a security agreement to contain particular words or phrases to create a security interest when it is otherwise clear the parties intended to do so would contravene

¹⁷*Id.* at 380.

¹⁸684 F.2d 704 (10th Cir. 1982).

¹⁹*Id.* at 706.

²⁰*Galindo v. City of Coffeyville*, 256 Kan. 455, 467 (1994); *see also City of Arkansas City v. Anderson*, 242 Kan. 875, syl. ¶1 (1988).

this rule, and Kansas state courts would be unlikely to adopt it without more specific direction from the legislature than can be found in the UCC. Second, the Tenth Circuit cases all involved bank lenders, parties in the business of making loans protected by security interests. Even if Kansas state courts might require such lenders to use granting language to create security interests, the Court doubts they would be inclined to be so strict with non-professional lenders like Farah. Third, an Article 9 commentator on whom Kansas state courts often rely, Barkley Clark (in recent years writing with Barbara Clark), strongly criticizes the *Transport* approach as one that makes form more important than substance and conflicts with the UCC drafters' general philosophy that substance should control.²¹ He advises:

In spite of authority to the contrary, the courts should not require formal words of grant in the security agreement as a condition of attachment. The mandate of Article 9 is only that the security agreement be signed by the debtor and contain a reasonable description of the collateral. There is no requirement for words of grant. In fact, such a requirement smacks of the antiquated formalism the drafters were trying to avoid. As long as the documentation as a whole fairly reflects a meeting of the debtor's and creditor's minds on the matter, magic words should not enter the picture. A filed financing statement, standing alone, will probably not do the job. However, in combination with other documentation, such as promissory notes, bills of sale, and written memoranda, the financing statement should be given weight in that direction.²²

²¹ Barkley Clark & Barbara Clark, *The Law of Secured Transactions Under the Uniform Commercial Code*, ¶ 2.01[1][c] at p. 2-14 (rev. ed. 2004).

²²*Id.* at p. 2-16.

This approach is more in tune with the Kansas Supreme Court's directive to determine the parties' intent than is the Tenth Circuit's approach of looking only for specific granting language.

While Farah and the Debtor may not have used the clearest language to create or provide for a security interest in the vehicle, they clearly grasped and adequately expressed the aspect of a lien that is undoubtedly most important to both parties to a secured vehicle sale: if the buyer doesn't pay, the seller can repossess. The insurance requirement added to the implication that a security interest was intended. Any possible doubt that the Debtor intended to give Farah a lien by signing the agreement was resolved when he (or his wife or other agent) applied for and obtained the title and registration receipt showing Farah's lien on the vehicle, and, so far as appears in the record, did not protest the lien notation. Under these circumstances, the Court is convinced that a Kansas state court would conclude that Farah's transaction with the Debtor adequately created or provided for Farah to have an interest in the vehicle to secure payment.

CONCLUSION

The Court concludes that the agreement between the Debtor and Farah adequately provided for Farah to have a security interest in the vehicle, that is, an interest to secure payment. The Trustee's attack on Farah's lien on the Debtors' vehicle must fail, and the relief sought in his complaint must be denied.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based on this ruling will be entered on a separate document as required by FRBP 9021 and FRCP 58.

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