

#S-5

signed 4-14-04

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

**In Re:**

**CHRISTOPHER LEE HABERMAN,  
CATHERINE MAY HABERMAN,**

**DEBTORS.**

**J. MICHAEL MORRIS, Trustee,**

**PLAINTIFF,**

**v.**

**ST. JOHN NATIONAL BANK,  
CHRISTOPHER L. HABERMAN,  
CATHERINE M. HABERMAN,**

**DEFENDANTS.**

**CASE NO. 02-11974-7  
CHAPTER 7**

**ADV. NO. 02-5273**

**ORDER DETERMINING THAT THE TRUSTEE CAN AVOID ST. JOHN  
NATIONAL BANK'S LIEN ON THE DEBTORS' CAR, BUT THAT THE  
COURT CANNOT YET RESOLVE OTHER QUESTIONS**

This proceeding is before the Court for decision based on the parties' stipulations and briefs. The plaintiff-trustee appears by counsel Sarah L. Newell. Defendant St. John National Bank appears by counsel Dale J. Paulsen. The defendant-debtors' counsel, Don Riley, has signed the stipulations, but has not submitted a brief on behalf of the debtors. The Court has reviewed the relevant materials and is now ready to rule.

The Bank has a lien on the Debtors' car that the Trustee is trying to avoid and preserve for the benefit of the estate. The Court concludes that the lien is not perfected, so the Trustee can avoid it, turning the Bank's formerly secured claim against the car into a

general unsecured claim against the bankruptcy estate. The lien is automatically preserved for the benefit of the estate, and although the Debtors have claimed the car as exempt, the Trustee can enforce the lien against the car. The lien is limited to the amount of the Bank's claim as of the day the Debtors filed for bankruptcy, or the value of the car on that day, whichever is less. The parties will need to inform the Court whether they can agree on the amount of the lien, or want to present evidence so the Court can decide the question. Immediately after filing this proceeding, the Trustee sought and obtained an order declaring the estate's interest in any postpetition payments the Debtors might make on the debt secured by the car. Because the Bank appears to be asking for reconsideration of that order, though, and the record does not reveal whether the Bank agreed to the order or whether the Debtors made any postpetition payments, the parties will need to submit additional stipulations or evidence before the Court can determine whether the Trustee can recover any postpetition payments the Debtors might have made.

### **FACTS**

The parties' stipulations, pleadings in the court file, and an admission in the brief filed by the Bank reveal the following facts.

Many years ago, the Bank had a lien that was noted on the title to a 1980 Pontiac Trans Am, but sometime in 1996 or before, a Bank officer signed a lien release notation on the title. The Bank concedes that the title was then returned to the Debtors. Various documents submitted apart from the parties' stipulations, including a copy of a car title attached to the Trustee's brief, list the owners of the car as James M. and Cathy Tucker, not

debtors Christopher and Catherine Haberman. The parties have not explained this name discrepancy. The Court can only assume that Cathy Tucker somehow became the sole owner of the car, married debtor Christopher Haberman, and is now debtor Catherine Haberman. Apparently, the Debtors retained the title showing the Bank's lien and its lien release, and never applied for one showing the current owners' names or the absence of a lien on the car. Consequently, the records of the Division of Vehicles of the Kansas Department of Revenue (the Division) still indicate that the Tuckers own the car and the Bank has a lien on it.

In October 2001, the Debtors gave the Bank a new security interest in the Trans Am to secure a debt of \$3,050. They gave the Bank the old title, and the Bank put it in a "collateral box." The Bank took no other steps to perfect its new security interest. It did not require the Debtors to sign an application for a mortgage title. Neither the Bank nor the Debtors submitted anything to the Division about the new lien, and no title showing the new lien was ever issued.

The Debtors filed a joint Chapter 7 bankruptcy petition in May 2002. They signed a reaffirmation agreement that the Bank accepted a month later. The Debtors' discharge was entered in August 2002, and the Debtors filed a rescission of the agreement less than 60 days later. The reaffirmation agreement has never been filed with the Court.

In October 2002, the Trustee filed the complaint that commenced this proceeding, naming the Bank and the Debtors as defendants. Count one sought to avoid the Bank's lien on the car under 11 U.S.C.A. §544(a), and to preserve the lien for the benefit of the estate

under §551. Count two stated that the Trustee did not object to the Debtors' claim that the car is exempt, but asked the Court to determine the parties' rights to the car.

Shortly after filing the complaint, the Trustee filed a motion asking the Court to order the Debtors to give the Trustee any payments that came due on their debt to the Bank, and to declare that any postpetition payments the Debtors had already made to the Bank or might make to it in the future would be property of the estate if the Trustee succeeded on the lien avoidance count. The Debtors objected that they preferred to continue to make payments to the Bank. The Bank responded that the motion should be denied because the Bank had a perfected security interest in the car.

At a hearing on the motion, the Trustee appeared as his own attorney. The courtroom minute sheet from the hearing indicates Chief Judge Nugent ruled that the Debtors should continue to make payments to the Bank, but that the payments would be turned over to the Trustee if the Court determined the Bank's security interest was avoidable. The three attorneys approved the form of an order that accurately reflected the ruling, and Judge Karlin signed it. Apparently mistakenly, the order was identified as an "agreed order" when it was entered on the Court's docket. The Court would simply declare that the docket entry was mistaken, but the Trustee's briefs also describe the order as an agreed one. The briefs are signed by another attorney in the Trustee's office, though, not by the Trustee himself, so the attorney may have based her description of the order on the docket entry, rather than knowledge of what happened at the hearing before Chief Judge Nugent.

The parties submitted the proceeding for decision on their stipulations and briefs. The Trustee filed a brief, the Bank filed a response, and the Trustee filed a reply. The Debtors have not filed a brief.

## **DISCUSSION AND CONCLUSIONS**

### **A. The Trustee’s Ability to Avoid the Bank’s Lien**

*1. The Trustee has the status of a judicial lien creditor.*

The Bankruptcy Code gives Chapter 7 trustees various avoiding powers, and the Trustee is relying on one here that is based on the ability of a judicial lien creditor under state law to defeat interests in the Debtors’ property. Section 544(a) of the Code gives the Trustee the status of a judicial lien creditor:

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists.<sup>1</sup>

Section 101(36) defines “judicial lien” to mean “lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding.” So, when the Debtors filed for bankruptcy, §544(a)(1) gave the Trustee the rights of a judicial lien creditor of the Debtors (whether or not such a creditor actually existed), authorizing the Trustee to avoid any interest in the Debtors’ property that such a creditor could defeat. Under §551, any

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<sup>1</sup>11 U.S.C.A. §544(a)(1).

interest the Trustee avoids under §544 is preserved for the benefit of the bankruptcy estate, “but only with respect to property of the estate.” A trustee’s right to avoid liens under these provisions is commonly known as a “Strong-Arm Power.”

2. *The Bank’s security interest is not perfected, and would be defeated by a judicial lien creditor.*

The first question the Court must answer, then, is whether a judicial lien creditor’s interest in the Debtors’ car would have priority over the Bank’s security interest in it. The Bank’s present security interest was created after Revised Article 9 of the Kansas version of the Uniform Commercial Code took effect,<sup>2</sup> so the revised article applies in this case. Under it (with exceptions not applicable here), an unperfected security interest is subordinate to the rights of a lien creditor.<sup>3</sup> In terms echoing the “judicial lien” definition in the Bankruptcy Code, the UCC defines “lien creditor” to mean a “creditor that has acquired a lien on the property involved by attachment, levy, or the like,” and to include a trustee in bankruptcy from the date of the petition.<sup>4</sup> Under section 84-9-311(a)(2) and (b)<sup>5</sup> of Revised Article 9 (the Perfection Statute), to perfect a security interest in a car (again,

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<sup>2</sup>See 2000 Kan. Sess. L. ch. 142, §156 (fixing July 1, 2001 as effective date of Revised Article 9).

<sup>3</sup>See K.S.A. 2002 Supp. 84-9-317(a)(2)(A). Section 13 of ch. 159 of the 2002 Kan. Sess. Laws amended 84-9-317(a)(2)(B), but did not change (a)(2)(A).

<sup>4</sup>K.S.A. 2002 Supp. 84-9-102(52)(A) & (C).

<sup>5</sup>K.S.A. 2002 Supp. 84-9-311(a)(2) & (b). Section 11 of ch. 159 of the 2002 Kan. Sess. Laws amended 84-9-311, but did not change subsection (a) or (b).

with exceptions not applicable here), a creditor must comply with provisions in the Kansas vehicle registration and certificate of title statute (the Title Statute).<sup>6</sup>

The Title Statute contains the provisions that control the perfection of nearly all security interests in vehicles. Buried in the middle of it are instructions that explain how the Bank should have perfected its security interest in the Debtors' car.

When a person acquires a security agreement on a vehicle subsequent to the issuance of the original title on such vehicle, such person shall require the holder of the certificate of title to surrender the same and sign an application for a mortgage title in form prescribed by the division. Upon such surrender such person shall immediately deliver the certificate of title, application, and a fee . . . to the division. Upon receipt thereof, the division shall issue a new certificate of title showing the liens or encumbrances so created . . . .<sup>7</sup>

This procedure ensures that no lien-free certificate of title for the car remains in circulation. Under the predecessor to the Perfection Statute,<sup>8</sup> courts applying Kansas law declared that notation on the certificate of title as required by the Title Statute was the only way to perfect a security interest in a vehicle covered by that statute.<sup>9</sup> This requirement ensures the reliability of selling vehicles by assigning their titles.<sup>10</sup> That is, potential

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<sup>6</sup>K.S.A. 2002 Supp. 8-135(c).

<sup>7</sup>K.S.A. 2002 Supp. 8-135(c)(6). The 2002 and 2003 amendments to 8-135 changed the amount of the fee to be delivered with the certificate of title and application, but otherwise did not amend these provisions. See 2002 Kan. Sess. L. ch. 134, §2 at p. 741; 2003 Kan. Sess. L. ch. 30, §1 at p. 86.

<sup>8</sup>K.S.A. 1999 Supp. 84-9-302(3)(c) (repealed by 2000 Kan. Sess. Laws, ch. 142, §155, eff. July 1, 2001).

<sup>9</sup>See *In re Reed*, 147 B.R. 571, 572-75 (D.Kan. 1992); *Beneficial Finance Co. v. Schroeder*, 12 Kan. App. 2d 150, 152-54, *rev. denied* 241 Kan. 838 (1987).

<sup>10</sup>See *Mid American Credit Union v. Board of Sedgwick County Comm'rs*, 15 Kan. App. 2d 216, 223, *rev. denied* (1991) (allowing lien perfection without notation on title would endanger reliability of sales by title assignment).

buyers can rely on the titles to show whether any liens exist that they need to worry about.

While the Perfection Statute is not identical to the old Article 9 provisions, the Court believes the differences were not intended to lead to a different result in a dispute like the one between the Trustee and the Bank.

At first glance, it might seem incongruous to hold that the Bank's lien is unperfected in this case. The records at the Division show that the Bank has a lien, and the Bank has the certificate of title that shows its lien release in a box under its control. However, in Kansas, taking possession of a title does not perfect a lien on a vehicle. The Court is not required to answer the question whether the Bank would have a perfected lien if it had never executed the lien release on the title before it made the new loan and the Debtors gave it the new security interest in the car. In this case, the Bank did execute the lien release. By doing that, the Bank left open a way for the Debtors to obtain a lien-free title. The Title Statute includes a provision indicating that a lienholder's name will be removed from a title when the owner presents "satisfactory evidence . . . to the division that the lien or encumbrance has been paid."<sup>11</sup> Although they gave the original to the Bank, the Debtors might have kept a copy of the certificate showing the lien release. If they did, they could have taken it to the Division (maybe along with other evidence showing they had paid off the old lien), and claimed to have lost the original certificate. Under these circumstances, the Debtors might have convinced the Division they were entitled to a certificate of title with no lien notation simply by failing to mention the new lien they had given the Bank. On

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<sup>11</sup>K.S.A. 2002 Supp. 8-135(c)(6).

the other hand, if the Bank had followed the requirements of the Title Statute for its new lien, the Debtors would not have had the chance to get a lien-free title because the Division's records would have shown that the new lien was created after the lien release was added to the old certificate of title, and that any other proof of payment the Debtors had was for the old lien.

3. *The Bank's arguments against lien avoidance are not convincing.*

(a) *The Debtor's exemption claims do not affect the Trustee's Strong-Arm Power.*

The Bank argues that the Trustee may not avoid its lien because the car is not property of the bankruptcy estate since the Debtors claimed it as exempt. This is wrong. When the Debtors filed for bankruptcy, all their property — even property, like the car, that they claimed as exempt — became property of the bankruptcy estate.<sup>12</sup> While the Debtors had the right to exempt property from that estate,<sup>13</sup> their exemption claims were not effective until the time to object to them had passed and any objections were resolved.<sup>14</sup> The Trustee's Strong-Arm Power was fixed “as of the commencement of the case,”<sup>15</sup> before the Debtors' exemptions became effective. Thus, the Debtors' exemption claims could not affect the Trustee's Strong-Arm Power, even though property claimed as exempt may cease

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<sup>12</sup>11 U.S.C.A. §541(a)(1).

<sup>13</sup>See 11 U.S.C.A. §522(b).

<sup>14</sup>See *Taylor v. Freeland & Kronz*, 503 U.S. 638, 643-45 (1992) (11 U.S.C.A. §522(l) makes exemption claims final unless someone objects in time fixed by Fed. R. Bankr. P. 4003(b)).

<sup>15</sup>11 U.S.C.A. §544(a).

to be property of the estate once the exemption claims become final. Furthermore, exemptions are for the benefit of debtors, and a creditor has no standing to assert the debtor's exemption as a defense to an avoidance action.<sup>16</sup>

Other considerations also support the view that a debtor's claim that property is exempt should generally have no impact on a trustee's ability to avoid a lien on that property. First, the trustee's "avoiding powers exist to implement the goal of every insolvency statute, which is the equal distribution of a debtor's assets among its general non-priority creditors."<sup>17</sup> The Strong-Arm Power furthers this goal by authorizing the trustee to defeat liens that applicable (usually state) law makes vulnerable to the claims of other creditors. As the Tenth Circuit has said:

Section 544(a) protects creditors by giving the trustee the status of a judicial lien creditor as of the commencement of the case; if an unperfected security interest exists, the trustee has rights in the collateral that are superior to the secured party's rights . . . . "The purpose of [section 544] is . . . to preserve the assets of the estate against unfiled, unrecorded, or secret liens." *In re Teerlink Ranch Ltd.*, 886 F.2d 1233, 1235-36 (9th Cir.1989); [additional citation omitted].<sup>18</sup>

Second, if a consensual lien like the Bank's may not be avoided, the creditor will be able to enforce it against the encumbered property despite the debtor's exemption claim; if it can be avoided, the trustee will be able to enforce it and distribute the proceeds to the general

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<sup>16</sup>*Fox v. Smoker (In re Noblit)*, 72 F.3d 757, 758-59 (9th Cir. 1995); *Morris v. Citifinancial (In re Tribble)*, 290 B.R. 838, 844 (Bankr. D. Kan. 2003).

<sup>17</sup>5 *Collier on Bankruptcy* ¶544.01 (Alan N. Resnick & Henry J. Sommer, eds.-in-chief, 15th ed. rev. 2003).

<sup>18</sup>*Clark v. Valley Fed. Savings & Loan Ass'n (In re Reliance Equities, Inc.)*, 966 F.2d 1338, 1344 (10th Cir. 1992).

unsecured creditors. In either case, the debtor must pay someone for the property, or lose it. Finally, for some involuntary transfers and some nonpossessory, nonpurchase-money security interests that a trustee has avoided, the debtor may exempt the property recovered to the extent the debtor could have exempted it if the transfer had not occurred.<sup>19</sup> If Congress had intended for debtors' exemption claims to keep trustees from exercising their avoiding powers under all circumstances, this provision would not have been necessary.

*(b) The Bank's reaffirmation agreement with the Debtors is invalid, and it would not have any effect on the Trustee's Strong-Arm Power in any event.*

The Bank contends that its reaffirmation agreement with the Debtors bars the Trustee from avoiding its lien on the car. To be effective, a reaffirmation agreement must be filed with the Court and not be rescinded by the debtors.<sup>20</sup> Although the Bank's agreement was made before the Debtors were granted their discharge, the Debtors could rescind it until the discharge was granted or 60 days after it was filed, whichever was later.<sup>21</sup> The agreement was never filed, so the Debtors' rescission in October 2001 was timely, and invalidated the agreement. Moreover, nothing in the Bankruptcy Code — in particular,

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<sup>19</sup>11 U.S.C.A. §522(g); *see also* 4 *Collier on Bankruptcy* ¶522.12[1] (explaining operation of §522(g)).

<sup>20</sup>11 U.S.C.A. §524(c)(3) & (4).

<sup>21</sup>§524(c)(4).

neither the reaffirmation nor the avoiding powers provisions<sup>22</sup> — indicates that the Debtors' reaffirmation of the debt has any effect on the Trustee's avoiding powers.

## **B. The Effect of Avoiding the Bank's Lien**

- 1. The Court can describe limits on the amount of the lien the Trustee can enforce against the Debtors' car, but cannot now determine its exact amount.*

The Tenth Circuit Bankruptcy Appellate Panel recently ruled that when a trustee avoids and preserves a creditor's lien, the trustee succeeds to the creditor's lien rights, but does not obtain any right to collect the creditor's claim from the debtor postpetition.<sup>23</sup> From the collateral securing the lien, the trustee can recover the amount of the creditor's claim as of the day the debtor filed for bankruptcy, or the value of the collateral on that day, whichever is less.<sup>24</sup> In this case, according to the reaffirmation agreement that the Bank attached to its brief, the debt secured by the car was \$3,237.50 on the day the Debtors filed for bankruptcy, so that is the most the Trustee can recover on the avoided lien (unless this amount is incorrect or is disputed). Although the parties have presented nothing on this point, it is unlikely that a 1980 Pontiac Trans Am was worth \$3,237.50 in May 2002, so the Trustee will probably be able to recover no more than the value of the car as of the bankruptcy filing date. In any event, the parties will need to inform the Court whether they

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<sup>22</sup>11 U.S.C.A. §524 & §§544 through 551.

<sup>23</sup>*Morris v. Vulcan Chemical Credit Union (In re Rubia)*, 257 B.R. 324, 327 (10th Cir. B.A.P.), *aff'd by unpub. op.* 23 Fed. Appx. 968 (10th Cir. 2001).

<sup>24</sup>*See* 257 B.R. at 328-29.

can agree on the amount of the lien, or want to present evidence so the Court can decide the question.

2. *As the record now stands, the Court cannot to determine whether the Trustee is entitled to recover all the postpetition payments the Debtors might have made to the Bank.*

As explained in the “Facts” section of this opinion, the Court cannot tell whether the order that declared the Trustee would be entitled to recover the Debtors’ postpetition payments to the Bank if the Court avoided the Bank’s lien (the “Order”) was agreed to by the Bank or decided by the Court. The Trustee’s briefs refer to it as an agreed order, but they were submitted by an attorney who did not attend the hearing on the motion that led to the Order and so might have called it an agreed order based on the docket entry that calls it agreed. In its brief, the Bank suggests that the Trustee is not entitled to recover postpetition payments the Debtors made to it. If the Bank in fact agreed to the Order, this assertion comes too late. If, as the courtroom minute sheet and the Order itself seem to indicate, the Bank did not agree, then the Court might need to address the Bank’s arguments. Whether that will be necessary, though, also depends on whether and when the Debtors actually made any postpetition payments, facts that do not appear in the record. Before the Court will consider the Bank’s arguments that the Trustee is not entitled to recover any postpetition payments the Debtors made to the Bank, the parties will need to inform the Court whether the Bank agreed to the Order. If the Bank did not agree to the order, the parties will need to present evidence or additional stipulations indicating whether

the Debtors actually made any postpetition payments to the Bank on the debt secured by their car and, if so, how much they paid and when.

### CONCLUSION

The Court concludes that the Trustee is entitled to avoid the Bank's lien on the car, and can enforce the lien for the benefit of the bankruptcy estate up to the lesser of the amount of the Bank's claim or the value of the car (both determined as of the day the Debtors filed for bankruptcy). Within 30 days of the date of this order, the parties are directed to inform the Court whether they can agree on the amount of the lien, or want to present evidence on the question. The parties are also directed to inform the Court within 30 days of the date of this order: (1) whether the Bank agreed to the relief granted in the Order; and (2) if not, whether and when the Debtors made any postpetition payments to the Bank. If the Court will need to address the Bank's arguments about the postpetition payments, the parties should also inform the Court how much each payment was for.

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. Because the decision does not resolve all the disputes in this proceeding, a judgment based on this ruling will not yet be entered on a separate document as required by FRBP 9021 and FRCP 58.

Dated this \_\_\_\_ day of April, 2004.

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DALE L. SOMERS  
BANKRUPTCY JUDGE

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that true and correct copies of the above **ORDER DETERMINING THAT THE TRUSTEE CAN AVOID ST. JOHN NATIONAL BANK'S LIEN OF THE DEBTORS' CAR, BUT THAT THE COURT CANNOT YET RESOLVE OTHER QUESTIONS** were mailed via regular U.S. mail, postage prepaid, on the \_\_\_\_ day of April, 2004, to the following:

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