



**IT IS HEREBY ADJUDGED and DECREED that the below described is SO ORDERED.**

**Dated: November 18, 2004**

**ROBERT E. NUGENT  
UNITED STATES BANKRUPTCY JUDGE**

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

<b>IN RE:</b>	)	
	)	
<b>LANE G. LUKE,</b>	)	<b>Case No. 03-14067</b>
	)	<b>Chapter 7</b>
<b>Debtor.</b>	)	
_____	)	
	)	
<b>J. MICHAEL MORRIS, Trustee,</b>	)	
	)	
<b>Plaintiff,</b>	)	
<b>v.</b>	)	<b>Adversary No. 03-5323</b>
	)	
<b>WELLS FARGO FINANCIAL</b>	)	
<b>ACCEPTANCE KANSAS, INC.,</b>	)	
<b>and LANE G. LUKE,</b>	)	
<b>Defendants.</b>	)	
_____	)	

**MEMORANDUM OPINION**

This is an adversary proceeding brought by the trustee, J. Michael Morris, exercising his powers as a hypothetical lien creditor under 11 U.S.C. § 544(b), to avoid the lien of Wells Fargo

Financial Acceptance Kansas, Inc. (“Wells Fargo”) in debtor’s pickup. The trustee contends that Wells Fargo was not perfected on the date of debtor’s bankruptcy filing, July 28, 2003.

The parties stipulated to the facts<sup>1</sup> as set out below and submitted memoranda of authority.<sup>2</sup> Having reviewed the record and the briefs, and heard oral argument, the Court is ready to rule.

### Jurisdiction

The Court has jurisdiction over this proceeding.<sup>3</sup> This adversary proceeding is a core proceeding under 28 U.S.C. § 157(b)(2)(K).

### Facts

Debtor Lane G. Luke filed his bankruptcy case on July 28, 2003. A few weeks before, on June 20, Luke refinanced his 2000 Ford pickup loan from Ford Motor Credit Corporation (“FMCC”) with the proceeds of a new loan from defendant Wells Fargo. Luke borrowed some \$10,787.44 and granted a security interest in his vehicle to Wells Fargo. When Wells Fargo closed the loan transaction, it requested the vehicle’s certificate of title from Luke, but the paper original that bore a notation of FMCC’s lien had been lost. Wells Fargo did obtain a copy of Luke’s registration. On June 20, Wells Fargo sent a check to FMCC for payoff of its loan with a request for a lien release. FMCC cashed the check on July 2, 2003 but did not forward the lien release until August 13. Only then did Wells Fargo submit its title application along with the release and applicable fee to the Kansas Division of Vehicles (the “Division”). Pursuant to KAN. STAT. ANN. § 8-135d (2003 Supp.), the Division created an electronic title showing Wells Fargo’s lien.

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<sup>1</sup> Dkt. 47.

<sup>2</sup> Dkt. 42 and 46.

<sup>3</sup> 28 U.S.C. § 1334.

## Analysis

The Kansas Uniform Commercial Code provides that perfection of a security interest in titled vehicles is to be accomplished in compliance with the Motor Vehicle Code.<sup>4</sup> The applicable sections of the Motor Vehicle Code<sup>5</sup> set forth in detail the procedure to be followed by a person claiming a security interest in a vehicle that has previously been titled. Two sections in particular govern the transaction at bar.

KAN. STAT. ANN. § 8-135(c)(6) (2003 Supp.) provides that when a lender takes a security interest in a vehicle after the original title has been issued on the vehicle, the lender “shall require the holder [owner] of the certificate of title to surrender the same and sign an application for a mortgage title . . . .”<sup>6</sup> When the title is surrendered, the lender “shall immediately deliver the certificate of title, application, and a fee of \$10 to the division [of motor vehicles]” at which time the Division “shall issue a new certificate of title showing the liens or encumbrances so created, but not more than two liens or encumbrances may be shown upon a title.”<sup>7</sup>

KAN. STAT. ANN. § 8-135d(a) (2003 Supp.) states that on or after January 1, 2003, when an assignment of a title, manufacturer’s statement of origin (“MSO”), or notice of security interest indicates that the vehicle is burdened with a lien, the Division will create an electronic certificate of title and retain that title in electronic form. Subsection (b) of § 8-135d authorizes the Secretary of

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<sup>4</sup> KAN. STAT. ANN. § 84-9-311(a)(2) and (b) (2003 Supp.).

<sup>5</sup> KAN. STAT. ANN. § 8-101, *et seq.* (2001 and 2003 Supp.).

<sup>6</sup> KAN. STAT. ANN. § 8-135(c)(6) (2003 Supp.).

<sup>7</sup> *Id.* The Court notes with interest that this section will eventually need further revision to conform to the electronic title statute. If paper titles are no longer issued for encumbered vehicles as provided in Kan. Stat. Ann. § 8-135d, a refinancing creditor will be unable to “require the holder of a certificate of title to surrender same . . . .” as this subsection requires.

Revenue to promulgate regulations carrying out the electronic title section. The Secretary has issued KAN. ADMIN. REG. 92-51-24(b) (2004) which authorizes the Division to print and mail a paper title to the owner of an electronically titled vehicle only when the liens encumbering the vehicle have been satisfied. This regulation was enacted in January of 2004.

In its brief and at oral argument on September 14, 2004, Wells Fargo argued that it had done all it could to perfect its security interest in the debtor's pickup. This argument invokes the ghost of an old bankruptcy case, *In re Littlejohn*.<sup>8</sup> In *Littlejohn*, the debtors purchased a new car and granted the lender a purchase-money security interest. The debtors then failed to apply for a certificate of title before filing their bankruptcy case. Applying former Article Nine,<sup>9</sup> the Tenth Circuit Court of Appeals concluded that the only manner in which the lender could have perfected its purchase money security interest was to present the "appropriate documents" to obtain the recording of its lien on the debtor's certificate of title. The appropriate documents at that time included the application for a certificate of title, the bill of sale to debtors showing the lien, and the applicable fee.<sup>10</sup> In 1974, there was no statutory provision enabling a lender's application for a secured title or the filing of a notice of security interest ("NOSI"). Thus, the Tenth Circuit held that the lender would not be penalized for the debtors' failure to apply for the certificate of title. Once the lender had delivered its bill of sale to the debtors with a notation of its lien, that was "sufficient to place a potential buyer or creditor on notice of the existence of the lien . . . ."<sup>11</sup> The Tenth Circuit concluded that the lender had done all it

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<sup>8</sup> *Commerce Bank v. Chambers (In re Littlejohn)*, 519 F.2d 356 (10th Cir. 1975) (applying Kansas law).

<sup>9</sup> KAN. STAT. ANN. § 84-9-302 (1974).

<sup>10</sup> See KAN. STAT. ANN. § 8-135 (1974).

<sup>11</sup> 519 F.2d at 359.

could and should not be held accountable for the debtors' failure to register their car.

In the wake of *Littlejohn*, the Kansas Legislature amended KAN. STAT. ANN. § 8-135 to add the NOSI mechanism whereby a creditor may file such a notice to perfect its security interest in the vehicle when making a purchase money loan. In *In re Kerr*<sup>12</sup>, the Tenth Circuit held that given a simple means of perfection independent of debtor action, lenders should be required to use it, and abandoned the *Littlejohn* "we did all we could" rule.<sup>13</sup>

Even if *Littlejohn* remained good law, it would not govern the transaction at bar. Here, debtor *refinanced* a previously existing loan. As noted above, the title statute expressly provides rules for perfection when a refinance occurs.<sup>14</sup> Wells Fargo had several alternatives when it determined that the debtor did not have a paper title. First, it could have delayed closing the loan and disbursing the proceeds until a title or a registration was produced. Second, it could have submitted its application for secured title along with its fee and a registration receipt to the Division on June 20, 2003, the date the loan closed. Had that occurred, the Division would have created a secured title and retained the electronic title until the lien was released. It is true that the title would have shown *two* liens, that of FMCC *and* Wells Fargo. Once Wells Fargo secured the FMCC release, however, it could have forwarded same to the Division for a release of record. As the debtor would not be given possession of a paper certificate of title until all the liens were cleared, Wells Fargo's interests would be satisfactorily protected. In fact, the Kansas Department of Revenue website expressly provides that when a vehicle is being refinanced, a secured title application may be submitted along with a

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<sup>12</sup> *Lentz v. Bank of Independence (In re Kerr)*, 598 F.2d 1206 (10th Cir. 1979).

<sup>13</sup> *Id.* at 1209.

<sup>14</sup> *See* KAN. STAT. ANN. § 8-135(c)(6) (2003 Supp.).

registration receipt to either the county treasurer or the Title and Registration Bureau. “A lien release may be submitted at the time of application, or at a later date to remove the refinanced lien.”<sup>15</sup>

The Court notes here that Kan. Stat. Ann. § 8-135(c)(6) is none too clear in that it specifically calls for the surrender by the borrower of a paper title (presumably soon to become an extinct document) and submission of same by the lender, along with its application and fee, to the Division. Nevertheless, after Wells Fargo obtained the lien release, it submitted a registration receipt, an application, the lien release, and a fee, and the Division noted its lien on the electronic title, albeit after debtors filed their petition.<sup>16</sup> This suggests that submission of the registration, the application, and the fee, had it been accomplished on June 20, 2003, would have sufficed to perfect Wells Fargo’s lien and to defeat the interests of any subsequent lien creditor.

Thus, on June 20, 2003, Wells Fargo could easily have perfected its security interest under the governing statutes and given notice of its lien to any potential purchaser or creditor reviewing the record. Wells Fargo would have fully complied with the requirement of KAN. STAT. ANN. § 84-9-311(b) that it comply with the certificate of title law and its lien would have been immune to the Trustee’s assault. Wells Fargo failed to do so and its security interest, which was unperfected at the date of filing, is subordinate to that of a lien creditor.<sup>17</sup> A trustee is a hypothetical lien creditor who, under § 544(a), stands in the shoes of a lien creditor and may avoid an unperfected security interest

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<sup>15</sup> <http://www.ksrevenue.org/faqs-dmytandr.htm>, November 3, 2004. The State has apparently established a system whereby liens may be released electronically.

<sup>16</sup> The Court assumes, without finding, that the creditor here did not want to record what would have been a second lien (at least until the GMAC release came through). By hesitating, Wells Fargo took the risk that a subsequent purchaser or lien creditor might slip in ahead of its priority—exactly as the trustee here did.

<sup>17</sup> KAN. STAT. ANN. § 84-9-317(a)(2) (2003 Supp.).

in property of the debtor, retaining the security interest for the benefit of the estate.

The briefs address two other arguments made by Wells Fargo in its brief. Wells Fargo asserts the contemporaneous exchange defense to preferential transfer found in 11 U.S.C. § 547(c)(1). This subsection does not afford a defense to a § 544 lien avoidance proceeding.

Wells Fargo also asserts that it is entitled to be equitably subrogated to Ford's lien. No part of the Bankruptcy Code specifically authorizes this subrogation and the Court can only assume that Wells Fargo intends that the Court, *sua sponte*, grant this equitable relief using its § 105 general powers.<sup>18</sup> This Court declines. At Kansas law, equitable subrogation is designed to prevent an injustice.<sup>19</sup> Here Wells Fargo had a clearly-defined statutory procedure to follow to perfect its security interest. It wholly failed in that attempt. The result is perhaps unfortunate, but by no means unjust.

Judgment should be entered for the Trustee on his complaint and against Wells Fargo avoiding its security interest in the debtor's 2000 Ford pickup and preserving the same for the benefit of the estate under 11 U.S.C. § 551. A Judgment on Decision shall issue this day.

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<sup>18</sup> Section 105(a) provides that “[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out *the provisions of this title*.” See *In re Miller*, 303 B.R. 471 (10th Cir. BAP 2003) (Equitable powers of § 105 cannot be used to override the plain language of the Bankruptcy Code); *In re Medical Management Group, Inc.*, 302 B.R. 112 [Table] (10th Cir. BAP 2003) (Although language of § 105 is broad, relief under this section is extraordinary).

<sup>19</sup> See *Bankers Trust Co. v. United States of America*, 29 Kan. App. 2d 215, 25 P.3d 877 (2001) (Equitable subrogation was not designed to relieve litigants from the consequences of their own negligence, ignorance, or mistakes of judgment; equitable subrogation may not be applied to relieve a party who takes a lien on property that is subject to prior tax lien of record.).