



SO ORDERED.

SIGNED this 14 day of September, 2005.

Dale L. Somers

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

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

In Re:

**JON A. HICKS and AMY E. HICKS,

DEBTORS.**

**J. MICHAEL MORRIS, TRUSTEE

PLAINTIFF,**

v.

**BOEING WICHITA CREDIT UNION;
JON A. HICKS AND AMY E. HICKS,

DEFENDANTS.**

**BOEING WICHITA CREDIT UNION,

Third Party Plaintiff,**

v.

**STATE OF KANSAS, DEPARTMENT OF
REVENUE, DIVISION OF VEHICLES,**

Third Party Defendants.

**CASE NO. 03-16625
CHAPTER 7**

ADV. NO. 04-5072

**MEMORANDUM DECISION GRANTING TRUSTEE'S
COMPLAINT FOR LIEN AVOIDANCE**

This is an adversary proceeding, brought by the Chapter 7 trustee, J. Michael Morris (Trustee), to avoid a lien pursuant 11 U.S.C.A. § 544 (a)(2).¹ The matter is before the Court for determination of the complaint of lien avoidance based upon a stipulation of facts and briefs of the parties. For the reasons stated below, the Court grants the Trustee's complaint for lien avoidance.²

The plaintiff Trustee asserts that the security interest in the Debtors' 1999 Ford was unperfected on the date of filing and therefore can be avoided and preserved for the benefit of the estate. Defendants are the Debtors, Jon A Hicks and Amy A. Hicks (Debtors), and Boeing Wichita Credit Union (BWCU), the creditor claiming a perfected lien in the Ford. BWCU filed a third-party complaint against the State of Kansas, Department of Revenue, Division of the Motor Vehicles (KDOR), for damages in the event that the Trustee prevails on his claim of lien avoidance. The Trustee appears by Klenda, Mitchell, Austerman & Zuercher, LLC. BWCU appears by Eric D. Bruce, Bruce, Bruce & Lehman, LLC. KDOR are appears by Jay D. Befort and Robert W. Challquist. The Debtors, having entered into an Agreed Order Resolving Adversary Action as to Debtors, do not appear.

The parties have submitted the issue of lien avoidance based upon stipulated facts. The Trustee claims that the security interest in the Ford is avoidable because it was not perfected on the date of

¹ This Court has jurisdiction. 28 U.S.C.A. § 1334. Further, this is a core proceeding which the Court may hear and determine as provided in 28 U.S.C.A. §§ 157(b)(1) and (b)(2)(K).

² The issue of the liability of KDOR to BWCU asserted in the third-party complaint filed by BWCU remains to be determined in future proceedings.

bankruptcy. Although the Trustee concedes that BWCU's purchase money lien was perfected by the timely filing of a Notice of Security Interest (NOSI), it is the Trustee's position that the lien became unperfected when KDOR, at the request of the Debtors, issued a vehicle title which did not note BWCU's lien. Both BWCU and KDOR assert that filing the NOSI perfected the lien and that it remained perfected notwithstanding the omission from the certificate of title.

I. STIPULATED FACTS.

The parties entered into a Stipulation of Facts, which states as follows:

1. On September 2, 2003, Debtors purchased a 1994 Ford Expedition with the VIN of 1FMPU18L5XLC09309 (Ford) from Innovative Auto Sales. BWCU was granted a purchase money security interest in the Ford.
2. On September 2, 2003, Amy Hicks signed a Notice of Security Interest (NOSI) in favor of BWCU on the Ford.
3. BWCU mailed a check in the amount of \$52.50 for recording fees to the KDOR with twenty-one NOSI forms, including the one on the Debtors' Ford. The check was deposited on September 10, 2003.
4. KDOR acknowledges receiving the NOSI dated September 2, 2003, from BWCU on September 8, 2003.
5. On October 22, 2003, the Debtors made a submission to the Kansas Department of Revenue in applying for title on the Ford pursuant to K.S.A. 8-135(b). This submission by the Debtors failed to note the lien of BWCU.

6. A paper document denominated "title" was subsequently printed by the Kansas Department of Revenue, indicating its "issue date" to be December 1, 2003. This document did not list the BWCU or anyone else as a lienholder. This document was mailed to the Debtors and it was in their possession on the date of the bankruptcy.

7. From at least December 1, 2003, through May 26, 2004, the digital records of the Kansas Department of Revenue showed the debtors to be the owners of the Ford, with no lien.

8. On December 8, 2003, Debtors filed for Chapter 7 bankruptcy protection.

9. On or about December 18, 2003, Debtors made submission of documents to the Kansas Department of Revenue. This submission of the Debtors listed the lien of the BWCU. The Debtors surrendered the December 1, 2003 title to the Kansas Department of Revenue as part of this submission.

10. On May 26, 2004, the BWCU's lien began to appear on the digital records of the Department of Revenue, by virtue of the second documents submission of the Debtors of December 18, 2003.

11. On May 7, 2004, the Debtors received their discharge.

II. ANALYSIS.

Trustee seeks to avoid BWCU's lien on the Ford pursuant to 11 U.S.C.A. § 544 (a)(2), which provides:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or any creditor, the rights and powers of . . .

(2) a creditor that extended credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect

to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists;

Controlling law is succinctly stated by the Tenth Circuit as follows:

Section 544(a) of the Bankruptcy Code “confers on a trustee in bankruptcy the same rights that an ideal hypothetical lien claimant without notice possesses as of the date bankruptcy petition is filed.” *Pearson v. Salina Coffee House, Inc.*, 831 F.2d 1531, 1532 (10th Cir. 1987). Consequently, “[s]ection 544(a) allows the trustee to avoid any unperfected liens on property belonging to the bankruptcy estate.” *Id.* The determination of whether a creditor’s security interest is unperfected, and therefore avoidable under section 544(a) is controlled by state law. *Id.* at 1533.³

A lien creditor includes a “creditor that has acquired a lien on the property involved by attachment, levy, or the like” and “a trustee in bankruptcy from the date of the filing of the petition.”⁴ A security interest is “subordinate to the rights of.... a person that becomes a lien creditor before the... security interest... is perfected...”⁵

In this case, therefore, the right of the Trustee to avoid BWCUC’s lien on the Ford is determined by whether BWCUC had a perfected security interest when the bankruptcy was filed on December 8, 2003. Article 9 of the Kansas UCC provides that perfection of a security interest in a titled vehicle is determined by the Kansas Certificate of Title laws.⁶ K.S.A. 8-135, addressing registration of vehicles, provides for two methods of perfection of liens on titled motor vehicles: (1) By having the lien noted on

³ *Morris v. CIT Group/Equipment Financing, Ins. (In re Charles)*, 323 F.3d 841, 842-43 (10th Cir. 2003).

⁴ K.S.A. 2003 Supp. 84-9-102 (52).

⁵ K.S.A. 2003 Supp. 84-9-317(a).

⁶ K.S.A. 2003 Supp 84-9-311(a)(2).

the certificate of title; and (2) by filing a notice of security interest (NOSI).⁷ In this case, BWCU filed a NOSI and claims perfection through this method. Therefore the controlling subsection is K.S.A. 2003 Supp. 8-135(c)(5), which provides in part:

Upon sale and delivery to the purchaser of every vehicle subject to a purchase money security interest as defined in article 9 of chapter 84 of the Kansas Statutes Annotated, and amendments thereto, the dealer or secured party may complete a notice of security interest and when so completed, the purchaser shall execute the notice, in a form prescribed by the division, describing that the vehicle and showing the name and address of the secured party and of the debtor and other information that division requires. The dealer or secured party, within 20 days of the sale and delivery, may mail or deliver the notice of security interest, together with the fee of \$2.50, to the division. The notice of security interest shall be retained by the division until it receives an application for a certificate of title to the vehicle and a certificate of title is issued. The certificate of title should indicate any security interest in the vehicle. Upon issuance of the certificate of title, the division shall mail or deliver confirmation of the receipt of the notice of security interest, date of the certificate of title is issued and the security interest indicated, to the secured party at the address shown on the notice of security interest. The proper completion and timely mailing or delivery of the notice of security interest by a dealer or secured party shall perfect a security interest in the vehicle described on the date of such mailing or delivery.

The parties agree that the NOSI, signed by Amy Hicks on a September 2, 2003, and sent by BWCU to KDOR shortly thereafter, was effective to perfect BWCU's purchase money security interest in the Ford. The question is whether that perfection continued after the certificate of title was issued until the date of filing.

The plain language of the subsection does not establish any time limit upon perfection acquired through the filing of a NOSI. The subsection states, "The proper completion and timely mailing or

⁷ See, *In re Charles*, 323 F.3d at 843.

delivery of the notice of security interest by a dealer or secured party shall perfect a security interest in the vehicle described on the date of such mailing or delivery.’⁸ The only reference to a time limit is the sentence addressing retention of the document, which states, “The notice of security interest shall be retained by the division until it receives an application for a certificate of title to the vehicle and a certificate of title is issued.”⁹ Nevertheless, it is the position of the Trustee, that BWCU’s perfection was lost when, on December 1, 2003, in response to the title application received from the Debtors, KDOR issued and delivered to the Debtors a paper certificate of title which did not include notation of BWCU’s lien.

The Trustee’s argument is based upon two Kansas Court of Appeals decisions, *Beneficial Finance Co. v. Schrorder* (hereafter *Beneficial Finance*),¹⁰ and *Mid American Credit Union v. Board of County Commissioners of Sedgwick County* (hereafter *Mid American*).¹¹ Before examining these cases, it is helpful to review two tenth circuit decisions which preceded them. The first is *Commerce Bank, N.A. v. Chambers (In re Littlejohn)*,¹² decided in 1975. The bank appealed from an order of the district court upholding the bankruptcy referee’s denial of the bank’s petition for reclamation of a vehicle from the bankruptcy estate because the bank’s lien was not noted on the certificate of title. The vehicle had been sold to the debtors prepetition and a sales tax receipt and a bill

⁸ K.S.A. 2003 Supp 8-135(c)(5).

⁹ *Id.*

¹⁰ 12 Kan. App.2d 150, 737 P.2d 52 (1987), rev. denied July 16, 1987.

¹¹ 15 Kan. App.2d 216, 806 P.2d 479 (1991), rev. denied May 9, 1991.

¹² 519 F.2d 356 (10th Cir.1975).

of sale issued which showed the lien on the car in favor of the bank. The debtors did not apply for registration or a certificate of title before they filed for bankruptcy. When the bank filed for reclamation, the trustee contended the bank's security interest was unperfected and reclamation was denied on this basis. On appeal, the bank urged that it had done everything required of it to perfect its lien when the buyer was given a sales tax receipt and a bill of sale which showed a lien in favor of the bank. The circuit court agreed. It read the controlling section of Article 9,¹³ literally as requiring for perfection only the tender of documents to state officials and payment of a fee, not the issuance of a certificate of title. The bank had provided the debtors with all of the documents they needed to submit to be issued a title. The Tenth Circuit held that the bank should not be penalized for the debtors' failure to comply with their responsibility to obtain a certificate of title for their vehicle. It reversed, finding the bank did all it could do to perfect its interest.

In 1979, 4 years after *Littlejohn*, the Tenth Circuit in *Lentz v. Bank of Independence (In re Kerr)*¹⁴ again considered a lien avoidance action in which the debtors had failed to register a vehicle in Kansas. The bank had financed the debtors' acquisition of a used car from an automobile dealer who delivered to the purchasers the previous owner's certificate of title endorsed on the reverse side with a notation of the bank's lien. The debtors did not apply for a Kansas title before they filed for bankruptcy. The trustee sought to avoid the lien. The bankruptcy judge and the district court relied upon *In re Littlejohn* and held against the trustee. On appeal, the trustee acknowledged that *Littlejohn* was appropriately relied upon by the lower courts, but argued that because the 1975

¹³ K.S.A. 1974 Supp. 84-9-302(3)(c).

¹⁴ 598 F.2d 1206 (10th Cir.1979).

legislature had provided for the filing of a NOSI and the bank did not avail itself of this method of self protection, *Littlejohn* should not control. The Tenth Circuit quoted the following regarding the legislative history of the 1975 amendments providing the option of filing a NOSI:

The 1975 legislature made one additional amendment to the UCC, which is wholly independent of the uniform amendments. Suppose a consumer buys a new car and finances it through a direct loan from Kansas National Bank. Under prior law, a number of days might pass between delivery of the bill of sale and notation of the bank's lien on the certificate of title. During this interim period, a creditor might levy on the car or the consumer might file a voluntary petition in bankruptcy. Under the UCC, the bank might be deemed to have an unperfected security interest prior to notation of the lien on the title, thus endangering the bank's security interest. In order to protect the bank during this interim, the legislature amended the certificate of title act to provide that the consumer may execute a "notice of security interest" form prepared by the dealer or secured party. This form is mailed to the Motor Vehicle Department with a fee of \$1 to insure protection until the title with the lien noted thereon is applied for and issued. The effect is to give the secured party perfection on the vehicle upon mailing or delivery of a "notice of security interest." With this amendment, lenders can breathe a deep sigh of relief.¹⁵

The court found that this change of law was sufficient basis for abandonment of the rule of *Littlejohn*.

It stated:

Our conclusion is that while this change was not a legislative attempt to overrule *Commerce Bank v. Chambers*, because it was passed prior to our opinion issued on June 25, 1975, it was in reaction to the problem treated in that case. The legislature perceived a hole in the statutory scheme whereby, contrary to the general philosophy of the UCC, the lender would be dependent upon the acts of the borrower to perfect its lien. The legislature took steps to provide a simplified method whereby the lender would not be subject to that risk, if it filed a brief

¹⁵ *Id.* at 1208, quoting Clark, *The New UCC Article 9 Amendments*, 44 J.K.B.A. 131, 178 (1975).

form and paid a nominal fee. Our Commerce Bank opinion attempted to deal equitably with the situation under the law as it then existed.¹⁶

The court held that because the bank had not filed a NOSI and its lien was not noted on the certificate of title, the lien was unperfected and could be avoided by the trustee.

Beneficial Finance,¹⁷ a 1987 decision and first of the two Kansas Court of Appeals decisions cited by the Trustee, was a priority dispute between parties claiming a lien on a mobile home, which at that time was considered a titled motor vehicle for purposes of perfection. Three methods of perfection had been utilized by the competing claimants: Notation of the mobile home's certificate of title; filing of a mortgage and a financing statement with the register of deeds; and filing a financing statement with the register of deeds. None of the parties had filed a NOSI. Nevertheless, when discussing the two available methods of perfection (notation on the certificate of title and filing a NOSI), the *Beneficial Finance* court interpreted K.S.A. 1986 Supp. 8-135(c)(5) as providing that the mailing or delivery of the NOSI perfects a secured party's interest only "during the period from attachment to notation on the certificate of title."¹⁸

The interpretation that the filing of a NOSI perfects a lien in a motor vehicle for only a limited period of time as stated in *Beneficial Finance* was found correct in *Mid American*,¹⁹ the second Kansas Court of Appeals decision relied upon by the Trustee. In that 1991 case, *Mid American*

¹⁶ *Id.* at 1208.

¹⁷ 12 Kan. App.2d at 150, 737 P.2d at 52.

¹⁸ *Id.*, 12 Kan. App.2d at 151, 737 P.2d at 53.

¹⁹ 15 Kan. App.2d at 216, 806 P.2d at 479.

bought suit against county and state officials alleging negligence in failing to list its lien on a vehicle certificate of title. Mid American had obtained a purchase money security interest in 1980 Corvette owned by Woods and had properly perfected by sending a NOSI. However, Woods never applied for a title and defaulted on the loan. The credit union repossessed the car and obtained a new title. It negotiated a resale of the car to Woods and indicated its lien by completing the assignment on back of the new certificate of title. When making application for title, Woods submitted the certificate of title showing Mid American's lien on the reverse side. However, the application prepared by county officials incorrectly stated there were no security liens, and the state, when issuing the new title, likewise did not note Mid American's lien. The car was transferred three times to different assignees without the noting of the lien. Woods again defaulted and had since disappeared. Mid American alleged that the failure of the defendant officials to note its lien on the certificate of title caused damage in the amount of the value of the vehicle. Mid American appealed from summary judgment in favor of the defendants. The Court of Appeals found that the officials owed duties to the lien creditor to examine the application in light of the assignment document. It then turned to the question of whether Mid American suffered damage, which in turn led it to examine whether Mid American's lien was impaired because it was not listed on the certificate of title. The court concluded in the affirmative, rejecting the holding of *In re Littlejohn*,²⁰ discussed above, which had held that documents only need to be "tendered" to perfect the security interest. The Court of Appeals stated:

After *Littlejohn*, the legislature amended K.S.A. 8-135(c)(5) and K.S.A. 84-9-302 (3)(c) to allow a creditor to file a notice of security

²⁰ 519 F.2d at 356.

interest with the KDR to cover the period between the sale and the purchaser's obtaining a certificate of title. L. 1975, ch. 32, §§1, 2.

We believe the interpretation of the relevant statutes by the court in *Beneficial Finance Co.*, 12 Kan. App.2d 150, 737 P.2d 52, and the Kansas comments are correct. The lien must be noted on the certificate of title to be perfected. Allowing perfection without such a notation would endanger the reliability of sales of vehicles by assignment of title. Here Mid American's security interest was not perfected because it was not listed on the certificate of title. Mid American should not be defeated because it did not send a notice of the security interest to the KDR the second time it assigned the title to Woods. While notifying the KDR of a security interest is a method of perfecting a lien on the vehicle, it is only a means to perfect the lien until the certificate of title is issued. *Beneficial Finance*, 12 Kan. App.2d at 151, 737 P.2d 52. Allowing it to be a method of perfection beyond this period would again diminish the reliability of a certificate of title. Of course, had Mid American filed a notice of security interest with the KDR, that agency might have caught the county's mistake. This is a fact for consideration in determining the extent of each party's negligence in causing the plaintiff's damages.²¹

The Trustee based, upon these Kansas Court of Appeals opinions, contends that the NOSI perfected BWCUC's lien only until the certificate of title was issued. In the view of the Trustee, because on the date the Debtors filed for relief, the certificate of title did not show BWCUC's lien, the lien was unperfected.

BWCUC and KDOR on the other hand, make similar arguments in support of the existence of perfection. They argue that mailing of the NOSI perfected BWCUC's lien in accord with the plain language of K.S.A. 2003 Supp. 8-135(c)(5). They argue that BWCUC did all it was required to do

²¹ 15 Kan. App.2d at 223-224, 806 P.2d at 484.

under the circumstances, citing the reasoning of *In re Littlejohn*,²² discussed above. Both convincingly argue that the Court of Appeals' statements regarding the limited effectiveness of perfection of a lien by NOSI were dicta in cases with facts different from this case.²³ They also cite cases construing the motor vehicle perfection statutes from other jurisdictions, but these cases are not helpful.

The Court finds that the most persuasive argument in support of finding that the perfection arising from the filing of the NOSI continued is the plain reading of the controlling statute. Article 9²⁴ provides that the certificate of title laws of Kansas govern both the perfection and the duration of perfection of security interests in motor vehicles. K.S.A 2003 Supp. 8-135(c)(5) states that submitting a NOSI to the KDOR perfects a security interest and establishes no time for expiration of that perfection. The only time limit in the section relates to KDOR's retention of the NOSI. This strict reading of the statute would sustain perfection of BWCU's line without adopting the rationale of *Littlejohn*, which has been abandoned by the Tenth Circuit and rejected by the Kansas Court of Appeals. If the effect of this Court's ruling were limited to this case or to lien disputes between secured parties and bankruptcy trustees, the Court might be inclined to adopt this reasoning. But the applicable statutes provide that the Trustee can avoid the lien if it is not perfected on the date of filing. The test of

²² 519 F.2d at 356.

²³ KDOR argues, in the alternative, that this Court is not bound by the Court of Appeals decisions because they were not issued by the highest court in the state, citing *Johnson v. Riddle*, 305 F.3d 1107 (10th Cir. 2002). This Court adopts the construction of the effect of a NOSI stated in *Beneficial Finance* and *Mid American* because it finds those cases correctly construed K.S.A. 8-135(c)(5), not because it regards the cases as establishing binding precedent. The Court therefore does not address the issue of whether it would be bound by the decisions, even if it disagreed with their construction.

²⁴ K.S.A. 2003 Supp. 84-9-311(a)(2) and (c).

perfection to be adopted by this Court will be applicable in all priority disputes where there is conflict between the liens stated on a NOSI and a later issued certificate of title. Further, the Court is persuaded by the limited legislative history cited in the cases above that the statute establishing perfection by filing a NOSI was enacted for the limited purpose of protecting purchase money lien holders between the date of purchase and the date of issuance of the certificate of title. To adopt the literal construction urged by BWCU and KDOR would expand the legislation beyond its intended purpose.

Because a purpose of the perfection and certificate of title statutes is to provide notice, the Court adopts the construction urged by the Trustee that the NOSI is inoperative after a certificate of title is issued. The need for public notice of liens through notation on certificates of title persuades the Court that the construction of the statute by the Court of Appeals in *Beneficial Finance* and *Mid American Credit Union* should be followed. If the filing of an NOSI perfected a lien even after a certificate of title (whether in paper or electronic form) were issued, certificates of title would lose their reliability as giving notice of all interests in titled vehicles. The filing of an NOSI does not give notice of a secured party's interest to the public, other secured parties, or to third-party purchasers. The Kansas certificate of title scheme has been effective for many years to give this notice. If the Court were to rule that the perfection resulting from the filing of the NOSI continued after the issuance of a certificate of title without notation of the lien, this would establish two parallel schemes for perfection.²⁵

²⁵ The Court observes that the importance of notice in perfection of liens in vehicles by notation on certificates of title is highlighted by doctrine which permits substantial compliance, rather than strict compliance, with applicable title statutes. The test for perfection by substantial compliance includes whether the creditor gave adequate notice of its interest to other potential secured creditors and whether a search of official records would reveal the security interest. *In re Charles*, 323 F.2d at 844. A holding

The section of Article 9²⁶ which makes the Kansas certificate of title statute controlling in this case provides that the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to Kansas titled vehicle statutes. Subsection (b) of the same provision of Article 9²⁷ provides compliance with that state law means of perfection is equivalent to the filing of a financing statement. A construction of K.S.A. 2003 Supp. 8-135(c)(5) which allowed for “secret liens” or liens different from those of a certificate of title based upon a NOSI, which is not easily available to the public, would not be an effective or appropriate substitute for the filing of a financing statement.

For the foregoing reasons, the Court grants the Trustee’s complaint for avoidance of the purchase money lien of BWCU on the Ford and preservation of the lien for the benefit of the estate.

IT IS SO ORDERED.

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that the filing of a NOSI perfects a lien even after the issuance of a conflicting certificate of title would not fulfill these criteria.

²⁶ K.S.A. 2003 Supp. 84-9-311(a)(1).

²⁷ K.S.A. 2003 Supp. 84-9-311(b).