



**SO ORDERED.**

**SIGNED this 19 day of January, 2006.**

*Dale L. Somers*

Dale L. Somers  
UNITED STATES BANKRUPTCY JUDGE

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

**In Re:**

**RANDAL STEVEN REED,**

**DEBTOR.**

**CASE NO. 04-13824**

**CHAPTER 7**

**CARL B. DAVIS, Trustee,**

**PLAINTIFF,**

**v.**

**ADV. NO. 04-05302**

**RANDAL STEVEN REED and**

**ROSE HILL BANK, f/k/a**

**Rose Hill State Bank,**

**DEFENDANTS.**

**MEMORANDUM AND ORDER GRANTING IN PART AND DENYING IN PART  
TRUSTEE'S COMPLAINT FOR LIEN AVOIDANCE**

On the 6th day of December, 2005 the Complaint of the Trustee for lien avoidance came on for trial. The Plaintiff, Chapter 7 Trustee, Carl B. Davis ("Trustee"), was represented by Carl B. Davis,

Davis & Jack, L.L.C. Defendant, Rose Hill Bank ("Bank"), was represented by Steve L. Speth, Speth & King. There were no other appearances.<sup>1</sup>

This matter was commenced by the Trustee's filing a Complaint on November 9, 2004, to avoid a lien in a boat, motor, and trailer pursuant to 11 U.S.C.A. § 544 and to preserve the lien for the benefit of the estate pursuant to 11 U.S.C.A. § 551.<sup>2</sup> Named defendants are Randal Reed, the Debtor ("Debtor"), who did not file an answer or otherwise oppose the claim, and Bank, which claims that it is the holder of a perfected, unavoidable lien in the boat, motor, and trailer. This Court has jurisdiction.<sup>3</sup> For the reasons stated below, the Court grants the Trustee's claim in part and denies it in part.

#### **FACTS.**

On or about June 16, 1999, Debtor, a resident of Kansas, purchased from Sportscraft Marine in Wichita, Kansas a twenty foot 1999 Starcraft boat, equipped with a Mercruiser motor, and a EZ Loader trailer ("Trailer"). The motor is an inboard/outboard and cannot be easily removed from the boat. In the remainder of this opinion, Boat will be used to refer to both the hull and the inboard/outboard engine.

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<sup>1</sup> The Debtor was present as a witness.

<sup>2</sup> Future references to title 11 in the text shall be to the Code section only. This case and the Complaint were filed before October 17, 2005, when most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 became effective. All statutory references to the Bankruptcy Code are to 11 U.S.C.A. §§ 101 - 1330 (2004), unless otherwise specified. Any references to the Federal Rules of Bankruptcy Procedure are to Fed. R. Bankr. P. (2004), unless otherwise specified.

<sup>3</sup> 28 U.S.C.A. § 1334. Further, this is a core proceeding which the Court may hear and determine pursuant to 28 U.S.C.A. §§ 157(b)(1) & (b)(2)(K).

Debtor was referred to Bank by Sportscraft Marine for financing. Bank agreed to finance the purchase. A joint payee check was issued to the Debtor and Sportscraft Marine. Debtor granted the Bank a lien in the property. Bank did not inquire nor did the Debtor advise where the Boat would be used or stored, but the form security agreement did obligate Debtor to keep the collateral at his residence unless otherwise advising the Bank. Bank filed a UCC-1 with the Kansas Secretary of State on June 28, 1999, describing the Boat and the Trailer. Because the Trustee does not contend the UCC-1 expired and the Bank claims perfection based upon the UCC-1, the Court assumes that a timely continuation statement was filed. If this assumption is in error, the Trustee should file a timely motion seeking amendment of this opinion.

Debtor purchased the Boat for use on Kaw Lake in Oklahoma, where he went on weekends. After purchasing the Boat and Trailer, Debtor took them to Oklahoma and left them there until the end of the 2000 boating season. In October 2000 and each October thereafter, he brought the Boat back to Kansas for winterization and kept it at his home on the Trailer in his driveway until the next April, when he again returned the Boat to Oklahoma. When in Oklahoma, Debtor stored the Boat and Trailer at a friend's house near the lake.

Debtor was advised by the Sportscraft Marine that the Boat was subject to the Oklahoma title statutes and on June 28, 1999, applied for an Oklahoma title for the Boat, but not the Trailer. Bank's lien was not noted on the Manufacturer's Certificate of Origin, the Application for Title, or the Certificate of Title. Debtor testified that the title application was completed by persons at the title office. The Court finds that the omission was unintentional and not fraudulent.

Debtor regularly made his payments to the Bank and maintained insurance as required. The Bank had no reason to believe that the Boat and Trailer were not in Kansas as required by the security agreement.

### **CONTENTIONS.**

Debtor filed a voluntary petition under Chapter 7 on July 13, 2004, when the Boat and Trailer were in Oklahoma. Neither the Boat nor the Trailer were claimed as exempt. The Trustee contends that Bank's security interest was not properly perfected on the date of filing and is therefor avoidable. Bank contends that it is perfected because it filed a UCC-1 with the Kansas Secretary of State. For the following reasons, the Court finds that the Trustee may avoid the Bank's lien in the Boat but not the Trailer.

### **ANALYSIS.**

Trustee seeks to avoid Bank's lien on the Boat and Trailer pursuant to § 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 extends 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.<sup>4</sup>

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.”<sup>5</sup> A security interest is “subordinate to the rights of... a person that becomes a lien creditor before the... security interest... is perfected... .”<sup>6</sup>

In this case, therefore, the right of the Trustee to avoid Bank’s lien on the Boat and Trailer is determined by whether Bank had a perfected security interest when the bankruptcy was filed on July 13, 2004. The Court will first consider lien avoidance as to the Trailer. The parties stipulate that the Trailer in 2004 was not subject to the title statutes of either Kansas or Oklahoma.

In Kansas in 1999, before the enactment of Revised Article 9, and in 2004, after the adoption of Revised Article 9 and when Debtor filed for bankruptcy relief, a permissible method for perfection of a security interest in the Trailer was the filing of a UCC-1.<sup>7</sup> The question is therefore whether on July 13, 2004, applicable law allowed perfection to be accomplished by filing of a UCC-1 in Kansas, where Debtor resided, even though the Trailer had been taken to Oklahoma for over a year after its purchase

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<sup>4</sup> *Morris v. CIT Group/Equipment Financing, Ins. (In re Charles)*, 323 F.3d 841, 842-43 (10th Cir. 2003).

<sup>5</sup> K.S.A. 2003 Supp. 84–9–102(52).

<sup>6</sup> K.S.A. 2003 Supp. 84–9–317(a).

<sup>7</sup> See K.S.A. 84-9-302 (Furse 1996); K.S.A. 2003 Supp. 84-9-310. Because Bank filed and continued a UCC-1, the Court does not consider whether the Trailer was consumer goods for which no filing was required.

and was located in Oklahoma approximately half of each year thereafter and on the date of filing. Debtor at all relevant times was a resident of Kansas. Revised Article 9, subject to exceptions not applicable to the Trailer, provides the law of the state where the debtor is located governs perfection and the effect of perfection and non-perfection.<sup>8</sup> “A debtor who is an individual is located at the individual’s principal residence.”<sup>9</sup> Revised Article 9 therefore directs that perfection of the security interest in the Trailer on the date of filing for bankruptcy relief is determined by the law of Kansas, without regard to where it was located.

On the date of filing for bankruptcy relief, a UCC-1 filed in Kansas when the Trailer was purchased was sufficient to perfect the security interest in the Trailer, even if it was not sufficient at all times in the interim. One of the transition rules for Revised Article 9 adopted in Kansas provides that the filing of a financing statement before the effective date of Revised Article 9 perfects a security interest after the effective date to the extent that the filing is sufficient to perfect a security interest under Revised Article 9.<sup>10</sup> It operates to make effective a financing statement filed under Article 9 which would not have perfected a security interest under Article 9 for various reasons, such as filing in the wrong place, but which would perfect a security interest under Revised Article 9.<sup>11</sup> Such a filing is effective to the extent it complies with Revised Article 9. As of the effective date of Revised Article 9, July 1, 2001, under Kansas law the Bank’s security interest in the Trailer was properly perfected by the

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<sup>8</sup> K.S.A. 2003 Supp. 84-9-301(1).

<sup>9</sup> K.S.A. 2003 Supp. 84-9-307(b)(1).

<sup>10</sup> K.S.A. 2003 Supp. 84-9-705(b).

<sup>11</sup> K.S.A. 2003 Supp. 84-9-705, Official UCC Comment to 9-705, ¶ 3.

filed UCC-1.<sup>12</sup> Bank continued the UCC-1 before its expiration, so that perfection continued to July 13, 2004. The Court therefore denies the Trustee's claim for lien avoidance as to the Trailer.

The law applicable to the Boat, however, is different because it is subject to the title statutes of Oklahoma, where it was transported, used, and stored. The Bank's UCC-1 filed in Kansas in June 1999 initially perfected its security interest in the Boat because Kansas law did not require a title for the Boat.<sup>13</sup> In 1999, the requirements for perfection changed, because the Boat was moved to Oklahoma (and remained in that state for about 15 months) and an Oklahoma certificate of title was issued.

In Oklahoma in 1999, notation of a lien on a certificate of title was the exclusive means of perfection. The Oklahoma Vessel and Motor Registration Act provided in part:

Except for a security interest in vessels or motors held by a dealer for sale or lease, a security interest, as defined in [Article 9 of the UCC], in a vessel or motor as to which a certificate of title may be properly issued by the Oklahoma Tax Commission shall be perfected only when a lien entry form prescribed by the Commission, and the existing certificate of title, if any, or application for certificate of title and manufacturer's certificate of origin or other identification number containing the name and address of the secured party and the date of the security agreement and the required fee are delivered to the Commission or to a motor license agent...<sup>14</sup>

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<sup>12</sup> Because not determinative of lien avoidance or of assistance in understanding the question of perfection of the date of filing for bankruptcy relief, the Court does not address whether the Bank's security interest, which was perfected in 1999 when the Trailer was purchased, remained perfected or became unperfected (and perhaps reperfected) during the period between purchase and the effective date of Revised Article 9.

<sup>13</sup> Although the state of perfection or nonperfection of the security interest in the Boat before July 13, 2004, is not determinative of the Trustee's right to avoid the lien, understanding of the change from perfected to unperfected status under old Article 9 when a title for the Boat was obtained is helpful in understanding the different status of the Boat and the Trailer on the date of filing for relief.

<sup>14</sup> 63 Okla. Stat. Ann. § 4013(A)(1) (1999).

In Oklahoma until July 1, 2001, the Oklahoma version of 9-103 provided as follows regarding security interests in multiple state transactions regarding goods covered by a certificate of title:

(2) Certificate of Title:

(a) This subsection applies to goods covered by a certificate of title issued under a statute of this state or another jurisdiction under the law of which indication or delivery for indication of a security interest on the certificate is required as a condition of perfection.

(c) Except with respect to the rights of a buyer described in the next paragraph, a security interest, perfected in another jurisdiction otherwise than by notation on a certificate of title, in goods brought into this state and thereafter covered by a certificate of title issued by this state is subject to the rule stated in paragraph (d) of subsection (1) of this section.<sup>15</sup>

The Boat, while perfected in Kansas, was brought into Oklahoma and a certificate of title issued.

Subsection (c), quoted above controlled. Except as to a buyer, subsection (c) provided that perfection was controlled by paragraph (d) of subsection (1) of 9-103, which stated:

When collateral is brought into and kept in this state while subject to a security interest perfected under the laws of the jurisdiction from which the collateral was removed, the security interest remains perfected; but if action is required by Part 3 of this article to perfect the security interest:

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<sup>15</sup> 12A Okla. Stat. Ann. § 9-103.1(2)(a) & (c) (1999). The rights of a buyer referred to in paragraph (c) above are stated in subsection (2)(d) as follows:

(d) If goods are brought into this state while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed, and a certificate of title is issued by this state and the certificate does not show that the goods are subject to the security interest or that they may be subject to security interests not shown on the certificate, this security interest is subordinate to the rights of a buyer of the goods who is not in the business of selling goods of that kind to the extent that he gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest.



(I) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this state, whichever period first expires, the security interest becomes unperfected at the end of that period and is thereafter deemed to be unperfected as against a person who becomes a purchaser after removal, or

(ii) if the action is taken before expiration of the period specified in subparagraph (1), the security interest continues perfected thereafter.<sup>16</sup>

Oklahoma law, Part 3 of Article 9, referenced in 9-103 quoted above, provided that filing of a financing statement was not necessary or effective to perfect a security interest in goods subject to a statute requiring perfection by notation on a certificate of title and that a security interest in property subject to the title statute could be perfected only by compliance with the statute.<sup>17</sup> Further, as quoted above, the Oklahoma Vessel and Registration Act required notation on the certificate of title to perfect a security interest.<sup>18</sup> In accord with Oklahoma version of 9-103, Bank's security interest in the Boat therefor became unperfected four months after the Boat was brought into the State of Oklahoma.

Further, once the Boat was titled in Oklahoma, the Kansas version of Article 9 looked to the law of Oklahoma to determine perfection. Article 9 in effect in Kansas in 1999 provided:

(2)(a) This subsection applies to goods covered by a certificate of title issued under a statute of this state or of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection.

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<sup>16</sup> 12A Okla. Stat. Ann. § 9-103.1(1)(d) (1999).

<sup>17</sup> 12A Okla. Stat. Ann. § 9-302(3)(b) & (d) (1999).

<sup>18</sup> 63 Okla. Stat. Ann. § 4013(A)(1) (1999).

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or nonperfection of the security interest are governed by the law (including a conflict of laws rules) of the jurisdiction issuing the certificate until four months after the goods are removed from that jurisdiction and thereafter until the goods are registered in another jurisdiction, but in any event not beyond surrender of the certificate. After the expiration of that period, the goods are not covered by the certificate of title with the meaning of this section.<sup>19</sup>

Even though the Boat was returned to Kansas after the boating season in all years but 1999, at all times it remained subject to the Oklahoma certificate of title. Under Kansas law, perfection was determined by the Oklahoma statutes, under which the Bank was not perfected.

The adoption of Revised Article 9 in Kansas does not change this result. Under Revised Article 9 in effect on the date of filing, when goods are covered by a certificate of title issued in another state, the local law of the jurisdiction under whose law a certificate of title is issued determines perfection, the effect of perfection or nonperfection and priority of security interests from the time the goods become covered by the certificate of title until the time the goods cease to be covered by the certificate of title.<sup>20</sup> The section applies without regard to the relationship between the goods or the debtor to the jurisdiction issuing the title.<sup>21</sup> In 2004, the law of Oklahoma applicable to vessels and motors was the same as in 1999: The exclusive method of perfection was by notation on the title.<sup>22</sup>

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<sup>19</sup> K.S.A. 9-103(2) (Furse 1996).

<sup>20</sup> K.S.A. 2003 Supp. 84-9-303.

<sup>21</sup> *Id.*

<sup>22</sup> 63 Okla. Stat. Ann. § 4013(A)(1) (2004). The amendments between 1999 and 2004 were not material to the issues before the court.

Under Kansas law, notation of the Bank's lien on the Oklahoma title was necessary to perfect the Bank's lien.

The Bank responds to the Trustee's argument that the lien is unperfected because not noted on the title by arguing the Boat is "rolling stock" so that the law of Kansas requiring perfection by filing a UCC-1 determines perfection and nonperfection. Bank's statutory authority is a provision of Article 9 in effect in 1999, which provided:

(3)(a) This subsection applies to accounts ... and general intangibles... and to goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes, shipping containers, road building and construction machinery and commercial harvesting machinery and the like, if the goods are equipment or are inventory leased or held for lease by the debtor to others, and are not covered by a certificate of title described in subsection (2).

(b) The law (including the conflict of law rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interest.<sup>23</sup>

Bank's position is flawed. First, this section does not apply because the Boat is not equipment or inventory.<sup>24</sup> Second, the section does not apply because Oklahoma issued a title for the Boat. Third, the controlling time for determining perfection is the date of filing, on which date the statute relied upon by Bank had been repealed and Revised Article 9 adopted. Bank does not cite Revised Article 9 in support of its position.

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<sup>23</sup> K.S.A. 84-9-103 (3)(a) & (b) (Furse 1996).

<sup>24</sup> K.S.A. 84-9-103, Official UCC Comment ¶ 5(b) (Furse 1996).

The Court observes that both Bank and Trustee are innocent parties. Bank as the secured lender did not commit any malfeasance or knowingly fail to act to protect its interests. There was no reason for Bank to know the Boat was titled in Oklahoma. The omission of the lien from the certificate of title was an oversight of which Bank had no notice. The Code provides the Trustee shall have the rights of a hypothetical lien claimant without notice of the Bank's interest, which by definition makes the Trustee an innocent party. In this situation, the legislatures of Kansas and Oklahoma have determined that public policy prefers strict enforcement of the rule that a lien must be noted on the certificate of title, if one is issued for the collateral. The Court is not free to weigh the equities.

Bank's lien was not noted on the Boat's certificate of title. Trustee may therefore avoid Bank's security interest in the Boat under section 544. The Trustee also seeks to preserve the lien for the benefit of the estate under section 551. The Court declines to order preservation of the lien under section 551. First, the Court notes that lien preservation under section 551 is automatic; a court order is not required. More importantly, the Court finds section 551 irrelevant. The Boat was not claimed as exempt, so the Debtor claims no interest. There is no creditor other than Bank claiming an interest in it. Prior to lien avoidance, the Boat was property of the estate subject to Bank's lien. Upon lien avoidance, the transfer of an interest to Bank is set aside and the Trustee on behalf of the estate becomes the only entity with an interest in the Boat. Lien preservation does not benefit the estate in this circumstance.<sup>25</sup>

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<sup>25</sup> When a lien is avoided, the transfer immediately becomes part of the estate by operation of section 541(a)(4). When the transferee has a nonpossessory interest in the interest to be avoided, such as a lien, avoidance brings the property back to the estate. Section 551 provides that avoided transfers are automatically preserved for the benefit of the estate, but only with respect to property of the estate.

## **CONCLUSION.**

For the foregoing reasons, the Trustee's complaint to avoid lien pursuant to section 544 will be denied as to the Trailer and granted as to the Boat.

The foregoing constitute 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 upon this ruling will be entered on a separate document as required by Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58.

**IT IS SO ORDERED.**

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The primary purpose of 551 as to avoided liens is to prevent creditors who have liens inferior to the avoided lien from enhancing their position because of the avoidance by the trustee. 5 *Collier on Bankruptcy* ¶ 551.01[1] (Alan N. Resnick & Henry J. Sommer eds.-in-chief, 15<sup>th</sup> ed. rev. 2005). Section 551 prevents windfall to junior lienors. John C. Chobot, *Preserving Liens Avoided in Bankruptcy - Limitations and Applications*, 62 Am. Bankr. L.J. 149 (1988).