The relief described hereinbelow is SO ORDERED.

SIGNED this 18th day of January, 2023.

Robert D. Berger
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In re:

GALINA K. NAZARENKO,

Debtor.

Case No. 21-20533
Chapter 7

ORDER DENYING MOTION FOR STAY RELIEF

Secured creditor Santander Consumer USA Inc. moves for relief from the automatic stay under 11 U.S.C. § 362(d) to exercise its rights against a vehicle owned by debtor Galina Nazarenko.[1] The Court will deny the motion because Santander's security interest in the vehicle was not perfected under the local law of

[1] ECF 11. This matter was submitted on briefs and stipulated facts. *See* ECF 37.

New York, as applied here via Kansas choice-of-law rules, at the time Nazarenko filed for bankruptcy.

1. Undisputed facts

Nazarenko was a Missouri resident when she bought a Kia Sportage with a New York title from a Kansas dealership on January 23, 2020. Santander, the purchase money lienholder, recorded a Notice of Lien with the Missouri Department of Revenue six days later. However, Nazarenko never re-titled the Sportage in Missouri (or any other state), even though the dealership had provided her with a Missouri title application.

In September 2020, Nazarenko moved to Kansas. Eight months later, on May 13, 2021, she filed a Chapter 7 bankruptcy petition in the District of Kansas and surrendered the Sportage, along with its New York title, to Santander. Santander then moved for stay relief under § 362(d) to exercise its rights against the Sportage. The Chapter 7 trustee objected on the ground that Santander's security interest in the Sportage might not have been perfected at the time Nazarenko filed for bankruptcy.[2]

[2] ECF 17.

2. Question(s) presented

The Chapter 7 trustee's objection to stay relief arises from her rights under § 544(a)(1) of the Bankruptcy Code.[3] Section 544(a)(1) gives a trustee the rights of a hypothetical creditor who obtains a judicial lien on all the debtor's property at the time the bankruptcy petition is filed. *See* 11 U.S.C. § 544(a)(1). The rights of such a creditor are determined by state law. *See Morris v. Hicks (In re Hicks)*, 491 F.3d 1136, 1140 (10th Cir. 2007) (citing *LMS Holding Co. v. Core-Mark Mid-Continent, Inc.*, 50 F.3d 1520, 1523 (10th Cir. 1995)).

Here, Santander and the Chapter 7 trustee agree that Santander's rights in the Sportage are superior to those of the trustee if Santander's security interest was perfected at the time Nazarenko filed for bankruptcy.[4] However, they disagree as to which state's local law[5]—that of Kansas, Missouri, or New York—governs perfection

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[3] "Bankruptcy Code" refers to Title 11, United States Code.

[4] *See* Kan. Stat. Ann. § 84-9-317(a)(2); Mo. Stat. Rev. § 400.9-317(a)(2); N.Y. U.C.C. Law § 9-317(a)(2).

[5] As used in the Restatement (Second) of Conflict of Laws:

> [T]he "local law" of a state is the body of standards, principles and rules, exclusive of its rules of Conflict of Laws, which the courts of that state apply in the decision of controversies brought before them.
>
> . . . [T]he "law" of a state is that state's local law, together with its rules of Conflict of Laws.

Restatement (Second) of Conflict of Laws § 4 (Am. L. Inst. 1971).

and priority.[6] To answer that question, the Court must determine which *choice-of-law rules* apply to this dispute.[7]

3. Analysis

Although it is well-settled that a federal court sitting in diversity must apply the choice-of-law rules of the forum state,[8] bankruptcy "is a bit of an odd duck." *PNC Bank v. Sterba (In re Sterba)*, 852 F.3d 1175, 1177 (9th Cir. 2017).[9] "[T]here is

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[6] Santander argues that Missouri's local law governs perfection and priority because Nazarenko was a Missouri resident when she bought the Sportage. *See* ECF 38 at 2. This argument is unpersuasive because Santander offers no support for it.

The trustee argues that New York's local law governs perfection and priority because the sales contract between Nazarenko and the dealership (which the dealership assigned to Santander) provides for application of Kansas law, and the applicable Kansas choice-of-law rule points to the local law of New York. *See* ECF 39 at 1-3. The Court agrees that Kansas choice-of-law rules apply here, but not because of the contract—contracting parties cannot vary Article 9's choice-of-law provisions regarding lien perfection and priority unless the law specified by those provisions would allow them to do so. *See* Kan. Stat. Ann. § 84-1-301(c)(8); Mo. Rev. Stat. § 400.1-301(c)(7); N.Y. U.C.C. Law § 1-301(c)(7); *cf.* Kan. Stat. Ann. § 84-1-302(a) ("*Except as otherwise provided . . . elsewhere in the uniform commercial code*, the effect of provisions of the uniform commercial code may be varied by agreement.") (emphasis added); Mo. Rev. Stat. § 400.1-302(a) (same); N.Y. U.C.C. Law § 1-302(a) (same, except replacing "the uniform commercial code" with "this act"); *Fishback Nursery, Inc. v. PNC Bank, Nat'l Ass'n*, 920 F.3d 932, 938 (5th Cir. 2019) (observing that it would be "unfair" to apply contracting parties' choice-of-law provision to a lien dispute with a third party [such as the Chapter 7 trustee here]).

[7] A conflict of choice-of-law rules exists here because Missouri adopted a non-uniform version of UCC § 9-303. *Compare* Mo. Rev. Stat. §§ 400.9-303(c), (d), *with* K.S.A. § 84-9-303(c).

[8] *See Dang v. UNUM Life Ins. Co. of Am.*, 175 F.3d 1186, 1190 (10th Cir. 1999) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941)).

[9] A conflict of law exists here because Santander's security interest was perfected under Missouri's local law but unperfected under that of Kansas and New York. *Compare* Mo. Rev. Stat. §§ 400.9-308(a), 9-311(a)(2) (citing Mo. Rev. Stat. §§ 301.600-.661), *with* Kan. Stat. Ann. §§ 84-9-308(a), 9-311(a)(2) (citing Kan. Stat.

a tension as to whether bankruptcy courts follow federal common law choice-of-law principles or the forum state's choice-of-law principles." *Jafari v. Wynn Las Vegas, LLC (In re Jafari)*, 569 F.3d 644, 648 (7th Cir. 2009). The majority view, expressed by the Second and Fourth Circuits, is that a bankruptcy court should apply the choice-of-law rules of the forum state absent some specific federal policy or interest that would dictate the use of a federal rule. *See Collier on Bankruptcy* ¶ 544.02[1] (Richard Levin & Henry J. Sommer eds., 16th ed.); *Bianco v. Erkins (In re Gaston & Snow)*, 243 F.3d 599 (2d Cir. 2001); *Compliance Marine v. Campbell (In re Merritt Dredging Co.)*, 839 F.2d 203 (4th Cir. 1988). The minority view, expressed by the Ninth Circuit, is that bankruptcy courts should apply federal choice-of-law rules. *See In re Sterba*, 852 F.3d at 1177 (citing *Lindsay v. Beneficial Reinsurance Co. (In re Lindsay)*, 59 F.3d 942, 948 (9th Cir. 1995)).[10] This Court need not decide between the two today, because Kansas choice-of-law rules apply here under either view.

Ann. § 8-135(c)(5)), *and* N.Y. U.C.C. Law §§ 9-308(a), 9-311(c)(2), *and* N.Y. Comp. Codes R. & Regs. tit. 15, § 20.15(b)(1).

[10] Other circuit courts, including the Tenth Circuit, have yet to decide the issue. *See Walters v. Stevens, Littman, Biddison, Tharp & Weinberg, LLC (In re Wagenknecht)*, 971 F.3d 1209, 1214 n.4 (10th Cir. 2020); *In re Jafari*, 569 F.3d at 649; *Arrow Oil & Gas, Inc. v. J. Aron & Co. (In re SemCrude L.P.)*, 864 F.3d 280, 291 n.5 (3d Cir. 2017); *Fishback Nursery*, 920 F.3d at 935; *cf.* 19 Fed. Prac. & Proc. Juris. § 4518 (3d ed.) ("One situation in which the choice between adopting forum state law and fashioning a uniform federal rule still is unresolved is the application of choice-of-law rules in cases in which the court's jurisdiction is based on federal bankruptcy law rather than on diversity of citizenship.").

a. Federal choice-of-law rule: Restatement (Second) of Conflicts

Federal choice-of-law rules follow the approach of the Restatement (Second) of Conflict of Laws. *Walters v. Stevens, Littman, Biddison, Tharp & Weinberg, LLC (In re Wagenknecht)*, 971 F.3d 1209, 1214 n.4 (10th Cir. 2020) (quoting *Liberty Tool, &*[11] *Mfg. v. Higgins (In re Vortex Fishing Sys., Inc.)*, 277 F.3d 1057, 1069 (9th Cir. 2002)). Section 253 of the Restatement, "Effect on Security Interest of a Dealing with Chattel in State to Which It Has Been Removed," provides:

> When a chattel, which is subject to a valid and perfected security interest, is removed to another state, the effect of a dealing with the chattel in that state upon the security interest will usually be determined in the same way that this question would be determined by the courts of that state.[12]

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[11] [Sic] in reported title.

[12] Restatement (Second) of Conflict of Laws § 253 (Am. L. Inst. 1971). The Court notes that the Restatement cites a prior version of Article 9 of the Uniform Commercial Code, which has been revised a number of times since the Restatement was published in 1971.

An introductory note in the Restatement explains the difference between the rule set out in § 253 and the "most significant relationship" rule set out in § 6:

> When a controversy relating to interests in a chattel is between parties to a *single inter vivos transaction*, the applicable law is the local law of the state which, with respect to the particular issue, has the most significant relationship to the parties, the chattel, and the transaction. . . .
>
> Different choice-of-law rules apply in other situations. Sometimes a controversy involving interests in a chattel is between parties to different transactions, such as when . . . an attaching creditor of the debtor is seeking to prevail over the secured creditor. Here *more than one transaction is involved and there was no prior relationship between the parties*. Questions of this sort are determined

Such determination includes "the whole law, including the choice-of-law rules of the second state." *See* Restatement (Second) of Conflicts § 253 rep.'s note (quoting *Davis v. P.R. Sales Co.*, 304 F.2d 831, 834 (2d Cir. 1962)).

In this case, the Sportage was removed from Missouri, under whose local law Santander's security interest was perfected,[13] to Kansas, where the Chapter 7 trustee became a hypothetical judicial lien creditor. Section 253 of the Restatement (i.e., the federal choice-of-law rule) thus directs this Court to determine the effect of the trustee's hypothetical lien "in the same way" that the courts of Kansas would—beginning with Kansas choice-of-law rules.[14]

b. Kansas choice-of-law rule: Kan. Stat. Ann. § 84-9-303(c)

Kan. Stat. Ann. § 84-9-303(c) provides a choice-of-law rule for disputes over perfection and priority of a security interest in goods covered by a certificate of title (such as the vehicle at issue here):

> The *local law of the jurisdiction under whose certificate of title the goods are covered* [emphasis added] governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered in the same way that they would be determined by the courts of the state where the chattel was situated at the time of the second transaction.

Id., ch. 9, topic 3, introductory note (emphases added). The "second transaction" here is the creation of the Chapter 7 trustee's hypothetical judicial lien via operation of 11 U.S.C. § 544(a).

[13] *See supra* note 9.

[14] *Cf. Krigel v. Mercedes-Benz Credit Corp. (In re Stanley)*, 249 B.R. 509, 513-14 (W.D. Mo. 2000) (applying Missouri choice-of-law rule because trustee became a hypothetical judicial lien creditor in Missouri, where bankruptcy case was filed).

> by the certificate of title until the goods cease to be covered by the certificate of title.

Thus, "the law of the issuing jurisdiction governs perfection and priority from the time the certificate is issued until the vehicle is no longer covered by that certificate." 3 Barkley Clark & Barbara Clark, *The Law of Secured Transactions Under the Uniform Commercial Code* § 15.06 (LexisNexis A.S. Pratt 3d ed.). Here, Santander and the trustee have stipulated that the Sportage remains covered by its New York title.[15] Accordingly, under Kan. Stat. Ann. § 84-9-303(c), the perfection and priority of Santander's security interest are governed by the local law of New York.

c. <u>New York local law: N.Y. Comp. Codes R. & Regs. tit. 15, § 20.15 and N.Y. U.C.C. § 9-317(a)(2)(A)</u>

The parties have stipulated that Santander did not attempt to perfect its security interest in New York.[16] And under N.Y. U.C.C. § 9-317(a)(2)(A), an unperfected security interest is subordinate to the rights of a lien creditor.[17] Thus, under the local law of New York, Santander's security interest is unperfected and subordinate to the Chapter 7 trustee's rights under 11 U.S.C. § 544(a)(1) as a hypothetical judicial lien creditor.

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[15] Stipulated Facts ¶ 12, ECF 37.

[16] Stipulated Facts ¶ 23, ECF 37; *cf.* N.Y. Comp. Codes R. & Regs. tit. 15, § 20.15. Nor did the Missouri notice of lien cause Santander's security interest to be indicated on the Sportage's New York title. *Cf.* N.Y. U.C.C. Law § 9-311(a)(3), (b).

[17] *See supra* page 3 & note 4.

4. Conclusion

Because Santander's security interest in the Sportage was unperfected under the local law of New York (applied here via Kansas choice-of-law rules) at the time Nazarenko filed her bankruptcy petition, (1) Santander's motion for stay relief under 11 U.S.C. § 362(d) is hereby denied, and (2) the Chapter 7 trustee may proceed with an action to avoid Santander's unperfected security interest under 11 U.S.C. § 544.

IT IS SO ORDERED.

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