

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

CEZARY ZAWADZINSKI,

Debtor.

Case No. 98-31738-MDM

Chapter 7

MEMORANDUM DECISION ON STATUS OF SECURITY INTEREST
OF CONSUMERS COOPERATIVE CREDIT UNION

The issue before the court is who has superior lien rights in a 1993 Jeep Cherokee owned by the debtor: the lender who paid off the debtor's previous loan or the chapter 7 estate?

The chapter 7 trustee filed an objection to the motion for relief from the automatic stay filed by Consumers Cooperative Credit Union ("Consumers"), and he also objected to Consumers' secured claim. He alleges that Consumers did not properly perfect its lien in the debtor's vehicle, and its lien is void as to the trustee. The trustee, acting as a hypothetical lien creditor under 11 U.S.C. § 544(a), claims the estate's right in the debtor's automobile is superior to that of Consumers, and the avoided lien is preserved under 11 U.S.C. § 551 for the benefit of the estate.

Consumers maintains that its security interest remains valid because a properly perfected security interest was assigned to it, and the perfection, albeit that of the prior lender, remains on the vehicle's certificate of title.

This court has jurisdiction under 28 U.S.C. § 1334(b). This is a core proceeding under 28 U.S.C. § 157(b)(2)(B) and (G). For the reasons set forth below, this court holds that the creditor's lien is avoided, and the lien is preserved for the benefit of the estate.

BACKGROUND

The material facts are not in dispute. The debtor entered into a purchase money financing transaction with Bank One Wisconsin, by which Bank One was granted a lien on the debtor's 1993 Jeep. That lien was duly perfected and a confirmation of the perfection was issued by the Wisconsin Department of Transportation on May 23, 1998. The certificate of title to the vehicle was held by the debtor, pursuant to Wisconsin law, and showed Bank One as secured party. Wis. Stats. § 342.09(1).

The debtor refinanced his loan for the Jeep with Consumers on October 19, 1998. Consumers sent Bank One a check for the entire loan amount with a payoff letter stating that the check "is to serve as payment in full for the account of Cezary Zawadzinski." Consumers also requested that Bank One forward to it the title on the Jeep. According to Consumers' brief, Consumers does most of its business in Illinois, and the practice in Illinois is for lenders to hold a vehicle title until the loan is paid. Unlike Illinois, in Wisconsin the debtor retains possession of the certificate of title. Since Bank One did not hold the title, it signed and delivered to Consumers the original release of lien form found on the back of the confirmation of security interest perfection on October 22, 1998. That release has never been filed with the Department of Transportation.

Failing to obtain the title from Bank One, Consumers then made at least two direct requests to the debtor to transmit the title directly or to direct Bank One to do so. He did not respond.

At the time of debtor's chapter 7 bankruptcy filing on November 23, 1998, Consumers had not received the certificate of title, and the debtor had not applied for a new certificate of

title. At all times, Consumers has retained possession of Bank One's release of security interest. Bank One's lien continues to be listed on the records on file with the Department of Transportation.

Pending a resolution of this objection, Consumers has been accepting postpetition loan payments and holding them in trust. At some point, however, the debtor failed to make payments, and Bankruptcy Judge Russell A. Eisenberg granted Consumers' motion for relief from the automatic stay on September 17, 1999. This would allow Consumers to recover and to sell the vehicle. It would then hold the proceeds in trust until rights in the funds are determined. Apparently, however, the debtor still has the car, and as far as the court is aware, the debtor continues to pay Consumers.

ARGUMENTS

The chapter 7 trustee contends that because the lien of Consumers was never duly perfected, the lien should be declared void as to the trustee and preserved for the estate under section 551 of the Code. When the original debt was satisfied, the Bank One lien ceased to exist as a matter of law, and Bank One never assigned its lien interest to Consumers. The burden of perfection lies with the secured party, and the requirements for perfection have not been met. As a hypothetical lien creditor, the trustee can avoid Consumers' purported lien and can collect the amount due for the estate.

Consumers counters with the assertion that Wisconsin law does not require the name of the current, actual lienholder to be listed on the certificate of title for the continued perfection of the lien. Wis. Stats. § 342.21. The payment by Consumers and transmittal of the release by Bank

One constituted an assignment of Bank One's lien to Consumers. Since Bank One's lien was shown on the title as of the date of filing, perfection continues for Consumers.

DISCUSSION

Procedurally, the issue of Consumers' lien arises in the context of an objection by the trustee to the claim and to relief from the stay, not in the usual adversary proceeding "to determine the validity, priority, or extent of a lien or other interest in property, other than a proceeding under Rule 4003(d)." Fed. R. Bankr. P. 7001(2). However, it is necessary to determine the perfection of Consumer's lien to resolve the matters before the court. Indeed, one court found that although a determination as to the validity of a lien as against the trustee may more properly have been sought by an adversary proceeding, deciding the issue in the context of a motion for relief from the automatic stay was more efficient and cost effective for the parties. *In re Fisher*, 185 B.R. 457, 459-60 (Bankr. W.D.N.Y. 1995); *see also In re Spring Grove Transport, Inc.*, 202 B.R. 862 (Bankr. E.D.Va. 1996) (motion for relief from automatic stay denied due to unperfected interest). Thus, it is appropriate to proceed in this manner.

Perfection of Security Interest in Motor Vehicle

Under Wisconsin law, perfection of a security interest in a motor vehicle is accomplished by

[T]he delivery to the department [of transportation] of the existing certificate of title, if any, an application for a certificate of title containing the name and address of the secured party, and the required fee. It is perfected as of the time of its creation if such delivery is completed within 10 days thereafter, and without regard to the limitations expressed in s. 409.301(2); otherwise, as of the time of such delivery.

Wis. Stats. § 342.19(2). The method provided in ch. 342 is the exclusive method for perfecting security interests. Wis. Stats. § 342.24. The requirements for perfection of Bank One's security interest were met in this case. As Consumers' security interest was never perfected under § 342.19(2), Wis. Stats., in order for it to maintain its interest in the vehicle, it must somehow bootstrap itself into Bank One's position as a perfected lienholder. The only way it can do this is if it is an assignee of Bank One's interest.

Release or Assignment?

Typically, a release of a security interest is effectuated after the outstanding obligation is satisfied by the debtor and secured party delivers the release and notice to the owner. The owner must then deliver the release and certificate to the department, which in turn issues a new certificate to the owner. *See* Wis. Stats. § 342.22. After it was paid, Bank One executed the document entitled "Releasing a Security Interest," which gave three methods for doing so. It was on the opposite side of the Department of Transportation's form for confirmation of security interest perfection, and it contained the language required by § 342.22(1), Wis. Stats., explaining that the owner is to send the release to the Department, which will issue a new title. There are separate statutes relating to assignments and releases, §§ 342.21 and 342.22, Wis. Stats., respectively, and the form executed by Bank One meets all of the specifications of the latter.

In this case, however, Bank One executed a "release" of its lien and delivered it to Consumers, not the debtor. Consumers argues that by doing so, Bank One was assigning its security interest to Consumers. Section 342.21, Wis. Stats., provides:

(1) A secured party may assign, absolutely or otherwise, the party's security interest in the vehicle to a person other than the owner without affecting the interest of the owner or the validity of the security interest, but any person without notice of the assignment is protected in dealing with the secured party as the holder of the security interest and the secured party remains liable for any obligations as a secured party until the assignee is named as secured party on the certificate.

(2) The assignee may *but need not*, to perfect the assignment, have the certificate of title endorsed or issued with the assignee named as secured party, upon delivering to the department the certificate and an assignment by the secured party named in the certificate in the form the department prescribes.

Wis. Stats. § 342.21 (emphasis added). Thus, an assignee is still perfected under § 342.21(2), Wis. Stats., without issuance of a new title naming the assignee as the secured party.

An assignment is a transfer of an interest in property and can include the transfer of a security interest. While an assignment need not be in any particular form, some evidence of intent to assign is necessary. *See* Restatement (Second) of Contracts § 342 (1979). Here, no such intent is present. Bank One only released its interest when it was paid; it transferred nothing by that release. True, Consumers paid Bank One, and the release was mailed to Consumers, but the letter transmitting the check had asked only for the car title, not an assignment of a security interest. Bank One clearly did not follow the statutory procedure requiring delivery of the release to the debtor. *See* § 342.22(1), Wis. Stats. However, this does not change the nature of the document issued from a release, as it unambiguously states, to an assignment.

Treating this release as an assignment could very well frustrate the policy that perfection of security interests in motor vehicles serves. A creditor or other party wishing to acquire an interest in the vehicle would find Bank One's recorded interest, and if that interest were assigned, Bank One's records should reveal the fact. However, Bank One's records in this case might only

reveal that it was paid and executed a release. The inquirer could assume that the owner just failed to obtain a clear title, as § 342.22, Wis. Stats., provides, and the car is paid for. Or Bank One's files might say where the release was sent, but this is insufficient to provide notice of perfection by another creditor. Therefore, Consumers' lien is unperfected.

Debtor's Failure to Respond

Consumers argues that it should not be penalized for the debtor's failure to deliver the certificate of title after repeated requests. Consumers is correct that the debtor has certain responsibilities in the creation of a security interest. Section 342.20, Wis. Stats., provides:

If an owner creates a security interest in a vehicle, unless the name and address of the secured party already is contained on the certificate of title for the vehicle:

(1) The owner shall immediately execute, in the space provided therefor on the certificate of title or on a separate form or in an automated format prescribed by the department, an application to name the secured party on the certificate, showing the name and address of the secured party, and cause the certificate, application and the required fee to be delivered to the secured party.

(2) The secured party shall immediately cause the certificate, application and the required fee to be mailed or delivered to the department.

(3) Upon receipt of the certificate of title, application and the required fee, the department shall issue to the owner a new certificate containing the name and address of the new secured party. The department shall deliver to such new secured party and to the register of deeds of the county of the owner's residence, memoranda, in such form as the department prescribes, evidencing the notation of the security interest upon the certificate; and thereafter, upon any assignment, termination or release of the security interest, additional memoranda evidencing such action.

Wis. Stats. § 342.20(1) - (3). Additionally, § 342.23(2)(a), Wis. Stats., requires that the owner promptly deliver the owner's certificate of title to the secured party upon receipt of notice from the secured party that the security interest is to be assigned, extended or perfected.

Notwithstanding these owner requirements, the Wisconsin Supreme Court has clearly stated that the obligation to perfect a security interest is wholly upon the secured party. *Milwaukee Mack Sales, Inc. v. First Wisconsin Nat'l Bank*, 93 Wis.2d 589, 596, 287 N.W.2d 708, 712 (1980). Even if the debtor committed fraud, the secured party is not relieved of this burden. *Id.* This is because protection of its interests is well within the control of the lender, which can not only demand compliance with perfection procedures before paying out the money, it is considerably more sophisticated (in theory) in the legalities of automobile financing than the average consumer. Obviously, hindsight is 20/20 vision. Consumers should have required the debtor to provide it with an executed application to name Consumers as a secured party on the certificate, the certificate of title, and the required fee *at the time* the debtor signed the refinancing documents on October 19, 1998. However, Consumers sent the Form MVT 1282, Application for Title/Registration, to the debtor almost three months after Bank One was paid.

CONCLUSION

The court finds that Consumers Cooperative Credit Union's lien on the debtor's 1993 Jeep Cherokee was unperfected on the date the debtor filed bankruptcy. Because Consumers' interest was unperfected, the trustee's hypothetical judicial lien under § 544(a) has priority, rendering Consumers' lien subject to avoidance by the chapter 7 trustee. Consumers' motion for relief from the stay will be denied, the previous order for relief will be vacated, and the trustee's objection to the claim will be sustained. The claim will be allowed as unsecured.

This decision represents the court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052, which is applicable to contested matters under Fed. R. Bankr. P. 9014. A separate order consistent with this decision will be entered.

Dated at Milwaukee, Wisconsin, March 28, 2000.

BY THE COURT

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Honorable Margaret Dee McGarity
United States Bankruptcy Judge