

Jerry's Auto Sales of Lennox, South Dakota, purchased a 1992 Dodge Caravan from Jerry and Bonnie Peterson. On December 7, 1995, Chrysler Credit Corporation released its lien on the vehicle. On February 21, 1996, Mark and Susan Steinfurth, the debtors, purchased the van from Jerry's Auto Sales, financing \$8,400 of the purchase price through Home Federal. At the time of the debtors' purchase on February 21, Jerry's Auto Sales wrote the debtors' address on the back of the certificate of title received from the Petersons, but left blank the line for the name of the purchaser, which was to be completed by the debtors. Jerry's Auto Sales also wrote on the back of the certificate of title that Home Federal was the lienholder. Jerry's Auto Sales mailed the original title to the debtors and asked them to take the title to the county treasurer's office to pay the sales and transfer tax so that a new title could be issued. On February 23, 1996, Sylvia Bruns of Home Federal's office in Lennox sent the debtors a letter which included a request to take the title "to the county treasurer's office and have it transferred IMMEDIATELY." The debtors either lost the original certificate of title or never received it in the mail.

On April 1, 1996, the debtors filed a Chapter 7 bankruptcy petition. On April 12, 1996, the South Dakota Secretary of State issued a duplicate certificate of title listing Jerry or Bonnie Peterson as the owners of the van. Upon receipt of the duplicate title, Jerry's Auto Sales again wrote the assignment information on the back of the title, listed Home Federal as the lienholder, and gave the duplicate title to the debtors, who took it to the county treasurer's office and paid the sales and transfer tax. On May 1, 1996, the South Dakota Secretary of State issued a new certificate of title listing the debtors as owners of the van and Home Federal as the first lienholder.

The Trustee filed a complaint against Home Federal to avoid the Bank's security interest in the van on the ground that it was a preferential transfer under 11 U.S.C. § 547. Home Federal

answered and asserted affirmative defenses. The bankruptcy court ruled that § 547 does not apply because that statute governs transfers made before a bankruptcy petition is filed. The court suggested that "the more pointed issue is whether the Bank had a perfected security interest in the van on the date of Debtors' petition in order to defeat the Trustee's interest as a hypothetical lien creditor under 11 U.S.C. § 544 and S.D.C.L. § 57A-9-301. See generally First National Bank of Denver v. Turley (In re Turley), 17 B.R. 99 (Bankr.D.S.D. 1981), aff'd, 705 F.2d 1024 (8th Cir. 1983)." (Letter Decision at 2.)

The bankruptcy court held that Home Federal did not have a perfected security interest in the van on the petition date based upon S.D. Codified Laws Ann. § 32-3-41.¹ The court reasoned that this statute required notation of Home Federal's lien on the face of the certificate of title by the Secretary of State if Home Federal's encumbrance was to be valid against other creditors. The court held that notation of the lien on the back of the certificate of title by Jerry's Auto Sales was not sufficient to perfect Home

¹In 1996, this statute provided (emphasis added):

Security interests noted on certificate valid against creditors of mortgagor, subsequent purchasers, and encumbrancers. Any mortgage, conveyance intended to operate as a mortgage, conditional sales contract, mechanic's lien, or similar instrument other than a financing statement covering a motor vehicle, trailer or semitrailer, if the instrument is accompanied by delivery of the manufacturer's statement of origin or the manufacturer's certificate of origin and followed by actual and continued possession of the same by the holder of the instrument, or in the case of the certificate of title, if a notation of same has been made by the secretary or county register of deeds on the face thereof, shall be valid against the creditors of the mortgagor, whether armed with process or not, and subsequent purchasers, mortgagees and other lien holders or claimants, but otherwise is not valid against them.

Federal's security interest.² Consequently, the court ruled that Home Federal's lien, perfected post-petition, was voidable, if not void, as an act in contravention of the automatic stay, 11 U.S.C. § 362, or it was voidable by the Trustee under § 544 and 549(a). The court further held that Home Federal did not have a defense under § 549(a)(2)(B) because its post-petition lien was not court-approved. The court included the van as property of the bankruptcy estate, subject only to any valid exemption debtors may have claimed under 11 U.S.C. § 522(b)(2) and S.D. Codified Laws Ann. § 45-35-4.

The bankruptcy court further held that the Trustee did not step into the shoes of the debtor and, therefore, was not encumbered with any equitable defenses Home Federal raised against the debtors, relying on In re Doyen, 56 B.R. 632, 634 (Bankr. D.S.D. 1986) (notation of lien on face of certificate of title is exclusive method of perfection of vehicle lien; equitable lien would undermine statute). Further, the court held Home Federal could not successfully argue that debtors did not have any legal or equitable interest in the van on the bankruptcy petition date under S.D. Codified Laws Ann. § 32-3-10.³ Relying on Island v.

²Section 32-3-41 has since been amended in 1997 to provide that notation of a lien on the back of the certificate of title by the seller, buyer, owner or holder of the instrument is sufficient to validate a security interest against other creditors. Home Federal does not argue that the current version of § 32-3-41 applies to the events at issue here.

³This statute provides:

**Statement or certificate of origin as passing title--
Waiver and estoppel inapplicable.** No person, except as provided in this chapter, obtaining or acquiring possession of a motor vehicle, trailer or semitrailer acquires any right, title, claim or interest in or to the motor vehicle, trailer or semitrailer, until he has been issued a certificate of title to the motor vehicle, trailer or semitrailer or has received a manufacturer's statement of origin or a manufacturer's certificate of origin for the same. No waiver or estoppel may be

Warkenthien, 287 N.W.2d 487 (S.D. 1980), the bankruptcy court reasoned that § 32-3-10 does not take precedence over South Dakota's Uniform Commercial Code provisions that a good faith purchaser is entitled to possession and a transfer of rights or ownership. Although the debtors may not have held an endorsed certificate of title to the van on the petition date, they did have the equitable right to have the title transferred to them, and that is the same right the Trustee acquired as property of the estate under 11 U.S.C. § 541. The bankruptcy court ruled that § 32-3-10 did not restore ownership of the van to the Petersons nor did it give Home Federal an opportunity to perfect its security interest post-petition in violation of the automatic stay.

Home Federal now renews on appeal its argument that, under § 32-3-10 and Locan v. Chesrown Rapid Credit (In re Weaver), 131 B.R. 804 (D.Ohio 1991), the van was not part of the bankruptcy estate at the time debtors filed their petition on April 1, 1996, since neither the debtors nor their bankruptcy estate had any interest in the vehicle until the Secretary of State issued the certificate of title on May 1, 1996. Home Federal distinguishes Island on the basis that it involved an entrustment situation while this case does not, and because 11 U.S.C. § 544 does not give the Trustee the rights of a buyer in the ordinary course of business with respect to personal property, as was the purchaser in Island. Home Federal argues that the Trustee's position is unavailing even if the vehicle is considered part of the bankruptcy estate because its lien was noted on the back of the certificate of title from the date the vehicle was sold to the debtors and Home Federal did all that was required of it to perfect its security interest, relying on Commerce Bank v. Chambers (In re Littlejohn), 519 F.2d 356 (10th

operated in favor of such person against a person having possession of the certificate of title or a manufacturer's statement of origin or a manufacturer's certificate of origin for such motor vehicle, trailer or semitrailer.

Cir. 1975); In re Huyck, 167 B.R. 908 (Bankr.S.D. 1994); In re Peek, 31 B.R. 30 (Bankr.S.D. 1983); and Lucas v. Pennbank, 142 B.R. 68 (W.D.N.Y. 1992). The Trustee urges affirmance of the bankruptcy court's reasoning and holding.

This Court has jurisdiction over the appeal pursuant to 28 U.S.C. § 158(a). The Court reviews the bankruptcy court's findings of fact for clear error and its legal conclusions de novo. Wegner v. Grunewaldt, 821 F.2d 1317, 1320 (8th Cir. 1987). Because the matter is presented on stipulated facts, the Court reviews de novo the bankruptcy court's legal conclusions in favor of the Trustee.

The Court agrees with the bankruptcy court that § 547, which governs preference actions, is inapplicable in this case because it concerns only transfers made before a bankruptcy petition is filed. See In Re Rine & Rine Auctioneers, Inc., 74 F.3d 854, 857 (8th Cir. 1996) ("Under the Bankruptcy Code, a trustee may avoid a pre-petition transfer of property by the debtor to a third party upon proof of several criteria. 11 U.S.C. § 547(b).") The more pertinent questions are whether Home Federal had a perfected security interest in the vehicle on the date of debtors' bankruptcy petition so as to defeat the Trustee's interest as a hypothetical lien creditor under § 544 and whether the recordation of Home Federal's lien on the certificate of title after the debtors filed their bankruptcy petition was voidable by the Trustee as a post-petition transfer under § 549(a).

The bankruptcy court correctly determined that Home Federal did not have a perfected security interest in the vehicle at the time the bankruptcy petition was filed. State law controls questions concerning the nature and extent of a debtor's interest in property and the nature and extent of a lien on a debtor's property. In re Rine & Rine Auctioneers, Inc., 74 F.3d at 857; In re Pierce, 809 F.2d 1356, 1359 (8th Cir. 1987). Under South Dakota statutes, §§ 32-3-28, 32-3-41, as they existed in 1996, perfection

of a security interest in a motor vehicle was required to be accomplished by notation of the lien on the face of the certificate of title. See In re Doyden, 56 B.R. at 633. The bankruptcy court correctly held that Home Federal's lien was unperfected at the time of the bankruptcy filing on April 1, 1996, because the lien had not been noted on the face of a certificate of title issued by the Secretary of State to the debtors. See e.g., id.; In re Davis, 57 B.R. 351 (Bankr.S.D. 1985). Under South Dakota law, an unperfected security interest is subordinate to the rights of a person who becomes a lien creditor without knowledge of the security interest and before it is perfected. The trustee in bankruptcy is one such lien creditor. S.D.C.L. § 57A-9-301; 11 U.S.C. § 544(a)(1); In re Corsica Enterprises, Inc., 40 B.R. 769 (Bankr.D.S.D. 1984). See also First Nat'l Bank of Denver v. Turley, 705 F.2d 1024, 1026 (8th Cir. 1983). Therefore, the Trustee could defeat Home Federal's unperfected lien under § 544.

Home Federal argues, as it did below, that the vehicle was not property of the bankruptcy estate when the petition was filed, that the debtors had no rights in the vehicle under § 32-3-10 because a certificate of title had not been issued to them, and under In re Weaver, the post-petition recordation of Home Federal's lien was not a "transfer of property" that diminished the bankruptcy estate, but rather resulted in the bankruptcy estate acquiring an interest in a vehicle, subject to a lien, to which the estate had not had a prior claim.

The commencement of a bankruptcy case creates an estate, and property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The Court agrees with the bankruptcy court that, at the time debtors filed their bankruptcy petition, debtors had possession of the van and the expectancy that ownership of the van would be transferred to them by the certificate of title, as evidenced by their Motor Vehicle Retail Installment Contract

(Stipulation of Facts, Ex. C). See Turley, 705 F.2d at 1026 (identifying similar interest of debtors in mobile home at time of bankruptcy filing). This equitable interest became property of the estate upon the filing of the bankruptcy petition. The Court recognizes that, under § 32-3-10, the debtors did not obtain full rights of ownership in the vehicle until the Secretary of State issued the certificate of title.⁴ See Schroeder v. Herbert C. Coe Trust, 437 N.W.2d 178, 184 (S.D. 1989) ("Legal ownership of a vehicle does not pass unless title to the vehicle is issued in the owner's name. SDCL 32-3-10, 32-3-11.") However, even if the operation of § 32-3-10 did not permit the Trustee to defeat Home Federal's purported lien on the vehicle under § 544 as of the date the bankruptcy case commenced, § 549(a) of the Bankruptcy Code permits the Trustee to defeat Home Federal's post-petition lien recorded on the certificate of title on May 1, 1996, which is the same date the debtors' full ownership interest in the vehicle ripened.

Home Federal relies on In re Weaver, 131 B.R. at 807, for the proposition that the bankruptcy estate gained property upon the recordation of the lien and the estate was not diminished by the perfection of the lien; therefore, no "transfer of property of the estate" occurred. The bankruptcy court properly rejected this argument on the basis that the automatic stay of § 362(a)(4) prohibits "any act to . . . perfect any lien against property of the estate[.]" Acts which violate the automatic stay are void, In re Nasr, 191 B.R. 698, 693 (Bankr.S.D.Ohio 1996), and the Trustee was properly permitted to defeat the perfection of Home Federal's

⁴The Court does not agree with the bankruptcy court's conclusion that Island v. Warkenthien controls in this case. Island did not involve a bankruptcy case, and as Home Federal points out, the Trustee at the commencement of a bankruptcy petition has the status of a hypothetical judicial lien creditor and does not take the rights of a buyer in the ordinary course of business as to personal property, as did the vehicle purchaser in Island.

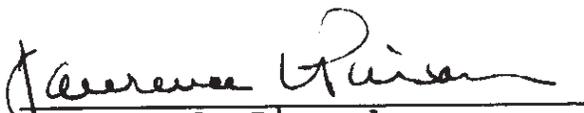
lien.

Finally, the Court also rejects Home Federal's argument that the ruling below was erroneous because the bank's lien was noted on the back of the certificate of title from the date the vehicle was sold to the debtors and Home Federal did all that was required of it to perfect its security interest, relying on Commerce Bank v. Chambers (In re Littlejohn), 519 F.2d 356 (10th Cir. 1975). As Home Federal acknowledges, the Tenth Circuit has now abandoned the rule announced in Littlejohn because of subsequent developments in Kansas statutory law, Matter of Kerr, 598 F.2d 1206, 1209 (10th Cir. 1979), and the Court will not adopt the Littlejohn analysis in this case. Additionally, Home Federal has not shown that it did all that it could to accomplish perfection of its lien. The record reveals that Home Federal had one contact with the debtors through what appears to be a standardized customer letter, directing the debtors to have the title transferred immediately. The record reveals no other action taken by Home Federal to assure the prompt recordation of its lien. While the state legislature has now amended § 32-3-41 to permit perfection of a security interest by listing that interest on the back of the certificate of title, such action comes too late to assist Home Federal in this case. Accordingly, for all of the reasons stated,

IT IS ORDERED that the Judgment of the bankruptcy court is affirmed.

Dated this 11th day of September, 1997.

BY THE COURT:


Lawrence L. Piersol
United States District Judge

ATTEST:
JOSEPH HAAS, CLERK

BY: Sharon Louvo
(SEAL) DEPUTY

FILED

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UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH DAKOTA
SOUTHERN DIVISION

[Signature]
CLERK

In Re:
MARK JACOB STEINFURTH
Soc. Sec. No. 503-86-7929
and
SUSAN XUAN STEINFURTH
f/k/a Susan Schultz
f/k/a Susan James
Soc. Sec. No. 504-04-5121

Debtors.

Bankr. No. 96-40221
Chapter 7

HOME FEDERAL SAVINGS BANK,

Appellant,

-vs-

JOHN S. LOVALD, Trustee,

Appellee.

Adv. No. 96-4032

CIV 97-4004

JUDGMENT

In accordance with the Memorandum Opinion and Order entered
this date with the Clerk,

IT IS ORDERED, ADJUDGED, and DECREED that the Judgment of the
bankruptcy court is affirmed.

Dated this 11th day of September, 1997.

BY THE COURT:

[Signature]
Lawrence L. Piersol
United States District Judge

ATTEST:
JOSEPH HAAS, CLERK

BY: *[Signature]*
(SEAL) DEPUTY