UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501

IRVIN N HOYT
CHIEF BANKRUPTCY JUDGE

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January 9, 1997

Trustee John S. Lovald, Plaintiff
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Subject: ***Trustee v. Dakotaland Federal Credit Union (In re Charles C. Dammann)***, Adversary No. 96-4027, Chapter 7; Bankr. No. 96-40373

Dear Trustee and Counsel:

The matter before the Court is the Trustee's preference complaint regarding Dakotaland Federal Credit Union's secured interest in a vehicle. This is a core proceeding under 28 U.S.C. § 157(b)(2). This letter decision and subsequent judgment shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that the Credit Union's perfection of its lien is voidable as a preference.

Stipulated facts. On March 25, 1996, the Credit Union financed Charles C. Dammann's (Debtor's) purchase of a 1989 Pontiac, the subject vehicle. On April 30, 1996, as part of this loan transaction, the vehicle was retitled in Debtor's name and the Credit Union was listed as the first lien holder. This reissued title, however, was made more than twenty days after the note was signed. Debtor filed a Chapter 7 petition on May 16, 1996. Therefore, the Credit Union's lien was perfected within ninety days of the petition date. The lien, if not voided, would allow the Credit Union to receive more in a Chapter 7 liquidation than if the lien had not been perfected. Debtor was insolvent when the lien was perfected.

The Credit Union's regular business practice is to instruct the borrower to deliver the certificate of title to the county register of deeds and ask that it's lien be noted thereon when the title is transferred into the borrower's name. It is also the Credit Union's regular business practice to check thirty days after the loan was made to insure that its lien has been noted on the title.

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Discussion. Under 11 U.S.C. § 547(b), a trustee may avoid a transfer to a creditor that occurred within ninety days of the petition date if the transfer was for a debt that preceded the transfer, the debtor was insolvent at the time of the transfer, and the transfer enabled the creditor to receive more than it would have under a Chapter 7 liquidation. *Buckley v. Jeld-Wen, Inc. (In re Interior Wood Products Co.)*, 986 F.2d 228, 230 (8th Cir. 1993). The trustee bears the burden of proof on each element of a preference under § 547(b). 11 U.S.C. § 547(g). The purpose of § 547(b) is to restore the bankruptcy estate to its pre-preferential transfer condition, *Halverson v. Le Sueur State Bank (In re Willaert)*, 944 F.2d 463, 464 (8th Cir. 1991), and prevent the debtor from favoring one creditor over others by transferring property shortly before filing bankruptcy. *Begier v. IRS*, 496 U.S. 53, 58 (1990).

Section 547(c) also sets forth certain exceptions to the avoidable preference rule. The preferences that may not be avoided by the trustee include those in which the transfer was a contemporaneous exchange for new value, 11 U.S.C. § 547(c)(1), and a purchase money security interest that is perfected within twenty days after the debtor receives possession of the property. 11 U.S.C. § 547(c)(3).

The Trustee argues that subsections (c)(1) and (c)(3) are mutually exclusive, that is, if the subsection (c)(3) exception does not apply then neither can the exception at subsection (c)(1). The Credit Union admits that the exception under subsection (c)(3) does not apply because the Credit Union did not perfect its security interest within twenty days after Debtor took possession of the vehicle. The Credit Union, however, argues that subsection (c)(1) still applies and that its lien was perfected within the time the Credit Union generally allows for such transactions. The Trustee argues (c)(1) does not apply because that exception applies only to "enabling loans."

Based on the parties' stipulated facts and briefs, the only questions presented are whether the Credit Union may claim an exception under subsection (c)(1) if it fails to meet the twenty-day perfection exception under subsection (c)(3) and, if so, whether the exchange in fact was substantially contemporaneous.

PERFECTION OF PURCHASE MONEY SECURITY INTERESTS UNDER § 547(c)(1). Several circuit courts and bankruptcy courts have adopted the Trustee's argument in holding that the exceptions under subsections 547(c)(1) and (c)(3) are mutually exclusive. That is, if a purchase money security interest creditor cannot invoke the preference exception under subsection (c)(3) because its security

interest was not perfected within twenty days of the debtor taking possession of the property, then the creditor cannot argue that the exchange was nonetheless substantially contemporaneous and thus a preference exception under subsection (c)(1). *Pongetti v. General Motors Acceptance Corp. (In re Locklin)*, 101 F.3d 435, 443-43 (5th Cir. 1996); *Wachovia Bank and Trust Co. v. Bringle (In re Holder)*, 892 F.2d 29, 30-31 (4th Cir. 1989); *Union Bank & Trust Co. v. Baker (In re Tressler)*, 771 F.2d 791, 794 (3rd Cir. 1985); *Gower v. Ford Motor Credit Co. (In re Davis)*, 734 F.2d 604, 605-07 (11th Cir. 1984); *Valley Bank v. Vance (In re Vance)*, 721 F.2d 259, 260-62 (9th Cir. 1983); *Gibson v. General Motors Acceptance Corp.*, 104 B.R. 432, 434-35 (Bankr. N.D. Fla. 1989); and *Bergquist v. Cessna Finance Corp. (In re A.E.F.S., Inc.)*, 39 B.R. 66, 67-68 (Bankr. D. Minn. 1984). *See also Ray v. Security Mutual Finance Corp. (In re Arnett)*, 731 F.2d 358, 362-65 (6th Cir. 1984)("contemporaneous exchange" exception to trustee's avoidance power inapplicable beyond ten days after creation of security interest, even in non purchase money situation); and *W.T. Vick Lumber Co., Inc. v. Chadwick (In re W.T. Vick Lumber Co., Inc.)*, 179 B.R. 283, (Bankr. N.D. Ala. 1995). *Compare Pine Top Insurance Co. v. Bank of American National Trust and Savings Assoc.*, 969 F.2d 321, 328-29 (7th Cir. 1992)(modifier "substantial" makes contemporaneity a flexible concept); *Dye v. Rivera (In re Marino)*, 193 B.R. 907, 913-16 (9th Cir. BAP 1996)(court considered § 547(e)(2) and concluded *non* purchase money security interest that is perfected more than ten days after the date of transfer may be considered substantially contemporaneous in fact); and *Kepler v. Security Pacific Housing Services (In re McLaughlin)*, 183 B.R. 171, 174-75 (Bankr. W.D. Wis. 1995)(follows *Pine Top*).

This Court agrees with the majority line of cases that holds a purchase money security interest must be perfected within twenty days[1] to avoid a preference action by the Trustee pursuant to § 547(c)(3). A creditor holding a purchase money security interest may not argue that a perfection of its interest more than twenty days after the transfer is nonetheless "substantially contemporaneous" and therefore excepted under § 547(c)(1). The discussion of the impact of a contrary conclusion and the courts' studies of the legislative history is thorough and need not be repeated here. Accordingly, the Credit Union may not argue that the perfection of its lien on the vehicle was not a preference under the exceptions at §§ 547(c)(1) or 547(c)(3).

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[1] Section 547(c)(3) was amended in 1994 to extend the time for perfecting a purchase money security interest from ten days to twenty days.

"SUBSTANTIALLY CONTEMPORANEOUS" UNDER § 547(c)(1). Even if the exception at § 547(c)(1) could be applied to the Credit Union's perfection of its purchase money security interest, this Court could not conclude that the perfection was *substantially* contemporaneous with the creation of the note that allowed Debtor to purchase the vehicle.

Whether a transfer was substantially contemporaneous is a question of fact. *Tyler v. Swiss American Securities, Inc. (In re Lewellyn & Co., Inc.)*, 929 F.2d 424, 427 (8th Cir. 1991). "Substantially contemporaneous" is not defined by the Code. Instead, a court must look at all surrounding circumstances. *Eide v. United States (In re Quade)*, 108 B.R. 681, 683 (Bankr. N.D. Ia. 1989). Factors to consider include the agreement of the parties and any government regulations that may affect the transfer. *Lewellyn*, 929 F.2d at 428. Some courts have considered a commercially reasonable standard. *See Eide v. Mason (In re Mason)*, 189 B.R. 932, 937 (Bankr. N.D. Ia. 1995).

Perfection of a lien interest on a vehicle in South Dakota is governed by S.D.C.L. Ch. 32-3. Chapter 32 generally provides that a certificate of title is to be properly endorsed by the Secretary of State when a vehicle is sold or by the county register of deeds when a vehicle is encumbered. S.D.C.L. §§ 32-3-5, 32-3-25, 32-3-26, 32-3-28, and 32-3-38. For an encumbrance to be valid against other creditors, the encumbrance must be noted on the face of the certificate of title by the Secretary of State or the county register of deeds. S.D.C.L. § 32-3-41; *Pokela v. Dakota United Methodist Federal Credit Union (In re Huyck)*, 167 B.R. 908, 910 (Bankr. D.S.D. 1994).

In this case, the Credit Union's lien was not noted on the face of the certificate by the Secretary of State or the county register of deeds until a month after Debtor borrowed funds from the Credit Union and purchased the vehicle. While it may have been the Credit Union's practice to expect its borrower promptly to do the leg work necessary to get vehicle liens perfected, the Court cannot conclude that such a practice is commercially reasonable where state law apparently does not protect the creditor in the interim. Moreover, there is no evidence that the month's delay was due to any processing lags by state or county officials in retitling the vehicle. Thus, the delay in perfection of the lien can only be attributed to the Credit Union's failure to protect itself and its misplaced delegation of and reliance on Debtor to accomplish perfection.

Finally, the Court does not accept the Credit Union's argument that Debtor had no interest in the vehicle before the perfection

date under S.D.C.L. § 32-3-10. That section provides:

> 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 . . . until he has been issued a certificate of title to the motor vehicle. . . . No waiver or estoppel may be operated in favor of such person against a person having possession of the certificate of title . . . for such motor vehicle. . . .

Section 32-3-10 has been previously considered by the South Dakota Supreme Court. In *Island v. Warkenthien*, 287 N.W.2d 487 (S.D. 1980), the court held 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 of ownership. Title statutes are not meant to prevent a court of equity from ordering that a title be transferred if the holder has bound himself to do so. *Id.* at 489 (quoting *Levin v. Nielsen*, 306 N.E.2d 173, 179 (Ohio 1973)).

Section 32-3-10 has a similar impact here. While Debtor may not have held an endorsed certificate of title to the vehicle before the Credit Union perfected its lien, he did have the equitable right on the purchase date to have the title transferred to him. "New value," so to speak, was created for Debtor on that purchase date. However, the perfection of the Credit Union's secured interest in the vehicle took place on a later date that was not substantially contemporaneous under § 547(c)(1). *See McLaughlin*, 183 B.R. at 174-77.

Trustee Lovald shall prepare a judgment in accordance with this letter decision.

Sincerely,

Irvin N. Hoyt
Chief Bankruptcy Judge

CERTIFICATE OF SERVICE
I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to those creditors and other parties in interest identified on the attached service list.
Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota
By: _____
Date: _____

INH:sh
CC: adversary file (docket original; copies to parties in interest)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
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Charles L. Nail, Jr., Clerk
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Case: 96-04027 Form id: 122 Ntc Date: 01/09/97 Off: 4 Page : 1
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