

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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March 25, 1997

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Subject: **Yarnall v. First Premier Bank**  
**(In re Craig R. Smith),**  
Adversary No. 96-4024  
Chapter 7; Bankr. No. 95-40637

Dear Trustee and Counsel:

The matter before the Court is the Trustee's complaint to avoid First Premier Bank's unrecorded lien on 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 Bank's lien may be avoided under 11 U.S.C. § 544 and S.D.C.L. § 57A-9-301.

**SUMMARY OF FACTS.** The facts are not in dispute. Craig R. Smith purchased a 1993 Buick LaSabre in 1994. Norwest Bank financed the purchase and obtained a security interest in the vehicle. Norwest's lien was noted on the vehicle's certificate of title that was issued by the South Dakota Department of Revenue. On August 15, 1995, First Premier Bank lent Craig Smith sufficient funds to pay the balance of his loan with Norwest. Craig Smith gave First Premier Bank a secured interest in the vehicle by signing a Security Agreement that day. Norwest received the check to pay its note that day. The check cleared soon thereafter and Norwest issued several documents indicating its loan was paid in full. None of these documents were ever received by the County Register of Deeds so as to advise the Register that Norwest's lien could be removed from the vehicle's certificate of title. While unclear, these documents were evidently in Craig Smith's possession.

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Craig Smith filed a Chapter 7 petition on November 13, 1995 before Norwest's lien was removed from the vehicle certificate of title and before First Premier's lien was noted on the vehicle title. The vehicle title was in Craig Smith's name on the petition date.

Norwest mailed an "Order to Register of Deeds to Cancel Lien" dated December 12, 1995 to First Premier Bank. It was not disclosed by the parties whether the County Register of Deeds removed Norwest's lien post-petition from the vehicle title.

**DISCUSSION.** Both the Trustee and First Premier Bank are aware of this Court's recent decisions regarding the perfection of liens on vehicles in South Dakota. See *Trustee v. First Premier Bank (In Bassler)*, Adversary No. 96-4031, Bankr. No. 96-40328, slip op. (Bankr. D.S.D. January 16, 1997); *Trustee v. Dakotaland Federal Credit Union (In re Damman)*, Adversary No. 96-4027; Bankr. No. 96-40373, slip op. (Bankr. D.S.D. January 9, 1997); and *Trustee v. Home Federal Savings Bank (In re Steinfurth)*, Adversary No. 96-4032, Bankr. No. 96-40221, slip op. (Bankr. D.S.D. December 23, 1996). First Premier, however, urges a different result in this case on the theory that First Premier stepped into Norwest's shoes as the first lien holder when First Premier's funds were used to satisfy Norwest's lien. First Premier relies on S.D.C.L. § 44-3-6, which states:

One who has a lien inferior to another upon the same property has a right to be subrogated to all the benefits of the superior lien when necessary for the protection of his interests upon satisfying the claim secured thereby.

First Premier opines that the Trustee's powers under 11 U.S.C. § 544 cannot defeat the Bank's perfected interest under § 44-3-6.

The case law interpreting § 44-3-6 is limited and aging. There are also some conflicting interpretations. Compare *Pollock v. Wright*, 87 N.W. 584 (S.D. 1901), and *Kalscheuer v. Upton*, 43 N.W. 816, 818 (S.D. 1889). However, the Court is satisfied that the statute applies when a lender supplies new funds to a debtor to satisfy a lien on chattels and permits the new lender to step into the shoes of the former lien holder. See *Malmberg v. Peterson*, 108 N.W. 339, 340-42 (S.D. 1906); *DeLuce v. Root*, 80 N.W. 181, 182 (S.D. 1899); and *Kalscheuer*, 43 N.W. at 818 (the doctrine of subrogation is justly extended by analogy to one who, having no previous interest, and being under no obligation, pays off the

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mortgage, or advances money for its payment, at the instance of a debtor party, and for his benefit, interpreting predecessor statute to § 44-3-6).

The Court, however, is not satisfied that the general lien provisions of § 44-3-6 apply to liens on motor vehicles titled in South Dakota. Instead, various sections of Chapter 32-3 indicate that the more specific provisions governing the perfection and enforcement of liens on motor vehicles in Chapter 32-3 prevail. See *In re Doyen*, 56 B.R. 632, 633 (Bankr. D.S.D. 1986) (legislature intended notation on title to be the exclusive method of perfection). Section 32-3-40 provides that the law governing security interests prior to July 1, 1951 applies only to chattel liens placed on a motor vehicle before July 1, 1951. Sections 32-3-41 and 32-3-46 both indicate that only liens that are recorded on the face of the certificate are enforceable against a party other than the debtor. Moreover, § 32-3-38 gives the creditor a tool to get his new lien recorded; he may file his lien with the register of deeds who, with the lien holder, may use § 32-3-43 to compel the vehicle title holder to surrender the title so that it can be reissued with the new lien noted. Section 32-3-43 also permits the lien holder to recover damages if the certificate of title holders does not cooperate with the lien notation process.

The Legislature's rationale in requiring liens on vehicles to be recorded to be enforceable is understandable when considered in light of the facts in this case and the mobile nature of vehicles. See *Pokela v. Dakotas United Methodist Federal Credit Union (In re Huyck)*, 167 B.R. 908, 910 (Bankr. D.S.D. 1994). Debtor obtained funds from First Premier to pay his car mortgage with Norwest. Debtor took the funds, paid Norwest, and then received documents from Norwest indicating its mortgage was satisfied. Neither Debtor nor First Premier did anything more to protect First Premier's secured interest. Understandably, First Premier argues that is why the subrogation statute should apply. However, other creditors are in peril if First Premier does nothing to protect itself. Debtor, armed with a certificate of title and a lien satisfaction document from the prior lender, could easily have obtained other credit secured by the vehicle or sold the vehicle presumably free and clear of liens; the certificate of title would not have tipped off the creditor or purchaser that First Premier had stepped into Norwest's shoes to retain that first lien. As we noted previously in *Damman*, slip op. at 4, under Chapter 32-3 creditors are obligated to insure that their security interest in a vehicle is properly perfected. When a lien on a vehicle is not properly perfected on the petition date, the bankruptcy trustee steps ahead of that lien holder under 11 U.S.C. § 544 and S.D.C.L. § 57A-9-301.

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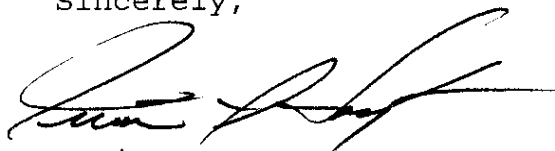
That is the result here.

The Court is aware that other courts have not allowed the trustee to avoid liens obtained through equitable subrogation. See *In re White*, 183 B.R. 713, (Bankr. M.D. Ca. 1995), and *Rinn v. First Union National Bank of Maryland*, 176 B.R. 401 (D. Md. 1995). In light of South Dakota's law governing the perfection and enforcement of liens on vehicles, however, the Court declines to adopt their application of equitable subrogation to defeat a trustee's powers under § 544. The result may be different if the subject property is real property or a different kind of chattel.

Finally, even if the Court were to assume that § 44-3-6 could generally be applied to liens on motor vehicles, the self-limiting provision within the statute precludes its application in this case. Section 44-3-6 limits the creditor's rights to subrogation to circumstances "when necessary for the protection of his interests upon satisfying the claim secured thereby." First, First Premier obtained its own security interest in the vehicle. The parties did not contemplate that First Premier would step into Norwest's shoes. See, e.g., *Midlantic National Bank v. Bridge (In re Bridge)*, 18 F.3d 195, 201 (3rd Cir. 1994). Second, §§ 32-3-39 and 32-3-43 gave First Premier another means of protecting its secured interest when it satisfied Norwest's lien. Therefore, subrogation under § 44-3-6 was not necessary to protect First Premier's interest.

Trustee Yarnall may prepare a judgment in compliance with this letter decision.

Sincerely,



Irvin N. Hoyt  
Chief Bankruptcy Judge

INH:sh

CC: case file (docket original; copies to parties in interest)

**NOTICE OF ENTRY**  
Under F.R. Bankr.P. 9022(a)  
Entered

**MAR 27 1997**

Charles L. Nail, Jr., Clerk  
U.S. Bankruptcy Court  
District of South Dakota

Case: 96-04024 Form id: 122 Ntc Date: 03/27/97 Off: 4 Page : 1  
Total notices mailed: 4

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