



Notation Equals Perfection: Analyzing Perfection and Avoidance of Automobile Purchase Money Security Interests in Bankruptcy

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An ambiguity in the interplay between sections of the Indiana Uniform Commercial Code and the Indiana Certificates of Title code provides a potential benefit to bankruptcy estates and a predicament for automobile financing lenders. Specifically, under Indiana law, is a security interest in a vehicle perfected upon application for a certificate of title, or upon the issuance of a certificate of title noting the lien? According to a 2017 decision from the United States Bankruptcy Court for the Northern District of Indiana, the answer is the latter.

Indiana Code Section 26-1-9.1-311(a)(2) provides that the filing of a financing statement is not effective to perfect a security interest in property subject to any Indiana statute covering automobiles, trailers, mobile homes, or boats, which provides for a security interest to be indicated on a certificate of title as a condition or result of perfection. The statute alluded to therein, Indiana Code Section 9-17-5-5(a), provides, in part, that a security agreement covering a security interest in a vehicle that is not inventory held for sale can be perfected only if the Indiana Bureau of Motor Vehicles (“BMV”) indicates the security interest on the certificate of title or duplicate. Indiana Code Section 9-17-5-5(b) provides that the secured party, upon presentation to the BMV of a properly completed application for certificate of title together with the fee prescribed, may have a notation of the lien made on the face of the certificate of title to be issued by the BMV. The BMV shall then enter the notation and the date of the notation.

In the bankruptcy context, an issue arises when, shortly before filing for bankruptcy, the debtor purchases a vehicle with financing from a lender, granting the lender a purchase money security interest in the vehicle. The lender then submits an application to the BMV requesting the issuance of a certificate of title for the vehicle noting the lender’s lien. More than 30 days after the debtor takes possession of the vehicle, the new title is issued with the lien noted. Shortly thereafter, the debtor files for bankruptcy. The lender then files a proof of claim in the debtor’s bankruptcy case as a secured creditor. To the lender’s surprise, the claim is disallowed by the trustee on the grounds that the debtor’s grant of the security interest during the 90 days prior to its bankruptcy filing was an avoidable preferential transfer, and thus the lender’s security interest was not perfected. The trustee moves to avoid the transfer. The lender, despite timely applying for a certificate of title, is relegated to the status of a general unsecured creditor.

This scenario recently played out in *Fischer v. AmeriCredit Fin. Serv. (In re Edmondson)*, Nos. 16-31174 HCD, 16-3034, 2017 Bankr. LEXIS 3710 (Bankr. N.D. Ind. Mar. 21, 2017). The case involved an adversary proceeding brought by the Trustee to avoid the debtor’s grant of a security interest in a vehicle to the lender, GM, 70 days prior to the petition

date. Pursuant to 11 U.S.C. § 547(b), a trustee may avoid a transfer of a debtor's interest in property: (1) to or for the benefit of a creditor (GM); (2) for or on account of an antecedent debt owed by the debtor before the transfer was made (borrowing from GM to purchase the vehicle); (3) made while the debtor was insolvent (debtor is presumed insolvent on and during the 90 days preceding filing pursuant to 11 U.S.C. § 547(f)); (4) on or within 90 days before the petition's filing; and (5) that would enable the creditor to receive more than it would have as an unsecured creditor. Thus, the debtor's grant of the security interest would be avoidable. However, 11 U.S.C. § 547 (c)(3) provides a small safety net for lenders.

It provides that a trustee may not avoid a transfer that creates a security interest in property acquired by the debtor that is perfected on or before 30 days after the debtor receives possession of the property. In *Fischer*, the BMV received GM's application for the certificate of title 30 days after the debtor received possession of the vehicle.

In its *Memorandum of Decision and Order on Summary Judgment Motions*, the court summarized the parties' disagreement as it related to the date when GM's security interest was perfected and whether that date fell within the preferential transfer period established under the Bankruptcy Code. GM argued that its security interest was perfected upon submission of its application for a certificate of title, relying upon Indiana Code Section 26-1-9.1-303 ("Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority.") The Trustee countered that, pursuant to Indiana Code Section 9-17-5-5(a), perfection does not occur until the BMV issues the certificate of title. Thus, if GM's interpretation of Indiana's vehicle perfection statutes was correct, its secured claim could not be avoided. If incorrect, the Trustee could avoid the claim.

In concluding that perfection does not occur until the BMV issues a certificate of title with the lien noted (thereby allowing the Trustee to avoid the transfer), the court pointed to guidance from the BMV and analyzed the policy reasons supporting this interpretation. A regulatory statement on the BMV's website provides the following explanation regarding perfection:

In the State of Indiana, security interest is not perfected on a motor vehicle until the Bureau of Motor Vehicles (BMV) issues a title with the security interest in the form of a lien indicated on the certificate of title. Indiana law states that a security agreement covering a security interest in a vehicle that is not inventory held for sale can be perfected only if the BMV indicates the security interest on the certificate of title or a duplicate.

Once an application for a motor vehicle certificate of title is processed, regardless of whether the title is processed at a BMV branch, full and partial service provider location, or dealership, the title enters a "Pending" status in the BMV system. The amount of time a title remains in a "Pending" status varies. In accordance with state law, the BMV will not issue the title until it is satisfied that the information submitted is correct and the person applying for a certificate of title is the owner of the vehicle. As long as the title is in a "Pending" status, the BMV may alter

and/or void the title at any time. It is not uncommon for Indiana Child Support Bureau and/or Department of Revenue liens to be added during this time.

As a result, security interest is not considered to be perfected until the title is issued by the BMV with a Title Issue Date and the lien recorded on the face of the title.

<https://www.in.gov/bmv/2412.htm>

The court also emphasized that perfection upon application, as suggested by GM, “would undermine the reliability of the public record as a point of reference for determining the existence of entities claiming a security interest in property.” In addition, the court concurred in the analysis of Judge Metz of the Southern District of Indiana that “if automatic perfection were the method of perfection for automobiles, there would be no need for the references to a certificate of title and the liens and encumbrances thereon in Ind. Code §9-17.” *Petr v. Forum Credit Union (In re Staton)*, Nos. 04-15755-AJM-7A, 04-662, 2005 Bankr. LEXIS 3595, at *13-14 (Bankr. S.D. Ind. May 24, 2005).

With the perfection of the security interest avoided, a trustee has several tools at its disposal. Pursuant to 11 U.S.C. § 550, the Trustee may recover the transfer from the lender for the benefit of the bankruptcy estate free and clear of the lender’s lien. In addition, pursuant to 11 U.S.C. § 551, any transfer avoided under 11 U.S.C. § 547 is automatically preserved for the benefit of the estate. Accordingly, bankruptcy trustees should pay close attention to vehicle purchases made by debtors during the 90 days preceding the petition date, as well as the timing of the BMV’s corresponding issuance of certificates of title.

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