UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

MICHAEL C. WEATHERS Case No. 97-10688 K

Debtor

MORRIS L. HORWITZ, as Trustee in
Bankruptcy for Michael C. Weathers

Plaintiff

-vs- AP 97-1118 K

MICHAEL WEATHERS and
GVTA Federal Credit Union

Defendants

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Trustee

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In this adversary proceeding the Chapter 7 Trustee in the case of Michael Weathers (the "Debtor") seeks to set aside, under 11 U.S.C. § 544(a), an unperfected lien on a certain motor vehicle. The Defendant is GVTA-Federal Credit Union ("Credit Union"). The Trustee's Complaint explains that the Credit Union's lien does not appear on the title certificate for the vehicle, and is therefore unperfected and invalid against the trustee in bankruptcy. The Credit Union argues that under the reasoning of the United States District Court for this district in *Pennbank v. Lucas*, 142 B.R. 68 (W.D.N.Y. 1992), it still has a perfected security interest in the motor vehicle, good as against the bankruptcy Trustee. This argument rests on the notion that where the failure to file the necessary lien documents is attributable to the wrongdoing of the Debtor, such wrongdoing should not result in a windfall for the Debtor's other creditors, at the lender's expense.

This matter was tried to the Court on January 20, 1998. The following are the Court's Findings of Fact, Conclusion of Law, and Judgment. This is a core proceeding under 28 U.S.C. § 157(b)(2)(K).

FINDINGS OF FACT

1. The Debtor, Michael Weathers, is a Corrections Officer who had an established relationship with the Credit Union, as of September of 1996.
2. He wished to refinance his 1996 Toyota, which was liened by M&T Bank.
3. In processing his loan application, the Credit Union followed its internal procedures for "new car loans," even though this was a refinancing and the vehicle and title were already

in possession of the Debtor.[1]

4. The Credit Union relied on the Debtor to determine what the payoff balance was to M&T, and when the Debtor executed the loan documents, the Credit Union gave to the Debtor a check for $12,363.68 and instructed him to pay off the M&T lien. The Debtor was also instructed to bring the Release of Lien from M&T back to the Credit Union, together with the Certificate of Title, so that the Credit Union could complete the Notice of Lien and mail the requisite materials to the Department of Motor Vehicles in Albany.

5. Initially, the effort failed because the payoff balance was incorrect. Consequently, the Debtor returned to the Credit Union and got a replacement check in the correct amount.

6. A check in the correct amount was given to him and he was again instructed to pay off the M&T loan, come back with the Release of Lien and the title, so that the information from it could be filled in on the form Notice of Lien and the Credit Union could mail it all into the Department of Motor Vehicles in Albany.

7. The Debtor knew what was expected of him. He did pay off the M&T lien and obtained a lien release, but he was going through a "nasty divorce" and did not immediately bring the materials to the Credit Union.

8. About a month later, the loan officer observed that there was no lien and called the Debtor. She did not reach him, but left a message at the Corrections Facility where she

[1] In this Court's experience, "new car loans" are handled very differently, at least by banks. The lenders rely on the car dealers to be the middleperson who assures that lien documents are complete and executed simultaneously with delivery of the vehicle and the purchase money check. Credit Unions may be different, but if so, it may be at their peril.

thought he worked. In fact, he worked at a different Corrections Facility, and he does not recall receiving any message.

9. Two or three months later the loan officer sent the Debtor a letter.

10. The Debtor received the letter but in light of his personal problems, he was unable to locate the title certificate and did not respond to the letter.

11. The loan officer may have sent him another letter a month after that (February of 1997), but the Debtor testified that he never received that letter and testified that he was not then residing at the address to which that letter was mailed.

12. In the meantime, the Debtor had been making timely payments to the Credit Union on the loan and had been certain to have the Credit Union designated as the loss-payee on the insurance for the car.

13. The Debtor filed a petition in bankruptcy in the same month that the second letter (which he did not receive) was sent.

14. Apparently, the Debtor continued to make regular payments on the loan even after the filing of the petition.

CONCLUSIONS OF LAW

As indicated above, the Credit Union argues that it is the Debtor's fault that it was unable to get itself noted as lienholder on the title certificate, and that consequently, the rationale of the case of *Pennbank v. Lucas, supra,* requires a finding that the unsecured creditors of

Michael Weathers should not receive a "windfall benefit" by virtue of the Debtor's wrongdoing. The Credit Union's argument would turn *Lucas* into a license to adopt a lending procedure that makes the borrower responsible for perfecting the lender's lien, while at the same time giving the lender the advantage of an unassailably perfected lien as against the borrower's other creditors in bankruptcy. This argument cannot be sustained.

In this Court, we always ask a fundamental question of a lender. "Did you rely on a lien or did you rely on the unsecured promise of the borrower?" Here it clearly seems to have been the latter, and the argument based on *Lucas* does not avail for a number of reasons.

First, *Lucas* dealt with an error made by the DMV not by the creditor, and the debtor's wrongdoing consisted of his failure to respond to the DMV's letters demanding return of the title certificate so that it could properly note the lienor thereon. There, the lender had no knowledge of the problem. Here, the mistake was the Credit Union's; it relied on the borrower. And the Credit Union at all times knew of the Debtor's defaults.

Secondly, it is clear that in the *Lucas* case the lender did everything right toward perfecting its lien. Again, the error was at the DMV. The Credit Union's argument here, on the other hand, requires a huge leap of faith - an enormous presumption or set of presumptions. We must presume that if the Debtor had not defaulted, the Credit Union would have properly filed its lien and would have obtained it in a fashion so timely as to be immune from preference attack. *See* 11 U.S.C. § 547. In fact, many lenders elect not to file the lien or fail to succeed in doing so. Though credit unions are rarely, if ever, among those who elect not to seek a lien, that does not mean that the same mistakes that other lenders make in their efforts do not befall credit unions.

Things fall between the seams. Lien filings do not always get mailed. Furthermore, as both *Lucas* and the case of *GMAC v. Waligora,* 24 B.R. 905 (W.D.N.Y. 1982), demonstrate, errors can occur in Albany; and they are not always the borrower's fault; and they are not always rectified before the borrower ends up in bankruptcy. Furthermore, liens filed to secure a previously unsecured loan can be voidable under 11 U.S.C. § 547 if filed within 90 days before the bankruptcy. Thus, if the Credit Union's argument were adopted, it would fare better than it would have fared if it had cured the problem, but did so during the 90-day period, but outside the enabling loan exception of § 547(c)(3). This writer is consistently loathe to grant the benefit of a presumption that something would have been done properly, which something is often not done, or not done right, in the real world.

Finally, unlike the lender in *Lucas*, the Credit Union here uses a procedure that is peculiarly dependent upon the borrower's skill, efforts, good will, and good fortune. There could conceivably be a decisive difference, for example, between simply counting on the borrower to drop the completed lien "package" in the mail on the way out of the lender's door (when in fact the borrower in a calculated, malicious move, drops it in a trash bin instead) and the present case in which it was left to the borrower (who ended up in divorce and bankruptcy) to discharge the M&T lien, and forward the release of lien and title. Moreover, for four months the lender took no "self-help," despite knowing of the defaults. The Debtor's good faith efforts to comply, on the other hand, are suggested in his naming of the Credit Union as loss-payee on the insurance policies.

In sum, the Credit Union did not rely on having a perfected lien, it relied on the

Debtor's unsecured promise to help it obtain such a lien, and the *Lucas* rationale does not apply.

The rationale of *Lucas* is not significantly different from that of the later-decided case of *Sanyo Electric v. Howard's Appliance Corp. (In re Howards Appliances Corp.),* 874 F.2d 88 (2d Cir. 1989), where the Second Circuit held that where a debtor's actions were the cause of a lender's unsecure position, a constructive trust would be imposed on the lender's collateral. Although the latter dealt with U.C.C. filings and *Lucas* with title law, they are both essentially "constructive trust" cases. What is essential to an understanding of both cases is that the lenders therein did not leave to the debtors what the lenders could have, and should have done for themselves in light of what they knew or were reasonably charged with knowing.

Here, for reasons that may well make good sense in a credit union setting, the policy in these refinance situations does not assure that a perfected security interest is in place for the loan at all times from disbursement of the funds, or at least within the time frame permitted by the enabling loan exception to the preference statute. 11 U.S.C. § 547(c)(3). The evidence suggests that this is the only loss of lien in perhaps 2000 car loan transactions handled by this one loan officer. That alone would bespeak the cost-effectiveness of continuing the procedures as they are. Here, in an aberrant circumstance, a borrower/member's personal problems resulted in an "insecure" position for this credit union. Neither *Lucas* nor any other theory bestows on this lender, at the expense of other creditors, the hypothetical status of a holder of a duly perfected lien, or of any other status above that of "unsecured creditor."

It is Ordered that the unperfected lien of the Credit Union is hereby set aside under 11 U.S.C. § 544. Leave is granted to the Trustee to seek an accounting of payments made

by the Debtor to the Credit Union since the filing of the bankruptcy petition, and to amend this Complaint, if necessary, to seek money judgment for payments improperly made or collected, in light of this Decision.

For tracking purposes in that regard, this matter is set on the Calendar Call of March 18, 1998 at 11:30 a.m. for a report. Entry of Judgment shall await the closing of this Adversary Proceeding.

SO ORDERED.

Dated: Buffalo, New York
February 9, 1998

/s/ Michael J. Kaplan

Michael J. Kaplan, U.S.B.J.