

IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE

In re

GEORGIANNA ELIZABETH GLEN)
WHITSON, a/k/a GEORGIANNA)
WHITSON)

Debtor.)

MICHAEL J. O'CONNOR, TRUSTEE)

Plaintiff,)

v.)

EASTMAN CREDIT UNION,)

Defendant.)

Case No. 93-33816
Chapter 7

Adv. Proc. No. 93-3158

M E M O R A N D U M

This case is before the court upon the Chapter 7 trustee's complaint pursuant to 11 U.S.C. § 544(a) seeking a determination that the estate's interest in a 1987 Toyota Camry is superior to that of a creditor holding an unperfected security interest. The parties have filed cross-motions for summary judgment and a joint stipulation of facts and they agree that this matter is ripe for adjudication under Rule 7056 of the Federal Rules of Bankruptcy Procedure. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(K).

I.

The pertinent facts as stipulated by the parties are as follows:

On or about December 20, 1991, defendant Eastman Credit Union ("Eastman") loaned \$4,912.49 to the debtor, Geogianna Whitson. To secure the loan, Eastman and the debtor entered into a security agreement whereby Eastman was granted a security interest in the debtor's 1987 Toyota Camry, which at the time was subject to the perfected lien of Toyota Motor Credit Corporation ("TMCC"). The debtor and Eastman agreed that Eastman would have a first lien on the Toyota Camry and that part of the proceeds of the loan would be used to pay off TMCC. In furtherance of this agreement, part of the loan proceeds in the amount of \$2,722.49 was used to pay off TMCC and discharge its lien. TMCC acknowledged payment in full and noted the discharge of its lien on the certificate of title for the Toyota Camry. Thereafter, TMCC sent the certificate of title to Eastman who held it until the filing of debtor's chapter 7 bankruptcy case. Eastman, however, failed to have its security interest noted on the certificate of title for the Toyota Camry.

II.

The sole legal issue presented by the parties is whether Eastman, not having perfected its security interest by having its lien noted on the certificate of title for the Toyota Camry, may nonetheless be equitably subrogated to the position of TMCC because part of the loan proceeds were used to pay off and discharge TMCC's perfected security interest. Eastman argues that Tennessee has long recognized the doctrine of equitable subrogation and assignment, and therefore, it should have priority over the lien of

the plaintiff trustee which is provided by 11 U.S.C. § 544(a)(1).

The Chapter 7 trustee contends that the provisions of Tennessee's certificate of title statutes, TENN. CODE ANN. §§ 55-3-101, *et seq.*, specifically §§ 55-3-125 and 126, set forth the exclusive means of perfecting a security interest in a motor vehicle. The trustee concludes that since Eastman did not have its security interest noted on the certificate of title for the Toyota Camry, he has priority over the unperfected security interest of Eastman. The court agrees.

III.

Under Tennessee law, perfection of a security interest in a motor vehicle is accomplished by notation of the lien on the vehicle's certificate of title in accordance with Tennessee certificate of title laws. See *In re Clark*, 112 B.R. 226, 229 (Bankr. E.D. Tenn 1990). A security interest in a motor vehicle (other than inventory) is not enforceable against the trustee in bankruptcy unless the security interest is indicated on the certificate of title. See *In re Graves*, 64 B.R. 329 (Bankr. M.D. Tenn. 1986), *aff'd*, 75 B.R. 227 (M.D. Tenn. 1987); *In re Custom Caps, Inc.*, 1 B.R. 99, 102 (Bankr. E.D. Tenn. 1979) (decided under Bankruptcy Act). Such is the case since 11 U.S.C. § 544(a)(1) provides a bankruptcy trustee with the rights of a hypothetical judicial lien creditor of the debtor without regard to any knowledge of unperfected or secret liens.

Specifically, TENN. CODE ANN. § 55-3-125 provides that

[n]o ... lien or encumbrance or title retention instrument upon a registered vehicle, other than a lien dependent upon possession entered into after March 1, 1951, or a lien of the state for taxes established pursuant to title 67, chapter 1, part 14, shall be valid against the creditors of an owner or subsequent purchasers or encumbrancers, until the requirements of this section and § 55-3-126 have been complied with, unless such creditor, purchaser, or encumbrancer has actual notice of the prior lien.

Neither of the exceptions concerning a lien dependent upon possession or a state lien for taxes is at issue here. And since Eastman is unable to challenge the Trustee's standing as a lien creditor without knowledge of Eastman's unperfected security interest, the express language of the statute makes it clear that the Trustee takes the Toyota Camry free of Eastman's invalid lien.

Eastman argues that it should be equitably subrogated to the previous position of TMCC to the extent that the proceeds which it loaned the debtor were used to extinguish TMCC's lien. The first problem with Eastman's argument is that there is no "position" of TMCC to which Eastman may be subrogated because TMCC's perfected lien was previously discharged and extinguished. The parties stipulated that "TMCC acknowledged payment of its lien and noted the discharge of its lien on the certificate of title ..." (emphasis supplied). A lien is automatically discharged when the debt from which the security interest arose has been paid in full. See *In re Apollo Travel*, 567 F.2d 841, 844 (8th Cir. 1977). See also *In re Hagler*, 10 U.C.C. Rep. Serv. 1285, 1289 (E.D. Tenn. 1972).

Secondly, the doctrine of equitable subrogation does not apply if the rights of third parties have intervened. See *Dixon v. Morgan*, 154 Tenn. 389, 399 (Tenn. 1926); *Amos & Central Coal Co.*, 277 S.W. 2d 457, 462 (Tenn. App. 1954). In this case, a third party has intervened, the bankruptcy trustee, who pursuant to § 544(a) of the Bankruptcy Code, has the status and powers of a lien creditor. See 4 COLLIER ON BANKRUPTCY, paragraph 544.01 (1986).

Finally, and most significantly, there is no authority under Tennessee law for this court to disregard the express language of TENN. CODE ANN. § 55-3-125 so as to create an exception for equitable subrogation under the facts of this case. None of the Tennessee decisions cited by Eastman in support of its argument involve a lien against a certificate of title under Tennessee's certificate of title statutes. Rather, each involves questions concerning the validity of liens against real property, and as a result, are inapposite. See *Dixon v. Morgan*, 154 Tenn. 389, 285 S.W. 558 (1926) (purchase of real property upon induced mistake that vendor's lien was the only encumbrance); *Harris v. Fourth & First Joint Stock Land Bank*, 8 Tenn. App. 301 (1928) (challenge of deed of trust by wife); *Peeples v. Smith*, 178 Tenn. 491, 159 S.W. 2d 832 (1942) (widow seeking declaration that homestead and dower interest are superior to deed of trust).

In *Harris*, the court never reached the question of whether to apply equitable subrogation since the deed of trust at issue was found to be valid. *Harris v. Fourth & First Joint Stock Land Bank*, 8 Tenn. App. at 305. Equitable subrogation was applied by the

courts in *Dixon* and *Peeples* so as to relieve mistakes which were not attributable to culpable negligence on the part of the subrogated parties. None of these cases lend any support for application of the doctrine to a situation such as this one which has resulted solely from the inaction of a party who was otherwise required by statute to undertake the action, i.e. have the lien noted upon the certificate of title.

Finally, Eastman urges the court to follow *Kaplan v. Walker*, 395 A.2d 897 (N.J. Super. Ct. App. Div. 1978), a decision wherein equitable subrogation was applied to thwart a state custodial receiver from taking priority over a nonperfected security interest of a second lender in a motor vehicle. The first lender had perfected its security interest which was discharged upon receiving payment from the second lender. The second lender failed to effect a transfer of the title to the motor vehicle (the original debtor was an officer of the insolvent corporation which had arranged and undertaken liability on the second loan) and likewise never had its lien recorded as required by New Jersey law. The New Jersey Superior Court held that the doctrine of equitable subrogation as substantive law had not been displaced by Article 9 of the U.C.C. as adopted in New Jersey.

The court in *Kaplan*, however, did not have before it a statute similar to TENN. CODE ANN. § 55-3-125 which renders a lien such as Eastman's invalid as to creditors and subsequent purchasers if it is not noted on the certificate of title. Compare TENN. CODE ANN. § 55-3-125 (1993) and N.J. STAT. § 39:10-11 (1993). In addition,

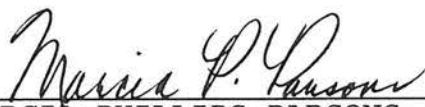
Kaplan has been criticized by one treatise writer as being wrongly decided in light of Section 9-301(1)(b) of the U.C.C. (TENN. CODE ANN. § 47-9-301(1)(b)) which subordinates an unperfected security interest to a receiver or bankruptcy trustee. See BARKLEY CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 2.16 (rev. ed. 1993). More recently, the Third Circuit Court of Appeals declined to apply *Kaplan* to a situation involving a priority contest between a trustee utilizing his "strong arm" powers as a hypothetical bona fide purchaser under 11 U.S.C. 544(a)(3) and a bank who failed to record a refinanced real estate mortgage. See *In re Bridge*, _____ F.3d _____, 1994 WL 58398 (3rd Cir. 1994). Accordingly, the court does not find *Kaplan* persuasive.

IV.

In light of the foregoing, the court declines to apply the doctrine of equitable subrogation to the facts of this case. The court will enter an order granting the Trustee's motion for summary judgment and denying Eastman's motion for summary judgment.

ENTER: May 5, 1994

BY THE COURT



MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE