

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:

Sheralyn Brown

Debtor(s).

James W. McRoberts, Chapter 13 Trustee

Plaintiff(s),

v.

Auto One Acceptance Corp.

Defendant(s).

In Proceedings  
Under Chapter 13

Case No. 95-31991

Adversary No. 95-3279

IN RE:

Jimmy & Karen Hadley

Debtor(s).

James W. McRoberts, Chapter 13 Trustee

Plaintiff(s),

v.

First of America Bank

Defendant/Third-Party Plaintiff,

v.

Karen Hadley

Third Party Defendant.

In Proceedings  
Under Chapter 13

Case No. 95-31828

Adversary No. 96-3031

IN RE:

Bill & Tracy Hooker

Debtor(s).

James W. McRoberts, Chapter 13 Trustee

Plaintiff (s) ,

v.

Avco Financial Service,

Defendant(s).

In Proceedings  
Under Chapter 13

Case No. 95-32413

Adversary No. 96-3029

### OPINION

The Chapter 13 cases under consideration present a common factual scenario. In each case, the debtor borrowed money prior to bankruptcy to purchase either an automobile or a mobile home and granted the creditor a security interest in the property. The creditor's lien, however, was never perfected. The debtor then filed for relief under Chapter 13 of the Bankruptcy Code.

The Chapter 13 plan submitted in each case specifically treats the creditor as a secured creditor, proposes to pay the creditor the value of its collateral plus interest at the rate of 9% per annum,<sup>1</sup> and provides no notice to the creditor that its lien might be challenged following confirmation. In addition, in each instance, the creditor filed a proof of claim prior to confirmation alleging a security interest in the debtor's vehicle. The Chapter 13 trustee did not object to the treatment of the creditor as secured until

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<sup>1</sup>The balance of the creditor's claim (i.e., the amount that exceeds the value of its collateral) is treated as unsecured.

after the plans were confirmed in each case. Following confirmation, the trustee brought an action under 11 U.S.C. §544(a)(1) to avoid the creditor's lien as an unperfected security interest.

The issue is whether a Chapter 13 trustee man, after confirmation, seek to avoid a creditor's lien under 11 U.S.C. §544 (a) (1) when the terms of the confirmed plan specifically treat the creditor as secured and provide no notice to the creditor that the lien might be challenged following confirmation.

Applicable Illinois law provides that an unperfected security interest in a motor vehicle is subordinate to a judgment lien such as that held by the trustee in bankruptcy pursuant to §544(a). United States v. Rotherham, 836 F. 2d 359, 364-65 (7th Cir. 1988); Matter of Keidel, 613 F. 2d 172, 173 (7th Cir. 1980). The Illinois Vehicle Code sets forth the requirements for perfection of a security interest in a motor vehicle<sup>2</sup> and provides that an unperfected security interest in a vehicle is not valid against subsequent transferees or lienholders of the vehicle. 625 ILCS 5/3-202 (a). The Uniform Commercial Code further provides that “an unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected.” 810 ILCS 5/9-301(l)(b).<sup>3</sup>

In these cases, the Chapter 13 trustee, as of the date of the filing of the bankruptcy petition, had the rights of a lien creditor with priority over the unperfected security interests of the defendant creditors.

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<sup>2</sup>The Vehicle Code provides that a security interest in a motor vehicle, including a mobile home, is perfected by

delivery to the Secretary of State of the existing certificate of title, if any, an application for a certificate of title containing the name and address of the lienholder and the required fee.

625 ILCS 5/3-202(b) (1993).

<sup>3</sup>“Lien creditor” is defined to include “a trustee in bankruptcy from the date of the filing of the petition. . . .” 810 ILCS 5/9-301(3).

In cases where the trustee's complaint to avoid lien was filed before confirmation of the Chapter 13 plan, this Court has previously held that the creditor's unperfected lien should be avoided pursuant to §544(a) and its claim treated as unsecured. See James W. McRoberts v. Transouth Financial (In re Bell), 194 B.R. 192 (Bankr. S.D. Ill. 1996). In the instant cases, however, the trustee waited until after confirmation of the plan to challenge the creditor's lien, despite his knowledge that the creditor was listed as secured in the Chapter 13 plan and that a proof of claim alleging a security interest had been filed. Such timing raises due process concerns.

An order confirming a plan of reorganization constitutes a judgment and a final adjudication on the merits of a bankruptcy proceeding. Stoll v. Gottlieb, 305 U.S. 165, 169-171 (1938); Laing v. Laing, 31 F. 3d 1050, 1051 (10th Cir. 1994); Kham & Nate's Shoes No. 2 Inc. v. First Bank of Whiting, 908 F. 2d 1351, 1354-55 (7th Cir. 1990). A fundamental due process requirement of notice exists in any proceeding which is accorded finality. Notice must be reasonably calculated to apprise interested parties and afford them an opportunity to present their objections. Mullane v. Central Hanover Bank & Trust, 339 U.S. 306, 314 (1950); In re Toth, 61 B.R. 160, 165 (Bankr. N.D. Ill. 1986) (citing Reliable Elec. Co., Inc., 726 F. 2d 620, 622 (10th Cir. 1984)). The notice must reasonably convey the required information, and it must afford interested parties a reasonable time to make their appearance. Mullane, 339 U.S. at 314. Even a creditor with knowledge of the bankruptcy proceeding has a right to assume that reasonable notice will be given before its claim is barred. Toth, 61 B.R. at 165. Section 1324 of the Bankruptcy Code attempts to satisfy this due process requirement by providing that “[a]fter notice, the court shall hold a hearing on confirmation of the plan. A party in interest may object to confirmation of the plan.” 11 U.S.C. §1324.

The Chapter 13 trustee argues that the Chapter 13 plans in these cases provided notice to the creditors that their secured status might be challenged following confirmation. The trustee relies on the following plan provision:

Payments to creditors will be made only if a claim is filed and allowed. The amounts stated are debtor's estimate of claims. The allowed claim amount will control . . . .

See Chapter 13 Form Plan.<sup>4</sup> This provision, the trustee contends, provides notice to creditors that the claims allowance procedure controls rather than the confirmed plan so that no due process concern arises.

While this plan provision may contain some aspect of notice, any notice it provides is buried within the provision and is not of such a nature as to reasonably convey to secured creditors that their secured status might later be challenged. This provision certainly does not provide notice to the creditors in a clear, straightforward manner. Therefore, it is not reasonably certain that the provision will inform secured creditors that their liens might be challenged following confirmation.

The following provision of the plan, moreover, provided specific notice to the creditors in these cases that they would be paid the value of their collateral plus interest:

From the payments received from the debtor(s), the Trustee shall make disbursements in the following priority and amounts:

. . .

G. Other Secured Claims:

. . .

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<sup>4</sup>This District has adopted a Chapter 13 plan form to be used by all Chapter 13 debtors. The confirmed plans at issue contain the above language. However debtor Brown and debtor Hadley have modified the first sentence cited above so that their plans read as follows: "Payments to creditors will be made only if a claim is filed and allowed except for current mortgage payments and current child support payments."

2. All other claims secured by collateral other than the debtor's residence shall be paid the value of their collateral with the balance treated as an unsecured claim. These secured claims shall be paid with interest at the rate of 9% per annum.

See Chapter 13 Form Plan. In each of the plans, the creditor's claim was provided for immediately below subsection (G)(2). While the subsection stated that creditors would be paid the value of their collateral plus interest, it provided no notice that the creditor's secured status might be challenged following confirmation.

Allowing the trustee to avoid the creditors, liens in the present cases, when the creditors had no previous notice that their secured status might be challenged following confirmation, would essentially deny the creditors the opportunity to be heard at the confirmation hearing in the capacity of a fully unsecured creditor. Lacking such notice, the creditors may have refrained from making objections to confirmation that an unsecured creditor might otherwise make.<sup>5</sup> The Court believes it is inequitable to lull a creditor into acceptance of a plan on the basis that the creditor will be treated as secured and then permit the trustee to challenge the secured status of the creditor's claim. Consequently, the Court finds that the Chapter 13 trustee is bound by the terms of a confirmed plan which specifically treats a creditor as secured, when neither the trustee nor the plan provides adequate notice to the creditor that the lien might be challenged following confirmation.

For the reasons stated in this opinion, the Court finds that judgment should enter in favor of the defendant creditors and against the Chapter 13 trustee in the trustee's lien avoidance actions under §544(a)(1). Because the trustee has failed to establish that requisite notice was given, the Court need not

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<sup>5</sup>For example, an unsecured creditor is more likely to make a “best efforts” objection when that creditor is faced with less than a 100% payment of its claim than a secured creditor who is paid 100% under the plan.

