

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

IN RE:

In Proceedings  
Under Chapter 7

JAMES & ANGELA LINSON

Case No. 03-42535

Debtor(s).

CYNTHIA A. HAGAN, TRUSTEE,

Plaintiff(s),

Adv. No. 04-4014

v.

CITY NATIONAL BANK

Defendant(s).

OPINION

The trustee in this case seeks to avoid the lien of City National Bank ("Bank") on the debtors' vehicle, alleging that the Bank's perfection of its lien following the debtors' bankruptcy constitutes a postpetition transfer avoidable under 11 U.S.C. § 549. The Bank responds that pursuant to Illinois statute, perfection of its lien "relates back" to the lien's creation prior to bankruptcy and thus may not be avoided under § 549. In addition, the Bank argues that because the instant transaction involves a refinancing of debtor Angela Linson's loan with another lender, the Bank's lien should be treated as perfected under either a subrogation theory or, alternatively, by application of the common law doctrine of earmarking.

The facts are undisputed except as noted below. On March 26,

2003, debtors James & Angela Linson entered into a security agreement with the Bank, wherein they refinanced a loan secured by debtor Angela Linson's 2002 Monte Carlo automobile. The Bank, on that date, issued a check in the amount of \$10,113.96 to the prior lienholder, Washington Mutual Finance ("Washington Mutual"). On March 27, 2003, Washington Mutual released its lien on the vehicle and sent the vehicle title to Angela Linson.

On October 21, 2003, the debtors filed their Chapter 7 case. Upon receiving notice of the debtors' bankruptcy filing, the Bank sent the vehicle title to the Illinois Secretary of State, along with an application for a new title. The title was received in the Secretary of State's office on November 12, 2003.

The parties disagree concerning when the Bank obtained the vehicle title from Angela Linson. The trustee asserts, based on the debtors' representation, that Angela Linson delivered the title to the Bank sometime after March 27, 2003, but before the petition date of October 21, 2003. The Bank, however, claims that Angela Linson delivered the title to the Bank via its drive-up window after the bankruptcy was filed.

Section 549 of the Bankruptcy Code provides that "the trustee may avoid a transfer of property of the estate . . . that occurs after the commencement of the case[.]" In this case, the Bank's lien on the debtors' vehicle was not perfected

until November 12, 2003, the date the title was delivered to the Secretary of State for purposes of having the Bank's lien noted on the vehicle title.<sup>1</sup> Under the Code, perfection of a creditor's lien constitutes a "transfer" of a debtor's interest in property. See In re Woodward, 234 B.R. 519, 525-26 (Bankr. N.D. Okla. 1999). Accordingly, the Bank's perfection of its lien following the debtor's petition date was a postpetition "transfer" within the meaning of § 549.

The Bank asserts that under § 3-202(b) of the Illinois Vehicle Code, perfection of its lien on the debtors' vehicle "related back" to the date of the lien's creation. The Bank maintains that, because its lien was "created" prior to bankruptcy, § 3-202(b) effectively renders the lien "perfected" prepetition, thus defeating the trustee's complaint.

Section 3-202(b), which provides for perfection of a security interest in a motor vehicle, states in pertinent part:

A security interest is perfected by the delivery to the Secretary of State of the existing certificate of title, if any, an application for a certificate of title . . . and the required fee. The security interest is perfected as of the time of its creation if the delivery . . . is completed within 21 days after the creation of the security interest or receipt by the new lienholder of the existing certificate of

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<sup>1</sup> This Court has previously held that, under Illinois law, perfection of a creditor's lien on a motor vehicle occurs only upon actual receipt by the Secretary of State of the required documents. See In re Jarvis, 242 B.R. 172, 177-78 (Bankr. S.D. Ill. 1999).

title from a prior lienholder . . . , otherwise as of the time of the delivery.

625 Ill. Comp. Stat. 5/3-202 (emphasis added).

The Bank cites no case, and the Court has found none, that applies the relation back provision of § 3-202(b) in a bankruptcy context to render a creditor's postpetition perfection of a vehicle lien valid notwithstanding § 549. However, in a similar case, the United States Supreme Court found that a creditor may not rely on a state law relation back provision to expand the time for perfecting a lien under § 547. See Fidelity Financial Services, Inc. v. Fink, 118 S. Ct. 651, 652-53 (1998). The Supreme Court in Fink stated that federal bankruptcy law, not state law, governs the time within which a creditor must perfect its lien and ruled that federal bankruptcy provisions may not be extended by compliance with a longer state law "relation back" provision. Id.; see also In re Jarvis, 242 B.R. 172, 174 (Bankr. S.D. Ill. 1999).

Although this case is brought pursuant to § 549 rather than § 547, the general principle of Fink is applicable here. Cf. Matter of Badger Lines, Inc., 140 F.3d 691, 697 (7th Cir. 1998).<sup>2</sup>

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<sup>2</sup> The Seventh Circuit Court of Appeals cited Fink in holding that state relation-back provisions do not apply in bankruptcy "to control a trustee's power to avoid preferences." Badger, at 697.

Under the reasoning of Fink, state law relation-back provisions cannot be used to defeat a bankruptcy trustee's power to avoid postpetition transfers. Accordingly, the Court finds the Bank's argument based on § 3-202(b) to be unpersuasive.

The Bank's further argument regarding the equitable doctrine of subrogation is likewise of no avail. In this Court's earlier decision of In re Pearce, 236 B.R. 261 (Bankr. S.D. Ill. 1999), the Court found subrogation to be inapplicable as a defense in a similar refinancing situation, where the refinancing creditor failed to timely perfect its lien in the debtors' collateral.<sup>3</sup> In this case, as in Pearce, there was no "agreement" by the debtors that the Bank would assume the perfected status of the original lender, Washington Mutual, so as become perfected under the equitable doctrine of subrogation. Rather, when the Bank paid the debtors' loan with Washington Mutual, the debtors granted the Bank a new security interest, which the Bank was obligated to perfect by having its lien noted on the title to the debtors' vehicle. As in Pearce, the perfecting of the

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<sup>3</sup> Subrogation is an equitable theory allowing one who pays a debt or claim for which another is primarily liable to "step into the shoes of," and exercise all the rights of, the creditor in question. In this way, one paying an obligation on another's behalf is substituted for, or subrogated to, the creditor and succeeds to the creditor's rights and remedies. Pearce, at 264.

Bank's lien was entirely the Bank's prerogative and also its responsibility. See Pearce, 236 B.R. at 265-266. Because Washington Mutual released its lien at the time of the Bank's payoff and the Bank subsequently failed to perfect its lien, the Bank's lien was unperfected on the date of the debtors' bankruptcy filing. On these facts, the Court adopts the reasoning of Pearce and finds the doctrine of subrogation to be inapplicable.

The Bank argues finally that the trustee's action must fail because, under the doctrine of earmarking, no "transfer" of the debtors' property occurred as required for avoidance under § 549. The Bank bases this argument on its assertion that the debtors never exercised control of the funds sent to Washington Mutual as a "payoff" of the debtors' loan. The Court previously considered a similar argument in In re Messamore, 250 B.R. 913 (Bankr. S.D. Ill. 2000), in which the refinancing creditor argued that there had been no transfer of property of the estate, and thus no diminution of the fund out of which creditors were to be paid, because the funds transferred were "earmarked" for the prior lender and did not become part of the debtors' estate. However, as explained in Messamore, the transfer in question is not the transfer of funds to the debtors' original creditor but the transfer that occurred when

the new creditor, the Bank in this instance, perfected its lien on the debtors' vehicle subsequent to the debtors' bankruptcy filing. Thus, the Bank has incorrectly invoked the doctrine of earmarking as a defense for its tardy perfection of its lien on the debtors' vehicle.

For the reasons stated, the Court finds that relief should be granted as requested in the trustee's complaint. Accordingly, the the Bank's lien on the debtors' vehicle will be avoided as a postpetition transfer prohibited under 11 U.S.C. § 549.

SEE WRITTEN ORDER.

ENTERED: June 14, 2004

/s/ Kenneth J. Meyers  
UNITED STATES BANKRUPTCY JUDGE