In the United States Bankruptcy Court

for the Northern District of Iowa

PAUL JERDEE and MONICA JERDEE	Bankruptcy No. 99-00176
Debtor(s).	Chapter 7
SHERYL YOUNGBLUT Trustee	Adversary No. 99-9117-C
Plaintiff(s)	
vs.	
UNION BANK & TRUST CO.	
Defendant(s)	

ORDER

This matter came before the undersigned on November 12, 1999 for oral argument. Attorney Eric Lam represented Plaintiff Sheryl Youngblut ("Trustee"). Attorney Daniel Swift represented Defendant Union Bank & Trust (the "Bank"). After argument, the Court took the matter under advisement. The matter is now ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157 (b)(2)(K).

STATEMENT OF THE CASE

Debtors own a 1990 Chevrolet Suburban (the "Truck"). The Bank claims a security interest in the Truck and is listed on the title as holding a first security interest. Trustee asserts that, in the absence of a written security agreement, the Bank's security interest in the Truck never attached.

FINDINGS OF FACT

The facts of this case are undisputed. On October 24, 1997, Debtors borrowed $100,000 from the Bank. As security for this loan, Debtors pledged, inter alia, a 1994 Chevrolet C 1500. Sometime in November 1998, Debtors approached the Bank about releasing its lien on the 1994 Chevrolet so that they could trade the vehicle. The Bank agreed and on November 7, 1998, Debtors used the proceeds from the sale of their Chevrolet C 1500 to purchase the Truck.

Debtors promised to execute a formal security agreement granting the Bank a security interest in the Truck. On November 7, 1998, Debtors signed an application for title on which they listed the Bank as having a first security interest. The State of Iowa subsequently issued a title to the Truck listing the Bank as holding a first security interest. Debtors never executed the formal security agreement the Bank gave them. Debtors filed for relief under Chapter 7 of the Bankruptcy Code on January 29, 1999.

CONCLUSIONS OF LAW

Trustee requests a determination of the Bank's interest in the Truck. The Bank asserts that it holds an "allowed secured claim" to the extent of the value of the Truck. To hold an "allowed secured claim," a creditor must have a valid and enforceable interest in property of the debtor's estate. 11 U.S.C. §506 (a); In re Martin, 233 B.R. 436, 444 (Bankr. D. Ariz. 1999) (failure to have a valid and recorded interest in debtor's property prevents creditor from holding "allowed secured claim"). State law determines the existence and extent of a creditor's interest in property of the estate. Butner v. United States, 440 U.S. 48, 55 (1979); In re Hilyard Drilling Co., 840 F.2d 596, 599 n.4 (8th Cir. 1988).

Under Iowa law, a nonpossessory security interest is only enforceable against the debtor and third parties if: 1) the debtor has "signed a security agreement which contains a description of the collateral"; 2) value has been given; and 3) the debtor has rights in the collateral. Iowa Code §554.9203 (1999). The latter two elements are satisfied in this case. The only issue is whether there is a signed security agreement describing the Truck as collateral. The Bank contends that Debtors' application for title and the title itself constitute a written security agreement. The Trustee asserts that a separate security agreement is required.

There are four basic requirements to establish a security agreement under Iowa law: 1) a writing; 2) manifesting an intent to create or provide for a security interest; 3) signed by the debtor; and 4) containing a description of the collateral. F.S. Credit Corp. v. Shear Elevator, Inc., 377 N.W.2d 227, 231 (Iowa 1985); Blessing v. Norwest Bank Marion, 429 N.W.2d 142, 144 (Iowa 1988) (Iowa does not recognize oral security agreements). The only writings before the Court are Debtors' application for title, which Debtors signed, and the title certificate for the Truck. The issue is whether these writings together manifest Debtors' intent to create a security interest in the Truck in favor of the Bank.

The Court must make a two-step inquiry to determine if a debtor intended to grant a security interest. First, it must determine whether the language in the writing objectively establishes that the parties intended to create a security interest. In re Bossingham, 49 B.R. 345, 349-50 (S.D. Iowa 1985), aff'd, 794 F.2d 681 (8th Cir. 1986). If the answer is in the affirmative, the Court must then determine if the evidence establishes that the debtors subjectively intended to grant a security interest. Id. If the writing satisfies this two-step inquiry, no specific words of grant are necessary. Id. A financing statement may satisfy the objective portion of the test if it contains language sufficient to indicate that the debtor intended to grant a security interest. Kaiser Aluminum & Chem. Sales, Inc. v. Hurst, 176 N.W.2d 166, 168 (Iowa 1970). A typical financing statement, however, does not meet this standard. Id.

Iowa courts have not decided whether an application for notation of a security interest in a motor vehicle, signed by the debtor, is sufficient to constitute a written security agreement. The Iowa Supreme Court has stated that an application for notation on a title is necessary to establish a security interest in a vehicle. Blessing, 429 N.W.2d at 145. The court did not indicate, however, whether an application for notation alone is sufficient to constitute a written security agreement.

Courts that have addressed the issue are divided. CompareRoan v. Murray, 556 N.W.2d 893, 896 (Mich. Ct. App. 1996) (title application noting security interest constitutes written security agreement); Kreiger v. Hartig, 527 P.2d 483, 485 (Wash. Ct. App. 1974) (oral agreement together with signed application for title noting security interest constitute written security agreement); Baystate Drywall, Inc. v. Chicopee Savs. Bank, 429 N.E.2d 1138, 1142 (Mass. 1982) (title noting security interest together with security agreement that debtor did not sign satisfied "written security

agreement" requirement); In re McCormick, 24 B.R. 718, 720 (Bankr. E.D. Mich. 1982) (signed title application and title noting security interest constitute written security agreement); with Shelton v. Erwin, 472 F.2d 1118, 1120 (8th Cir. 1973) (under Missouri law, a bill of sale and title application do not constitute a written security agreement); In re Wolsky, 68 B.R. 526, 529 (Bankr. D.N.D. 1986) (application for title not a written security agreement).

States that require specific words of grant to create a security interest have consistently found that a title application alone does not constitute a written security agreement. See, e.g., Shelton, 472 F.2d at 1120 (Missouri law requires specific language of grant; therefore, title application is insufficient to create a security interest); Wolsky, 68 B.R. at 529-30 (North Dakota law requires specific words of grant, which prevents a title application from creating a security interest); In re Newman, 3 U.C.C. Rep. Serv. 2d 1143, 1144 (Bankr. D. Kan. 1987) (notation on title ineffectual because Kansas requires specific words of grant). States that do not require specific words of grant to create a security agreement have consistently found that a title application and subsequent notation on a title can constitute a written security agreement. McCormick, 24 B.R. at 720 (Michigan does not require specific words of grant to create a security interest; consequently, application for title together with title that subsequently issued are sufficient to satisfy "written security agreement" requirement); Baystate, 429 N.E.2d at 1141 (because the court can look to many documents to determine intent of parties, application for title can satisfy "written security agreement" requirement); Kreiger, 527 P.2d at 485-86 (same).

Iowa does not require specific words of grant if the language of the writing is sufficient to determine both an objective and a subjective intent to create a security interest. Kaiser, 176 N.W.2d at 168; Bossingham, 49 B.R. at 350. Moreover, the Iowa Supreme Court has indicated that a financing statement may constitute a written security agreement if it contains language indicating an intent to grant a security agreement. Kaiser, 176 N.W.2d at 168. With regard to motor vehicles, notation on the title of the vehicle takes the place of a financing statement as a method of perfection. Iowa Code §§321.50(1), 554.9302(3)(b), 554.9304; Blessing, 429 N.W.2d at 145.

Iowa courts do not require specific words of grant. The Iowa Supreme Court has indicated that documents of perfection may constitute a "written security agreement." Therefore, the Court looks to Debtors' application for title and the title itself to determine if a written security agreement exists.

Do the Title and Title Application Show an Objective Intent to Create a Security Interest?

A writing satisfies the "objective intent" requirement if it indicates the possibility of an agreement. Bossingham, 49 B.R. at 349 (financing statement and handwritten note referencing the underlying debt satisfy the "objective intent" test); 4 James White & Robert Summers, Uniform Commercial Code §31-3(a), at 101 (4th ed. 1994). Debtors signed an "Application for Certificate of Title And/Or Registration For a Vehicle." (Ex. 3.) The application asks for a "complete statement of security interests." Debtors listed the Bank as holding a "First Security Interest." (Ex. 3.) The title itself also lists the Bank as holding a first security interest. The language of these documents indicates the possibility of a security agreement, and therefore satisfies the "objective intent" requirement.

Is There Sufficient Evidence of a Subjective Intent to Grant a Security Interest?

Once a creditor establishes the possibility of a security agreement, it must establish that the parties in fact intended such an agreement. Bossingham, 49 B.R. at 350 ("subjective intent" test satisfied where

court previously found that the parties actually intended to create a security interest). Other courts have found the "subjective intent" test satisfied when the creditor introduced writings by the debtor referencing the security interest. Id.; In re Owensboro Canning Co., 82 B.R. 450, 455 (W.D. Ky. 1988) (letter referencing prior creation of security agreement satisfies "subjective intent" requirement).

The parties agree that Debtors "promised to pledge the Suburban and execute the necessary documents." (Fact Stip. ¶ 9.) After this promise, Debtors signed a title application acknowledging that the Bank in fact held a first security interest in the Truck. Debtors' written acknowledgment of the security interest, together with the stipulation of the parties, is sufficient to factually establish that Debtors subjectively intended to grant a security interest to the Bank.

The title application and title certificate satisfy the "written security agreement" requirement of Iowa Code sec.554.9203. Pursuant to the foregoing, the Court looks to the application and the title itself to determine Debtors' intent. These documents taken together establish that Debtors objectively intended to grant the Bank a security interest in the Truck. Together with the stipulations of the parties, these documents also establish that Debtors subjectively intended to grant the Bank a security interest in the Truck. There being no dispute between the parties that the Bank properly perfected this security interest, the Bank has a valid and enforceable security interest under Iowa Code sec. 554.9203.

The Truck as Proceeds of Previous Collateral

Even if Debtors' title application and title certificate do not constitute a security agreement, the Bank has a valid and enforceable security interest in the Truck as proceeds of previous collateral. Section 554.9306(2) of the Iowa Code provides:

> Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

The Trustee argues that the Bank waived its interest in proceeds by authorizing the disposition of its original collateral. This argument, however, confuses the continuation of a security interest in the collateral itself with the continuation of a security interest in the proceeds from the sale of the collateral. A security interest in the original collateral is unenforceable against third parties if the secured party authorizes the sale of the collateral. Ottumwa Prod. Credit Assoc. v. Keoco Auction Co., 347 N.W.2d 393, 397 (Iowa 1984); Humboldt Trust & Savs. Bank v. Entler, 349 N.W.2d 778, 782-83 (Iowa App. 1984); Ottumwa Prod. Credit Ass'n v. Heinhold Hog Mkt., 340 N.W.2d 801, 802 (Iowa App. 1983). The secured party does not reacquire an interest in the original collateral because the debtor later fails to remit proceeds of the sale as promised. Heinhold, 340 N.W.2d at 803; Humboldt Trust, 349 N.W.2d at 782.

The issue here, however, is not whether the Bank has a security interest in the collateral Debtors sold. Instead, the issue is whether the Bank has an enforceable security interest in the proceeds from that sale, i.e., the Truck. Section 554.9306(2) separates a secured party's interest in the original collateral and its interest in the proceeds thereof. This section provides that a "security interest continues in collateral notwithstanding sale ... unless the disposition was authorized by the secured party ... and also continues in any identifiable proceeds." Iowa Code §554.9306(2) (emphasis added). The use of the phrase "and also" indicates that the drafters intended to grant a secured party two rights: 1) the continuation of its security interest in the collateral sold, which is conditioned on a lack of approval

by the secured party; and 2) an additional interest in identifiable proceeds, which is unconditional. See, e.g., In re Kerner Printing Co., 178 B.R. 363, 367 (Bankr. S.D.N.Y. 1995) (although creditor's consent to sale releases lien on original collateral, the creditor retains a security interest in proceeds). The statute, therefore, contemplates that a secured party's interest in proceeds will continue even if it authorizes the sale of the original collateral.

The comments to sec.554.9306 support this conclusion by stating that the drafters intended to continue the prior rule that the secured party has a claim to proceeds "[w]hether a debtor's sale of collateral was authorized or unauthorized." Iowa Code §554.9306 cmt. 2(a). Even so, there is a lack of uniformity over this issue. Compare In re Quaal, 40 B.R. 619, 621 (Bankr. D. Minn. 1984) (authorization to sell milk that secured party held as collateral waived secured party's interest in proceeds therefrom); with In re Hollie, 42 B.R. 111, 120 (Bankr. M.D. Ga. 1984) (authorization to sell milk, although waiving security interest in the milk, does not waive the secured party's interest in proceeds). At least one treatise argues that the better view is that authorization to sell, although waiving the secured party's rights in the original collateral, does not affect the secured party's rights in the proceeds from that sale. 4 James White & Robert Summers, Uniform Commercial Code §31-11, at 151 (4th ed. 1994).

Iowa law strikes a middle ground. As the Trustee correctly points out, the Iowa Supreme Court has observed that a secured party may lose its rights in proceeds if it authorizes the sale of the original collateral. C& H Farm Serv. v. Farmers Savs. Bank, 449 N.W.2d 866, 875 (Iowa 1989). The Iowa Supreme Court, however, has recognized that in certain cases, a secured party authorizing the sale of collateral retains an interest in the proceeds. Humboldt Trust, 349 N.W.2d at 782. Specifically, Iowa courts recognize and enforce a secured party's rights in proceeds against the debtor and against third parties who have knowledge of such rights. Wilkin Elevator v. Bennet State Bank, 522 N.W.2d 57, 62-3 (Iowa 1994) (secured party retained interest in proceeds from sale of collateral when contest was between secured party, debtor, and third party who had no interest in the proceeds); Humboldt Trust, 349 N.W.2d at 783 (secured party retained security interest in proceeds in debtor's possession); In re Holtz, 62 B.R. 782, 785 (Bankr. N.D. Iowa 1986) (secured party who authorized sale of original collateral retained an interest in proceeds that was enforceable against debtor); C&H Farm Serv., 449 N.W.2d at 875 (although authorization of sale usually waives rights in proceeds, secured party retains rights in proceeds as against third party who has knowledge of those rights); United States v. Security State Bank, 686 F. Supp. 733, 736 (N.D. Iowa 1988) (secured party retained interest in proceeds as against third party who acted as clerk at sale of collateral, despite secured party's authorization of the sale).

The Bank properly perfected its interest in the Truck. See Iowa Code §321.50. Perfection generally serves as constructive notice to third parties. First State Bank v. Shirley Ag. Serv., Inc., 417 N.W.2d 448, 451-2 (Iowa 1987) (purpose of financing statement is to put other creditors on constructive notice that a security interest may exist). The bankruptcy trustee is charged with this constructive notice. 11 U.S.C. §544(a); In re Paramount Int'l, Inc., 154 B.R. 712, 714 (Bankr. N.D. Ill. 1993) (bankruptcy trustee charged with knowledge of documents of public record). The bankruptcy trustee, however, is not charged with any actual knowledge of the Bank's interest. See id.; In re Double J Cattle Co., 203 B.R. 484, 487 (D. Wyo. 1995). The Iowa courts have not determined whether a secured party's interest in proceeds is enforceable against a third party with constructive, but not actual, knowledge of the interest.

Iowa law jealously protects its system for perfection of interests in motor vehicles. An owner noted on an authentic title prevails over an innocent purchaser who relies on a fraudulent title. Vannoy Chevrolet Co. v. Baum, 151 N.W.2d 515, 517 (Iowa 1967). In addition, a third party is absolutely

barred from asserting an interest in a vehicle unless the third party's interest is noted on the certificate of title. Schultz v. Security Nat'l Bank, 583 N.W.2d 886, 889 (Iowa 1998); Blessing, 429 N.W.2d at 144-45.

The importance Iowa gives to the constructive notice a title notation provides and the language of sec.554.9306(2) lead the Court to conclude that a secured party with a properly perfected interest in a motor vehicle that is proceeds prevails over a third party with constructive notice of the secured party's interest. Therefore, the Bank has a valid and enforceable security interest in the Truck as proceeds that is superior to the interest of the Trustee.

CONCLUSION

Debtors' signed application for a certificate of title together with the subsequently issued title certificate constitute a written security agreement. The parties do not dispute that the Bank properly perfected its security interest in the Truck. The Bank's security interest in the Truck is therefore valid and enforceable.

The Bank also has an interest in the Truck as proceeds from the sale of collateral. This interest is enforceable against the Trustee because of the constructive notice the Bank's perfection provides.

WHEREFORE, for all the reasons set forth herein, the Court determines the Bank's rights in the Truck are superior to the rights of the Trustee.

SO ORDERED this 30th day of November, 1999.

Paul J. Kilburg
Chief Bankruptcy Judge