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

In the Matter of: Case No. 02-02489-lmj7

STEPHEN E. SEYE,
SHERYAL L. SEYE,

Debtors

MEMORANDUM OF DECISION
(date entered on docket: April 4, 2006)

Creditor Poweshiek County Savings Bank ("Bank") seeks relief from that portion of this Court's December 4, 2002 order that held Chapter 7 Debtors Stephen and Sheryal Seye ("Debtors") could avoid the Bank's lien on their exempt tools of the trade. The Bank contends it has a purchase-money security interest in that collateral. Debtors disagree. Having reviewed the record of the December 3, 2002 evidentiary hearing in light of the arguments made in support of and in opposition to the pending motion, the Court now enters its decision in favor of the Bank.

The Court has jurisdiction of this matter pursuant to 28 U.S.C. section 1334 and the standing order of reference entered by the United States District Court for the Southern District of Iowa. This is a core matter under 28 U.S.C. section 157(b)(2)(K).

BACKGROUND

I. Procedural Background.

On May 9, 2002 Debtors filed a petition for relief under Chapter 13 of Title 11 of the United States Code. On August 28, 2002 the Bank filed Proof of Claim Number 10 in the amount of $150,828.22 as of the petition date. The claim was based on the following four secured loans: (1) Loan Number 627-28619, a Small Business

Administration guaranty note for $65,000.00, dated October 6, 1997 and having a balance of $51,759.79; (2) Loan Number 45-22140, a business consolidation note for $76,892.25, dated June 8, 2001 and having a balance of $72,506.47; (3) Loan Number 41-22383, a consumer note for $25,000.00, dated October 12, 2001 and having a balance of $22,353.15; and (4) Loan Number 66-22393, a commercial note for $10,000.00, dated October 22, 2001 and having a balance of $4,208.81. Equipment, among other items of collateral, secured the three commercial notes.

On October 7, 2002 the Bank filed a motion for relief from the automatic stay with respect to three vehicles and personal property that Debtors used in their decorating business. After Debtors filed an objection to the motion on October 17, 2002, the Court scheduled the contested matter for a preliminary hearing by phone on November 4, 2002. In the interim Debtors filed a motion to convert their case to one under Chapter 7 and the Court granted that motion on October 30, 2002. During the preliminary hearing on the Bank's motion, Debtors' attorney represented Debtors would be amending Schedule C (Property Claimed as Exempt) to claim vehicles and tools of the trade exempt and would be filing a motion to avoid the Bank's lien on those tools of the trade.

Prior to the December 3, 2002 evidentiary hearing on the contested matter, Debtors did amend Schedule C to claim $3,171.00 worth of tools of the trade exempt pursuant to Iowa Code section 627.6(10) but did not file a motion to avoid the Bank's lien on those tools. At the outset of the hearing, Debtors' attorney indicated Debtors still intended to file the motion and understood the Bank would argue it had a purchase-money security interest in the collateral. After verifying that the Bank would resist any motion to avoid the lien on the theory its security interest was a purchase-money

security interest and that the Bank believed the documentation already submitted for the hearing on the stay matter would support that theory, the Court directed the parties to address the lien avoidance matter as part of the hearing on the motion for relief from stay.

At the conclusion of the evidence, the Court took an hour recess to consider Bank's Exhibits A through J, Debtors' Exhibits 1 and 2, and the testimony of Jack Arendt, President and CEO of the Bank, and of Debtor Stephen Seye. The Court then returned to the bench to enter findings of fact and conclusions of law into the record. With respect to the motion to avoid lien, the Court applied Iowa Code section 554.9107 (1999) and her recollection of controlling case law and concluded the Bank did not have a purchase money security interest in the tools of the trade.[1] Accordingly, the Court held that Debtors could avoid the Bank's lien on that collateral but, due to the circumstances of the day's proceeding, gave the Bank's attorney ten days to locate controlling authority to the contrary and to file a motion seeking relief from the ruling on lien avoidance. The Court entered an order to that effect the next day.

On December 16, 2002 the Bank filed the pending motion for relief from order to which Debtors filed an objection on January 6, 2003.[2] The Bank filed a reply on January 24, 2003. After conducting a telephonic hearing on March 4, 2003 to clarify the status of the underlying record, the Court directed the Clerk of Court to order a transcript of the December 3, 2002 hearing and took the matter under advisement.

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[1] Transcription errors appear on pages 86 and 87 of the transcript of the December 3, 2002 hearing. On page 86, "letter of recipe" in line 8 should read "letter briefs," "position for relief" in line 11 should read "motion for relief," and "term is a defined" in line 18 should read "term is not defined." On page 87, "have support a finding of purchased money security " in line 8 should read "not support a finding of purchase-money security."

[2] The motion was timely filed. December 14, 2002 was a Saturday. The deadline became December 16, 2002 by operation of Rule 9006(a) of the Federal Rules of Bankruptcy Procedure.

II. Factual Background.

As reflected by Exhibit B, an unsigned and undated real estate contract form with two attachments consisting of additional terms and a listing of furniture, fixtures and supplies, Debtors entered into a contract to purchase a business known as “Carpet Corner” from Dennis and Ruth Solem for $65,000.00. The anticipated closing date was September 1, 1997. The contract terms required Debtors to make a $6,500.00 down payment and to pay $58,500.00 upon taking possession of the business. The purchase price included real estate valued at $30,000.00, inventory valued at $15,000.00, and furniture, fixtures and equipment valued at $20,000.00.

As reflected by Exhibit A that contains the proof of claim form the Bank filed when this case was pending under Chapter 13 and various loan documents, Debtors relied on the Bank for financing the purchase of Carpet Corner. According to the U.S. Small Business Administration Low Documentation Loan Program Authorization and Loan Agreement (Guaranty Loans) found at pages 13 through 18 of Exhibit A, the Bank made a request of the Small Business Administration (“SBA”) on August 4, 1997 to guarantee 80% of a $65,000.00 loan the Bank would be making to Debtors doing business as Seye Floor Covering. The agreement indicated Debtors would use most of the loan proceeds to purchase Carpet Corner and any balance as working capital. Collateral would consist of real estate, machinery, equipment, furniture, fixtures, inventory, accounts receivable, automotive equipment, general intangibles and contract rights and would extend to after-acquired personal property including proceeds.

On September 8, 1997 Debtors executed a promissory note and security agreement found at pages 9 and 22 through 23 of Exhibit A, respectively. The

documents indicate the Bank provided Debtors a $12,000.00 line of credit in a lump sum advance on September 10, 1997 and took a security interest in inventory, equipment, accounts, instruments, documents, chattel paper and other rights to payment, and general intangibles that Debtors doing business as Seye Home Decorating owned at the time and might own in the future.[3]

Debtors did not execute the SBA note for $65,000.00 and the business security agreement, found at pages 10 through 12 and 24 through 25 of Exhibit A, respectively, until October 6, 1997. Attached to the Bank's January 24, 2003 reply to Debtors' objection to the pending motion is a letter dated September 12, 1997 that the Bank sent the SBA requesting interim financing for Debtors' purchase of Carpet Corner. In that letter, the Bank attributed the delay in processing the loan to a missing Internal Revenue Service form. In an acknowledgement stamped on that letter the same day, the SBA indicated its guaranty would extend to the interim financing only if the loan closed in accordance with the terms and conditions set forth in the authorization and loan agreement. It noted that the acknowledgement of interim financing would expire three months from September 12, 1997. Also attached to the Bank's reply is a title opinion dated August 1, 2001. The author certified the existence of marketable title to the commercial real estate in Debtors by virtue of a warranty deed dated September 30, 1997 and recorded October 20, 1997.

DISCUSSION

Debtors may avoid the fixing of the Bank's lien in their exempt tools of the trade if that lien is a nonpossessory, nonpurchase-money security interest. 11 U.S.C. §

[3] Apparently Debtors ceased using the name "Seye Floor Covering" upon the purchase of Carpet Corner.

522(f)(1)(B).[4] Regarding the burden of proof, the general maxim is that debtors must establish the elements essential to lien avoidance by a preponderance of the evidence. Schoonover v. Karr, 285 B.R. 695, 700 (S.D. Ill 2002), *aff'd*, 331 F.3d 575 (7th Cir. 2003); In re Soost, 262 B.R. 68, 74 (B.A.P. 8th Cir. 2001).

The Bank does not argue Debtors' amended claim of exemption in tools of the trade is not proper but contends Debtors cannot avoid the purchase-money security interest it holds in all of that equipment. Debtors maintain that the Bank does not hold a purchase-money security interest in any of the equipment. Resolution of the pending motion requires application of Article 9 of the Uniform Commercial Code as adopted by the Iowa legislature.

I. Applicable State Law.

The Bank relies on sections 554.9103(1) (definitions of "purchase-money collateral" and "purchase-money obligation"), 554.9103(2) (purchase-money security interest in goods), and 554.9103(6) (no loss of status of purchase-money security interest in nonconsumer-goods transaction) in support of its contention that it holds a purchase-money security interest in Debtors' tools of the trade. Debtors contend those statutory provisions do not apply in this case because all the transactions in issue took place before July 1, 2001, the effective date of Iowa Code section 554.9103. Citing Iowa Code section 4.5 that provides "[a] statute is presumed to be prospective in its

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[4] 11 U.S.C. section 522(f) provides in relevant part:

> (f)(1) Notwithstanding any waiver of exemptions but subject to paragraph (3), the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—
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> (B) a nonpossessory, nonpurchase-money security interest in any—
>
> (ii) implements, professional books, or tools of the trade of the debtor or the trade of a dependant of the debtor...

11 U.S.C. section 522(f)(1)(B)(ii).

operation unless expressly made retrospective," Debtors reason that Iowa Code section 554.9107 (1999) of former Article 9 and not Iowa Code section 554.9103 of revised Article 9 applies in this case because the Iowa legislature did not expressly make the revised section retrospective.

Iowa Code section 554.9701 (2001) does provide that "[t]he amendments to this Article as enacted in 2000 Iowa Acts, chapter 1149, take effect on July 1, 2001, and are applicable on and after that date." Nevertheless, as the Bank points out, Iowa Code section 554.9702 (2001) (savings clause) is dispositive of legislative intent. Relevant here, paragraph 1 (pre-effective-date transactions or liens) states that "[e]xcept as otherwise provided in this part, this Act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before July 1, 2001" and paragraph 3 (pre-effective-date proceedings) adds that "[t]his Act does not affect an action, case, or proceeding commenced before July 1, 2001." Iowa Code § 554.9702(1) and (3) (2001).

The Iowa legislature expressly made Iowa Code section 554.9103 (2001) applicable to pre-effective-date transactions and liens like those in this case. Debtors filed their petition on May 9, 2002, making this a post-effective-date case. Accordingly, the Court must apply Iowa Code section 554.9103 (2001), and that includes Iowa Code section 554.9103(7) (burden of proof in nonconsumer-goods transaction) that provides "[i]n a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest."[5]

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[5] The Court did not locate any decision addressing this burden of proof in an 11 U.S.C. section 522(f)(1)(B) context. It is this Court's conclusion that the Bank bears the burden of establishing it has a

II. Creation of Purchase-Money Security Interest in Tools of the Trade.

In Iowa Code section 554.9103(1)(b), the Iowa legislature defines a "purchase-money obligation" as "an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." In Iowa Code section 554.9103(1)(a), it defines "purchase-money collateral" as "goods or software that secures a purchase-money obligation incurred with respect to that collateral." In Iowa Code section 554.9103(2)(a), it indicates "[a] security interest in goods is a purchase-money security interest" in those goods "to the extent that the goods are purchase-money collateral with respect to that security interest."

In support of its contention that it gave Debtors funds that enabled them to acquire rights and title in Carpet Corner equipment, the Bank relies on the portions of Exhibit A that pertain to the $12,000.00 line of credit note and to the SBA guaranty loan and also on the related testimony of Mr. Arendt and Mr. Seye. Accordingly, the Bank reasons that the funds constitute a purchase-money obligation, the purchased equipment constitutes purchase-money collateral and the Bank's interest in that collateral is a purchase-money security interest.

Apparently relying on a September 12, 1997 mortgage that secured credit in the amount of $58,500.00 and that was attached to the Bank's December 13, 2002 motion for relief from stay with respect to real property, Debtors contend the value the Bank gave them enabled them to purchase the business real estate but not any of the business equipment. They also state the $12,000.00 line of credit they received in a

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purchase-money security interest under applicable state law but Debtors bear both an initial burden of proof and the ultimate burden of persuasion under 11 U.S.C. section 522(f)(1)(B).

lump sum from the Bank on September 10, 1997 did not enable them to purchase any of the equipment. Next, apparently relying on the October 6, 1997 mortgage that secured the SBA guaranty loan in the amount of $65,000.00 and that was attached to the same motion for relief from stay, Debtors maintain that execution of the October 6, 1997 SBA guaranty loan paid off any prior loan the Bank had made for the purchase of Carpet Corner and, in turn, extinguished any mortgage or other lien of the Bank.

Though the testimony and the exhibits offered at the hearing are less than crystal clear regarding the interim financing in September 1997 and may be responsible for a few of the confusing statements in the written arguments, the Court nevertheless finds that the record establishes that the Bank had a purchase-money security interest in the equipment Debtors obtained as a result of their purchase of the Solems' business. The documentation regarding the SBA guaranty loan leaves little doubt that the parties intended the $65,000.00 loan to enable Debtors to acquire essentially all the assets of Carpet Corner. The SBA guaranty loan process began in early August 1997 and concluded in early October 1997. That process encompassed the interim financing transaction or transactions that took place in September 1997.[6]

Furthermore, as revealed by the following exchange between Mr. Seye and his attorney on direct examination, Mr. Seye's testimony regarding the SBA guaranty loan is in contention with Debtors' arguments in opposition to the pending motion:

Q: I next want to ask you – At the time that you took out a loan for $65,000 to buy the business, was there any mention or effort to separate out the equipment loan?

A: No, there wasn't.

[6] The Court has not been able to locate a copy of any promissory note related to the September 12, 1997 mortgage in the exhibits admitted into evidence or in the contents of the Chapter 7 case file.

Q: Or to make that sort of what they would call a purchase money loan?

A: It was all lumped in one sum.

Q: So the equipment was in with the inventory, was in with the blue sky that you paid for, was in with the real estate you paid for?

A: Everything was in one lump sum.

Q: And when you made one payment, it went for everything?

A: Everything.

(Tr. at 42, ll. 13-25, and at 43, ll. 1-2.)

In sum, the interim financing transaction that permitted Debtors to complete the purchase of Carpet Corner is closely aligned to the completion of the SBA guaranty loan transaction and together the transactions in essence formed a single financing arrangement. See generally GE Capital Commer. Auto. Fin., Inc. v. Spartan Motors, Ltd., 246 A.D.2d 41, 47-48 (N.Y. App. Div. 1998) (finding literal requirements of former similar statute were satisfied notwithstanding an inverted purchase-loan chronology); Matter of Hooks, 40 B.R. 715, 720-21 (Bankr. M.D. Ga. 1984) (finding that transaction requiring two steps should not be fatal as long as both steps were contemplated as part of a single financing arrangement).

III. Continuation of Purchase-Money Security Interest Status.

Debtors also argue that the June 8, 2001 business consolidation loan refinanced the SBA guaranty loan and therefore changed the Bank's purchase-money security interest into a nonpurchase-money security interest.[7] The Bank asserts Debtors'

[7] Debtors advanced a similar argument regarding the September 1997 note(s) and the SBA guaranty loan.

argument is factually irrelevant because the loan was not refinanced and is legally unsound because Iowa Code section 554.9103(6) (2001) provides:

> 6. *No loss of status of purchase-money security interest in nonconsumer-goods transaction.* In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:
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> *a.* the purchase-money collateral also secures an obligation that is not a purchase-money obligation;
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> *b.* collateral that is not purchase-money collateral also secures the purchase-money obligation; or
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> *c.* the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

Iowa Code section 554.9103(6).

Having found the 2001 law is applicable in this case, the Court need not address whether the consolidation loan amounted to a novation that would have extinguished the purchase-money security interest under the former law. The Bank's legal argument is sound.

IV. Purchase-Money Security Interest in After-Acquired Tools of the Trade.

The Bank's loan documents encompass property acquired upon the sale, exchange or other disposition of its collateral and property acquired as a result of future advances. The Bank's security interest in such property retains a purchase-money security status. Citizens Savings Bank v. Miller, 515 N.W.2d 7 (Iowa 1994); Farmers Cooperative Elevator Co. v. Union State Bank, 409 N.W.2d 178 (Iowa 1987). The Bank relies on its loan documents and the cited case law in support of its argument that its purchase-money security interest extends to any equipment Debtors acquired after the purchase of Carpet Corner.

In their written objection to the pending motion, Debtors contend the record does not support a finding that additional purchases came from any sale, exchange or other disposition of any original equipment or from any advances from the Bank. Instead Debtors maintain Mr. Seye's testimony was to the contrary. The record, however, does not support Debtors' burden. That is, Mr. Seye testified that most of the equipment still in use was the same equipment Debtors received upon purchasing Carpet Corner. (Tr. at 41, ll. 20-25.) He did state they bought some equipment later, like display racks that were changed and updated anywhere from every three months to a year. (Tr. at 43, ll. 3-25.) Debtors, however, offered no testimony or evidence identifying the funds they used for subsequent purchases of equipment.

Mr. Arendt testified that it was his belief the Bank was the only financing source for Debtors' business transactions. (Tr. at 15, ll. 18-20.) Based on a comparison of Debtors' volume of business with that of the former owners, he would only guess that they had acquired more equipment. (Tr. at 20, ll. 5-12.) He did observe that the list of equipment in amended Schedule C did not "match totally" the list of equipment attached to the real estate contract. (Tr. at 26, ll. 6-11.) He, however, also testified that the Bank advanced additional funds to Debtors through operating loans like the June 8, 2001 business consolidation note. (Tr. at 29, ll. 3-18.)

CONCLUSION

WHEREFORE, for the reasons set forth in this Memorandum of Decision, the Court finds that the Bank has a purchase-money security interest in Debtors' tools of the trade and, therefore, the motion for relief from that portion of the December 4, 2002

Order granting the motion to avoid the Bank's lien on exempt tools of the trade must be granted.

A separate Order shall be entered accordingly.

/s/ Lee M. Jackwig
Lee M. Jackwig
U.S. Bankruptcy Judge

Parties receiving this Order from the Clerk of Court:
Electronic Filers in this Chapter Case; Stephen and Sheryal Seye