

UNITED STATES BANKRUPTCY COURT  
For the Southern District of Iowa

In the Matter of :  
GORDON W. BIXBY, JR., : Case No. 89-2859-C H  
Debtor. : Chapter 7

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**ORDER--MOTION TO AVOID LIEN**

On May 3, 1990, a hearing was held on the Debtor's motion to avoid non-possessory, non-purchase money security interest in exempt property. Kelly. D. Hamborg appeared on behalf of Debtor and Bob Siddens appeared on behalf of Avco Financial Services of Denison, Inc. ("Avco"). At the conclusion of said hearing, the Court took the matter under advisement. The Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A). The Court, upon review of the motion, resistance, exhibits submitted and arguments of counsel, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

**FINDINGS OF FACT**

1. Debtor filed his voluntary Chapter 7 petition on December 19, 1989.

2. On Schedule A-2, creditors holding security, Debtor lists Avco as holding a security interest in a stereo with a market value of \$400.00. The value of Avco's claim is listed at \$1,362.00.

3. On Schedule B-2, personal property, Debtor lists

household goods, supplies and furnishings valued at \$873.00. Debtor lists said household goods, supplies and furnishings valued at \$873.00 as exempt on Schedule B-4 pursuant to Iowa Code §627.6(5).

4. No objection to Debtor's claim of the household goods, supplies and furnishings valued at \$873.00 was filed within 30 days after the §341 meeting held on January 23, 1990.

5. On December 22, 1986, Debtor entered into a "Retail Installment and Security Agreement" ("Retail Installment Contract") with Avco for the purchase of a "Techniques stereo system" at World Radio. The cash price under the Retail Installment Contract, including sales tax of \$38.80 and \$169.95 warranty, was \$1,008.74. Debtor made a cash down payment of \$8.74. The amount financed was therefore \$1,000.00. The annual percentage rate of interest was 21 percent, with 36 monthly payments of \$37.67. Debtor gave Avco a purchase money security interest in the stereo system.

6. On February 9, 1988, Avco and Debtor entered into a "Loan Agreement with Provisions for Refinancing" ("Loan Agreement"). Under the Loan Agreement, Avco paid \$706.43 directly to Debtor and paid \$713.57 on the Retail Installment Contract account. The total amount financed was therefore \$1,425.00. The annual percentage rate on the Loan Agreement was 20.99 percent, with 36 monthly payments of \$53.68

commencing March 22, 1988. On the Loan Agreement, the parties entered into a new security agreement and listed a "Techniques stereo system purchased from World Radio 12/22/86 purchase money" as security for the Loan Agreement.

#### DISCUSSION

Section 522(f)(2)(A) allows a debtor to avoid a lien which impairs a properly claimed exemption if such lien is:

- (2) a nonpossessory, nonpurchase-money security interest in any--
  - (A) household furnishings, household goods...that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor...

Initially, Avco asserts that the stereo is not exempt. Debtor lists his total household goods, supplies and furnishings as \$873.00 on Schedule B-2 and claims the total amount as exempt under Iowa Code §627.6(5) on Schedule B-4. No timely objection to said exemption was made. Therefore, Debtor's household goods, supplies and furnishings valued at \$873.00, including the stereo valued at \$400.00 on Schedule A-2, are exempt.

Avco also asserts that it possesses a purchase money security interest in Debtor's stereo. The Bankruptcy Code does not define a purchase money security interest. Therefore, the Court must look to Iowa law. Pristas v. Landaus of Plymouth, Inc., 742 F.2d 797 (3rd Cir. 1984). A

purchase money security interest is defined by Iowa Code

§554.9107. The statute provides in relevant part:

A security interest is a "purchase money security interest" to the extent that it is

- a. taken or retained by the seller of the collateral to secure all or part of its price; or
- b. taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

Both parties agree that Avco obtained a purchase money security interest in the stereo pursuant to the Retail Installment Contract. The issue before the Court is whether Avco retained a purchase money security interest in the stereo after the formation of the Loan Agreement.

The test for determining if a purchase money security interest continues after refinancing is whether a novation of the prior contract has occurred. If the parties intended a novation, then the purchase money security interest is eliminated. In re Butler, No. 86-01651-C, slip op. (Bankr. N.D. Iowa May 28, 1987); In re Averhoff, 18 B.R. 198 (Bankr. N.D. Iowa 1982).

With respect to novation, the Iowa Supreme Court has stated:

It is the general and well-recognized rule that the necessary legal elements to establish novation are parties capable of

contracting, a valid prior obligation to be displaced, the consent of all the parties to the substitution, based on sufficient consideration, the extinction of the old obligation, and the creation of new one.

Wade & Wade v. Central Broadcasting Co., 288 N.W. 439, 443 Iowa 1939. The critical element is the intention of the parties to extinguish the existing debt by means of a new obligation. Tuttle v. Nichols Poultry & Egg Co., 35 N.W.2d 875, 880 (Iowa 1949).

A number of factors must be examined to determine whether new loan arrangements create a novation. Such factors include: whether new money was advanced; whether the debtor's payments were increased; whether additional collateral was provided by the debtor; and whether a new security agreement was executed. Matter of Ward, 14 B.R. 549, 553 (S.D. Ga. 1981); Averhoff, 18 B.R. at 202.

In the instant case, new money was advanced, Debtor's payments were increased and a new security agreement was executed. Neither party asserts that additional collateral was provided by the Debtor. Therefore, three of the four factors are met. However, the court must primarily look to the parties' state of mind to determine whether the Loan Agreement was intended to extinguish the debt under the Retail Installment Contract thereby constituting a novation. See Butler, slip. op. at 3.

Since the parties' intent determines whether a particular

transaction constitutes a renewal or a novation, the burden of proving the existence of novation by clear and convincing evidence rests on the party asserting novation. Butler, slip op., at 3. Further, the mere substitution of one writing for another, absent the intent of the parties to extinguish the original agreement, will not effect a novation. Id.

In the instant case, the Loan Agreement clearly states that the security for the Loan Agreement is a "Techniques stereo system purchased from World Radio 12/22/86 purchase money." The Court finds that the parties intended the purchase money security interest to continue when the Loan Agreement was executed. Therefore, the parties did not create a novation, and the Avco purchase money security interest in the stereo continued.

IT IS ACCORDINGLY ORDERED that Debtor's motion to avoid lien on the stereo valued at \$400.00 is denied.

Dated this 22nd day of May, 1990.

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Russell J. Hill  
U.S. Bankruptcy Judge