UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

HARLAN CHAPMAN,
MARIAN L. CHAPMAN,

Case No. 87-180-C

Engaged in Farming,

Chapter 7

Debtors.

ORDER ON OBJECTION TO EXEMPTIONS, MOTION TO AVOID FIXING OF LIENS AND MOTION FOR RELIEF FROM STAY

On March 25, 1987 an evidentiary hearing was conducted in Des Moines, Iowa concerning (1) a motion for relief from stay filed by the Raccoon Valley State Bank (Bank) on February 11, 1987 and the debtors' resistance thereto filed on February 17, 1987, (2) the debtors' motion to avoid the fixing of liens filed on February 17, 1987, and (3) the Bank's objections to exemptions filed on February 26, 1987 and the debtors' response thereto filed on March 4, 1987. Gregory W. Peterson appeared on behalf of the debtors and Bryan R. Jennings appeared on behalf of the Bank. The case has been submitted on a transcript of the hearing, various documents received into evidence and briefs.

FACTUAL BACKGROUND

The debtors' farm is located in Dallas County. The debtors are husband and wife but have not lived together for the past twelve years. Marian Chapman resides in Redfield,

Iowa. Harlan Chapman resides in rural Adel. He has farmed all of his life. As a result of financial difficulties, he has not been farming his own real estate since 1985. Instead, he has rented his land and has custom farmed. Marian Chapman works as a part time librarian in Redfield. During the time Harlan farmed his own land, she engaged in such activities as preparing and delivering meals to field workers, keeping books, running for machine parts and hauling grain. Since Harlan has had to resort to renting his land and custom farming, Marian's activities involving the farm have been confined to minimal bookkeeping chores.

On May 7, 1984, the debtor borrowed money from the Bank as evidenced by certain promissory notes. To secure the loans, the Bank took a security interest in, among other things, the debtors' farm equipment and machinery. The security agreements contain the standard clause stating that the Bank has the right to possession of the collateral upon default.

The debtors defaulted on the notes and sometime thereafter the Bank instituted an action in the Iowa District Court for Dallas County to enforce the security agreements. A jury verdict was entered in favor of the Bank and a judgment rendered entitling the Bank to possession of the machinery. The Bank was unable to enforce a writ of replevin because the Dallas County Sheriff had difficulty locating the machinery. Eventually the debtors and the Bank came to

terms on disposition of the equipment. On October 9, 1986, the Bank and Mr. Chapman executed a document (Agreement) providing in part as follows:

> 1) Bank is entitled to possession of certain items of farm machinery described in Exhibit A attached to their petition filed in Law No. 27027-0485.
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> ....
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> 2) Chapman agrees to assemble the remaining farm equipment near the road on the east field of his 120 acre farm by December 1, 1986, weather permitting, and to permit the Bank to conduct a sale of said machinery on those premises.

The debtors retained physical custody of the machinery after the Agreement was signed. Mr. Chapman did some custom combining in the fall of 1986. Thereafter, the equipment was lined up by Mr. Chapman and the Bank scheduled an auction for January 26, 1987. However, the auction was cancelled because the debtors filed their joint petition in bankruptcy on the auction date, thereby triggering the automatic stay.

The debtors both assert they are farmers for purposes of Iowa's exemption statute. They seek to avoid liens on equipment valued at $20,000.00 and claimed exempt pursuant to Iowa Code section 627.6(11)[1] The debtors' obligations

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[1] Some confusion has arisen concerning the correct numbering of the subsections under Iowa Code section 627.6. The confusion apparently has resulted from the striking of former subsection 5. All Iowa statutory citations in this order are taken from the official Iowa Code (1987) unless otherwise-noted.

arose prior to the May 31, 1986 effective date of the 1986 amendments to Iowa's exemption.statute.[2] Before May 31, 1986, Iowa law provided for a maximum farm machinery exemption of $5,000.00. Iowa Code section 627.6(10)(d)(1985).[3] The Iowa legislature amended section 627.6 by increasing the maximum farm machinery exemption to $10,000.00. 86 Acts, ch. 1216, section 6 (now codified at Iowa Code section 627. 6 (11) (a)).[4]

The Bank advances three arguments in support of its position that its liens on the machinery cannot be avoided

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[2] Had the obligations arisen after the effective date of the amendments, there could be no question the amendments would be applicable. Further, there is no question of applicability of the amendments to the "gap period" between the date of enactment and the effective date given this court's ruling that the amendments are applicable to obligations that had arisen prior to the effective date. Cf. Matter of Eakes, No. 83-1647-C (Bankr. S.D. Iowa, filed August 21, 1984) aff'd sub nom. United States of America v. Eakes, No. 84-714-A Civ. (S.D. Iowa, January 18, 1985) (finding that the holding in United States v. Security Industrial Bank, et. al., 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d (1982), wherein the Supreme Court determined that section 522(f)(2) of the 1978 Bankruptcy Code does not apply retroactively to abrogate liens acquired before the Code's enactment, did not apply to liens acquired between the enactment date (November 6, 1978) and the effective date of the Code (October 1, 1979)).

[3] The value of musical instruments, one motor vehicle and interest in certain wages and tax refunds was also included in the $5,000.00 limitation. Iowa Code section 627.6(10) (1985).

[4] Livestock and feed for the livestock may be claimed exempt along with implements and equipment but the combined value can not exceed $10,000.00.

and that the stay should be lifted to permit it to levy upon the machinery. First the Bank.maintains its interest in the machinery is possessory and therefore not subject to lien avoidance. Second, the Bank contends the debtors are not farmers as contemplated by Iowa's exemption statute. Finally, it argues that application of the 1986 amendments to the Iowa exemption statute (amendments), which raise the maximum limit for the farm machinery exemption from $5,000.00 to $10,000.00, is constitutionally impermissible.

On May 14, 1987 a discharge of joint debtors was entered in this case. Accordingly, the Bank's motion for relief from stay is moot pursuant to 11 U.S.C. section 362(c).

DISCUSSION

11 U.S.C. section 522(f) provides:

> (f) notwithstanding any waiver of exemptions, 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--
>
> (1) a judicial lien; or
>
> (2) a nonpossessory, nonpurchase-money security interest in any--
>
> (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the

> personal, family, or household use of the debtor or a dependent of the debtor;
>
> (B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor: or
>
> (C) professionally prescribed health aids for the debtor or a dependent of the debtor.

The Bank maintains that the debtors are precluded from avoiding the lien on the machinery because the Bank's interest in the machinery is possessory. Under section 522(f)(2), only liens arising from nonpossessory security interests may be avoided. Although the Bank does not have custody of the machinery, it argues that it does have constructive possession stemming from the Dallas County judgment and the Agreement. The debtors contend that their actual possession of the machinery renders the Bank's interest nonpossessory and thus subject to lien avoidance.

In support of its position, the Bank cites In re Sanders, 61 B.R. 381 (Bankr. D.Kan. 1986). In that case, a creditor had taken a security interest in the debtor's construction tools to secure a loan the creditor made to the debtor. The debtor defaulted on the loan and the creditor obtained a judgment. The creditor then seized a number of the debtor's tools. Shortly thereafter, the debtor filed a Chapter 7 petition, claimed the tools exempt and moved to avoid the creditor's lien under section 522(f)(2)(B). The court ruled that the creditor's nonpossessory security

interest became possessory once the creditor took possession of the tools. Hence the court denied the debtor's section 522(f) motion. Id. at 384.

The Sanders court declined to follow two cases that permitted debtors to avoid liens on collateral in possession of creditors In re McFarland, 38 B.R. 370 (Bankr. N.D. Iowa 1984), aff'd, 38 B.R. 374 (N.D. Iowa 1984); Matter of Wood, 13 B.R. 245 (Bankr. E.D. N.C. 1981). Those courts found the creditors' liens to be possessory because possession of the collateral was obtained involuntarily. McFarland, 38 B.R. at 373-374; Wood, 13 B.R. at 247. The Sanders court noted those cases failed to take into account the standard security agreement provision which grants creditors the right to possess the collateral upon default. Sanders, 61 B.R. at 383. The Bank argues that should this court adopt the approach taken by the McFarland and Wood court, it would still prevail. The Bank concludes that the debtors voluntarily relinquished possession of the machinery as evidenced by the October 9, 1986 Agreement, and hence the "involuntary possession" rule articulated in McFarland and Wood would not apply.

In each of the aforementioned cases, there was no question that the creditor had physical possession of the collateral. In the present case, the Bank does not have physical custody of the machinery. The Bank contends that it has constructive possession of the collateral and that

constructive possession gives it a possessory interest.

The conceptual difficulties involved in defining possession and applying the concept to different factual settings have been recognized by legal scholars. Shartel, Meanings of Possession, 16 Minn. L. Rev. 611 (1932) (hereinafter referred to as Shartel); Bingham, Legal Possession, 13 Mich. L. Rev. 535 (1915). Professor Shartel posits that possession can only be defined with regard to the purpose in hand and that "possession" may mean one thing in one setting and mean another in a different setting. Shartel, 16 Minn. at 612.

In the context of perfecting security interests under Article 9 of the U.C.C., possession is equated with one who has physical control of the collateral and intends to exercise control. Transport Equipment Co. v. Guaranty State Bank, 518 F.2d 377, 381 (10th Cir. 1975). [5] Article 9 does not otherwise define "possession". In re Kontaratos, 10 B.R. 956, 969 (Bankr. D. Maine 1981). In situations where

[5] Generally under Article 9, there are two methods of perfecting a security interest. A creditor may perfect under U.C.C. section 9.302(l) by filing a financing statement or under U.C.C. section 9.304 by taking possession of the collateral. However, for this discussion it should be noted that perfection of a security interest is important only to insure priority of the lien over intervening third parties. The absence of perfection does not affect the enforceability of the lien against the parties to the transaction. Accordingly, the absence of perfection is not relevant in the context of lien avoidance in bankruptcy. In re Matthews, 20 B.R. 654, 657 (Bankr. 9th Cir. 1982) reversed on other grounds, 724 F.2d 798 (9th Cir. 1984); In re Lanctot, 6 B.R. 576, 577 (Bankr. D. Utah 1980).

the U.C.C. is silent, common law supplements the statutory provisions. U.C.C. section 1.103. Pre-U.C.C. law defined possession as meaning physical control. In re Automated Bookbinding Services, Inc., 471 F.2d 546, 553 (4th Cir. 1972), citing, Restatement of the Law of Security (1941) at 6.

In criminal cases, possession of personal property has been held to involve the power to control and the intent to control. U.S. v. Angelini, 607 F.2d 1305, 1310 (9th Cir. 1979). Constructive possession has been defined as being in a position to exercise control. U.S. v. DiNovo, 523 F.2d 197 (7th Cir. 1975), cert. denied, 423 U.S. 1016, 96 S.Ct. 449, 46 L.Ed.2d 387 (1975); Sewell v. U.S., 406 F.2d 1289, 1293, nt. 3 (8th Cir. 1969).

Given that "nonpossessory" is used in section 522(f) in conjunction with "nonpurchase money security interest", an Article 9 concept, 6 this court finds that the Article 9

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[6] Purchase money security interest is defined in U.C.C. section 9.107 which provides:

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

Creditors holding purchase money security interests in collateral give them priority over certain other creditors asserting.security interests in the same collateral. U.C.C. section 9.312(3).

overall concept of "possession" as developed from the common law is an appropriate guide in.determining "possession" under section 522(f). Since the Bank did not have physical control of the collateral, it fails to establish a possessory interest.

Even under a standard of constructive possession--being in a position to exercise control, the Bank would not prevail. At all times relevant to this proceeding, from October 6. 1986 to the date of filing the bankruptcy petition, the debtors retained physical control of the machinery. The debtors were free to use the property and Mr. Chapman testified that he used a combine in the fall of 1986 for custom work. It was by virtue of Mr. Chapman's control of the machinery that the machinery was lined up for sale. The debtors filing the bankruptcy petition frustrated the Bank's attempt to exercise control over the collateral. The filing demonstrated that they did not voluntarily reliquish the machinery.

Adopting the Bank's theory that it became entitled to possession of the machinery upon default as set out in terms of the security agreements signed by the debtors and upon execution of the Agreement would effectively void the protections of section 522(f). Most debtors have defaulted on the terms of their security agreements--security agreements likely containing "possession upon default" clauses. By allowing creditors to claim possessory security interests

by means of "constructive possession" upon default, few debtors, if any, with secured obligations would be able to avoid liens. Such a result is at odds with Congress's policy of providing a debtor with a fresh start and a basis upon which to build financial rehabilitation.

II.

In deciding whether the debtors are farmers for exemption purposes, the court must first determine what law controls. It is clear that lien avoidance under 11 U.S.C. section 522(f) is a matter of federal law, not state law. Matter of Thompson, 750 F.2d 628, 630 (8th Cir. 1984). However, section 522(f) permits debtors to avoid liens on property to the extent the liens impair exemptions to which the debtors otherwise would have been entitled under the federal exemptions or under applicable state law. 11 U.S.C. 522(b)(1) authorizes states to "opt out" of the federal exemption scheme. Iowa has done so by virtue of Iowa Code section 627.10. Therefore, the court must turn to Iowa law to determine whether the debtors are farmers for purposes of Iowa's exemption statute. [7]

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[7] It is important to note that the definition of farmer under 11 U.S.C. section 101(17) is not applicable to exemption and lien avoidance issues. See In re LaFond, 791 F.2d 623, 625-626 (8th Cir. 1986). Flick v. United States through Farmers Home Administration, 47 B.R. 440, 442-443 (W.D. Pa. 1985); In re Schuette, 58 B.R. 417, 420 (Bankr. D. Minn. 1986); Middleton v. Farmer State Bank of Fosston, 45 B.R. 744, 747 (Bankr. D. Minn. 1985); Matter of Decker, 34 B.R. 640, 641 (Bankr. N.D. Ind. 1983). But see, In re Holman, 26 B.R. 110, 111-112 (Bankr. M.D. Tenn. l983); In re Liming, 22 B.R. 740, 742 (Bankr. W.D. Okla. 1982).

Iowa Code section 627.6(11) provides in part the following:

> If the debtor is engaged in farming... [the debtor may claim] any combination of the following, not to exceed a value of ten thousand dollars in the aggregate [exempt]:
>
> > a. Implements and equipment reasonably related to a normal farming operation. This exemption is in addition to a motor vehicle held exempt under subsection 9.
> > ....

Iowa's exemption statute is based upon the premise "that it is better that the ordinary creditor's claims should remain partially unsatisfied than that a resident of the state should be placed in such an impecunious position that he and his family became charges of the state." Note, Personal Property Exemptions in Iowa: An Analysis and Some Suggestions, 36 Iowa L.Rev. 76, 77 (1950). The Iowa Supreme Court has ruled that the purpose of the exemption statute "is to secure to the unfortunate debtor the means to support himself and the family; the protection of the family being the main consideration." Shepard v. Findley, 214 N.W. 676, 678 (Iowa 1927).

In construing Iowa's exemption laws, the court is mindful of the well settled proposition that Iowa's exemption statute must be liberally construed. Frudden Lumber Co. v. Clifton, 183 N.W.2d 201, 203 (Iowa 1971). Yet, this court must be careful not to depart substantially from the express language of the exemption statute nor to extend the legisla-

tive grant. Matter of Hahn, 5 B.R. 242, 244 (Bankr. S.D. Iowa 1980), citing Wertz v. Hale, 234 N.W. 534 (Iowa 1931) and Iowa Methodist Hospital v. Long, 12 N.W.2d 171 (Iowa 1944).

Bankruptcy Rule 4003 mandates that the objecting party has the burden of proving that the exemptions are not properly claimed. Here the Bank has that burden.

In deciding whether Mr. Chapman is a farmer, the court turns to In re Myers, 56 B.R. 423 (Bankr. S.D. Iowa 1985). In that case one of the issues presented was whether a custom farmer was a farmer for purposes of Iowa's exemption laws. After examining a number of Iowa Supreme Court cases, the court concluded custom farmers were such farmers. Myers, 56 B.R. at 427. It is also important to note that the Myers court gave great weight to the debtor's statement of intent to resume farming. The court stated:

> (The debtors'] intention must be afforded great weight .... It is not for this court to judge the wisdom, or even the feasibility, of defendants attempting to resume farming. This court finds nothing in the law which conditions the exemption for tools of a trade upon the debtor successfully pursuing that trade. If the debtors intend to be farmers, so be it.

Myers, 56 B.R. at 427, quoting, In re Pommerer, 10 B.R. 935,942 (Bankr. D.Minn. 1981).

Although Mr. Chapman did not farm his own propertv during the last three years, the evidence is uncontroverted that Mr. Chapman did engage in custom farming. That farming

activity qualifies him as a farmer for the purpose of claiming farm exemptions. The court also notes and finds credible Mr. Chapman's testimony that he intends to farm in the future.

The court must also determine whether Marian Chapman is a farmer under Iowa's exemption statute. The traditional image of a farmer is that of a man engaging in activities such as operating farm machinery and tending livestock. Until recently, very little attention has been given to the critical role women fulfill in family farm enterprises. In addition to participating in field work and animal husbandry, farm wives often are solely responsible for keeping the farm's books and performing domestic chores. Such tasks are as important to the operation of a farm as activities typically associated with farming. Indeed, the small farm in Iowa is truly a family operation. See, In re Pommerer, 10 B.R. 935, 942 (Bankr. D.Minn. 1981) ("One would have to blind oneself to reality not to.... recognize that a small farm... is a family operation. [Tlherefore, [a farm wife] must also be considered a farmer.").

The fact that a debtor has off farm employment does not detract from the debtor's status as a farmer.. In Myers, supra, the court was presented with a situation wherein the debtors who were full-time teachers asserted they also qualified as farmers. The court noted that the Iowa Supreme Court has not adopted a principal occupation test nor a

percentage of income test. Rather, the only requirement is that the work contribute to the debtor's support. Myers, 56 B.R. at 426.

Admittedly, this case presents unusual circumstances with respect to Marian's involvement involvement in the farming operation. The debtors have been living apart for twelve years and, since the time Harlan has been unable to farm his own land, Marion's involvement in the farm has been limited to minimal bookkeeping work. However, during the time Harlan was farming his own land, the record is clear that Marian was engaged in farming activities even though she had moved to Redfield. She kept books, hauled grain, prepared meals for those working in the fields and made trips to pick up machine parts. The court finds that although Marian presently is not involved in the farming operation to the degree she once was, this is a result of Harlan's present reliance on custom farming. There is nothing in the record to indicate that if he were to resume farming his own or rented land, she would not undertake the tasks she once performed. The finding that Marian, under these circumstances, is a farmer is in accord with the cases that have held that a temporary cessation of farming does not defeat a claimed exemption if the debtor intends to return to farming. See, e.g., Matter of Hahn, 5 B.R. 242, 245 (Bankr. S.D. Iowa 1980); Peasey v. Price, 69 N.W. 1120 (Iowa 1897); Hickman v. Cruise, 34 N.W. 316, 317 (Iowa 1887).

Finally, the fact that Marian has an off the farm job does not detract from her status as a farmer. The only requirement under Iowa law is that the farm work contribute to the debtor's support. The farm activities in which Mrs. Chapman engaged contributed to her support.

III.

The issue of whether the application of the amendments to obligations created prior to May 31, 1986 is permissible under the 5th Amendment has been resolved in this district by the appeal decision in the case of Matter of Reiste, No. 87-153-B (S.D. Iowa, filed May 11, 1987). Chief District Judge Harold D. Vietor upheld Bankruptcy Judge Michael J. Melloy's [8] ruling that retrospective application of the amendments did not constitute an uncompensated taking. Judge Melloy had incorporated by reference in the Reiste opinion the conclusions of law set out in In re Punke, 68 B.R. 936 (Bankr. N.D. Iowa 1987). The Reiste decision and conclusions of law pertaining to the takings issue found in Punke are incorporated by reference in the instant case.

CONCLUSION AND ORDER

WHEREFORE, for the reasons expressed above, the court concludes:

1. The Bank's security interest in the equipment and machinery is nonpossessory;

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[8] Sitting by designation.

2. The debtors are farmers for purposes of Iowa's exemption statute; and

3. The debtors are entitled to exempt farm machinery valued at $20,000.00 pursuant to Iowa Code section 627.6(11).

THEREFORE, the Bank's objections to exemptions are overruled. The debtors' motion to avoid liens is granted.

Signed and filed this 29th day of December, 1987.

LEE M. JACKWIG

U.S. BANKRUPTCY JUDGE