

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

RODGER A. DUKES,
HELEN J. DUKES,
Engaged in Farming,

Case No. 87-830-W

Chapter 7

Debtors.

ORDER ON RESISTANCE TO MOTION TO AVOID LIENS

On August 25, 1987 a resistance to motion to avoid liens filed by the Farmers Home Administration (FmHA) came on for telephonic hearing in Des Moines, Iowa. Charles L. Smith appeared on behalf of the debtors and John Beamer, Assistant U.S. Attorney, appeared on behalf of the FmHA. The matter has been submitted on a stipulation of facts, briefs, the affidavits of an FmHA official and Rodger A. Dukes and certain loan and security documents.

FACTUAL BACKGROUND

The debtors filed a joint petition for relief under Chapter 7 on March 27, 1987. They are farmers. They seek to avoid the FmHA's liens in the following property:

Group A

| | <u>Purchase Money (PM) or Pre-enactment (PE) Purchase</u> | |
|---------------------|---|----|
| JD 620 Tractor | PM | PE |
| Kewanee 10'2" disc | PM | PE |
| JD 4 row cultivator | PM | PE |
| JD 3-14 plow | PM | PE |

| | | |
|-----------------------------------|----|----|
| IHC 4-16 plow | PM | |
| JD 4 row rotary hoe | PM | PE |
| JD 494A planter | PM | PE |
| JD 9'6" grain drill | PM | PE |
| Kewanee 401 elevator | PM | PE |
| David Bradley 42' elevator | PM | PE |
| JD Model H manure spreader | PM | PE |
| JD #45 scoop and blade | PM | PE |
| 4" x 16' 3/4 HP motor grain auger | PM | PE |
| JD #5 mower | PM | |
| Kewanee 3 pt. 8" blade | PM | |
| Running gears for hay rack | PM | PE |
| JD 6 x 10 wagon | PM | PE |
| Sears 5 x 10 wagon | PM | PE |
| Ringing chute | PM | |
| 2 creep feeders | PM | PE |
| Tractor cylinder | | |
| Duals and weights for 756 tractor | PM | |
| 12 cattle panels | PM | |
| 10 pen portable hog house | PM | |
| Kory gravity flow wagon | PM | |
| 8 x 14 lowboy | PM | |
| Homemade seeder cart | PM | |
| Post hole digger | PM | |

Group B

| | | |
|--|--|--|
| Dakon 4 row cultivator | | |
| JD 10' rake | | |
| 561 B" Westfield auger | | |
| Endgate seeder | | |
| Air compressor | | |
| 12' bin sweep | | |
| 2 hog waterers | | |
| 4 hog panels | | |
| Bale carrier | | |
| JD #38 mower | | |
| 23 hog panels | | |
| 100 steel posts | | |
| 100 hedge posts | | |
| 6 rolls barbed wire | | |
| 6 rolls 32" hog wire | | |
| 1000 bu. wooden portable grain bin | | |
| Propane hog house heater | | |
| Chain saw | | |
| Riding lawn mower | | |
| Garden tiller | | |
| Misc. hand tools, wrenches, table saw | | |
| 1/2 interest JD self propelled combine | | |

The debtors first borrowed from the FmHA on April 4,

1973. Since then they have executed a number of notes and security agreements. The nature of the pertinent notes are summarized as follows:

| <u>Date of Note</u> | <u>Amount of Note</u> | <u>Disposition</u> |
|---------------------|-----------------------|---|
| April 4, 1978 | \$12,000.00 | Not paid, rescheduled with new money. |
| February 5, 1980 | \$32,147.49 | Note that resulted from rescheduling April 4, 1978 note. This note was split into two separate notes on March 18, 1981. |
| March 18, 1981 | \$22,197.43 | Not paid, deferred and rescheduled. |
| March 18, 1981 | \$12,129.87 | Rescheduled. |

The note dated April 4, 1978 is marked "not pd. rescheduled". The note dated February 5, 1980 contains the following language.

If "Consolidation and subsequent loan," "Consolidation," "Rescheduling," or "Reamortization" is indicated in the "Action Requiring Note" block above, this note is given to consolidate, reschedule or reamortize, but not in satisfaction of the unpaid principal and interest on the following described note(s) or assumption agreements) (new terms):

| FACE AMOUNT | INT.RATE | DATE | ORIGINAL BORROWER | LAST INSTALL DUE |
|---------------------|------------|----------------------|-----------------------|---------------------|
| \$112,000 00 | 8 % | April 4, 1978 | Rodger A. Duke | April 4 1985 |
| \$ | % | 19 | | 19 |
| \$ | % | 19 | | 19 |
| \$ | % | 19 | | 19 |
| \$ | % | 19 | | 19 |
| \$ | % | 19 | | 19 |

The "subsequent loan" and "consolidation" squares set forth in the "Action Requiring Note" block are checked. It is undisputed that the FmHA at one time had a purchase money security interest in the items listed in

Group A or that the FmHA's interest in the property arose prior to November 6, 1978. The parties stipulate that the FmHA's interest in the property listed in Group B arose after November 6, 1978 and that its interest is not a purchase money security interest.

DISCUSSION

I.

Relying on U.S. v. Security Industrial Bank, 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982), the FmHA asserts that the debtors cannot avoid the FmHA's security interest in machinery that served as FmHA's collateral prior to the enactment of the 1978 Bankruptcy Code. The debtors contend that this pre-Code security interest in the property has been extinguished by means of a novation. The debtors have the burden of demonstrating that all the elements of lien avoidance under section 522(f) are satisfied. In re Shands, 57 B.R. 49, 50 (Bankr. D. S.C. 1985); Matter of Weinbrenner, 53 B.R. 571, 578 (Bankr. W.D. Wisc. 1985).

In U.S. v. Security Industrial Bank, supra, the United States Supreme Court held that Congress did not intend to apply 11 U.S.C. section 522(f) retrospectively to security interests obtained prior to the Code's November 6, 1978 enactment date. Security Industrial, 459 U.S. at 82. Courts have recognized an exception to this rule where pre-Code liens have been extinguished and replaced by loans and security agreements executed after the enactment date.

See In re Avershoff, 18 B.R. 198 (Bankr. N.D. Iowa 1982); Matter of Hallstrom, Case No. 86-370-C (Bankr. S.D. Iowa, filed September 8, 1986).

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

It is the general and well-recognized rule that the necessary legal elements to establish a 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 (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).

The debtors are correct in pointing out that the factors this court utilizes in assessing the parties' intent are whether new money was advanced, whether the debtors' payments were increased, whether additional collateral was provided by the debtors, and whether a new security agreement was executed. See Matter of Scanlan, No. 86-2870-W, slip op. at 12 (Bankr. S.D. Iowa, July 30, 1987). However, there is no need to resort to rules of construction where the intent of the parties is expressed in clear and unambiguous language. State v. Starzinger, 179 N.W.2d 761, 764 (Iowa 1970). Here, the parties' intent is clearly manifested

in the language of the February 5, 1980 note. The language states that "this note is given to...consolidate...but not in satisfaction of the unpaid principal and interest on the [April 4, 1978] note. Further, the April 4, 1978 note is marked "not pd. rescheduled." Consequently, the court must conclude that the parties did not intend to extinguish the April 14, 1978 note by means of the February 5, 1980 note.

II.

The debtors next contend that the FmHA no longer has a purchase money security interest in the items listed in Group A. Under section 522(f) the debtor cannot avoid purchase money security interests. The debtors claim that the FmHA lost its purchase money status when it rewrote the April 4, 1978 note. The debtors rely primarily upon In re Matthews, 724 F.2d 798 (9th Cir. 1984). There the Ninth Circuit found that refinancing or consolidating loans by paying off the old loan and writing a new loan extinguishes the purchase money nature of the original loan. The court reasoned that the proceeds of the new loan were not used to acquire rights in the collateral. The undersigned's predecessor adopted this approach in Matter of Burson, No. 84-1205-W (Bankr. S.D. Iowa, May 19, 1985) and Matter of Crouse, No. 83-458-C (Bankr. S.D. Iowa, July 16, 1984).

Matthews is easily distinguished from this case. In Matthews the lender paid off the original loan with the new money advanced through the subsequent loan. In contrast,

the debtors here have not shown that the funds advanced by means of the February 5, 1980 loan were used to pay the balance of the April 4, 1978 loan. As discussed in Part I, the language of the February 5, 1980 note clearly shows that the new money advanced was not used to extinguish the original note. Therefore, the FmHA retains its purchase money status.

CONCLUSION AND ORDER

WHEREFORE, for the reasons expressed above the court finds that the FmHA continues to possess a purchase money security interest in the items listed in Group A and that the FmHA's pre-enactment security interest in certain machinery listed in Group A is not subject to a novation.

THEREFORE, the motion to avoid liens is denied with respect to the machinery listed in Group A. With respect to the items delineated in Group B, lien avoidance is granted.

Signed and filed this 29th day of February, 1988.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE