

In the United States Bankruptcy Court
for the Northern District of Iowa

DUANE P. WICKMAN and
KATHLEEN WICKMAN
Debtor(s).

Bankruptcy No. L-89-01250W

Chapter 7

RULING RE: MOTION TO AVOID LIENS

The matter before the Court is the motion to avoid liens filed by the Debtors, Duane and Kathleen Wickman. Debtors seek to avoid liens against the farm machinery and livestock listed in their Schedule B-4 of claimed exemptions. Those liens are held by the Farmers Home Administration ("FmHA"), which has filed an objection in response to the motion. This is a core proceeding under 28 U.S.C. section 157(b)(2)(K). The following constitutes findings of fact and conclusions of law pursuant to Fed.R.Bankr.P. 7052.

Background

- 1. Debtors filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code on August 21, 1989. Their Schedule A-2 of secured creditors listed a debt to FmHA in the amount of \$224,000. That debt was reportedly secured by farm machinery and livestock valued at \$21,563.
- 2. Debtors claimed an exemption in the amount of \$4,683 for livestock and feed under Iowa Code section 627.6(il)(b). They also claimed an exemption in the amount of \$6,360 for the following items of farm machinery and equipment under Iowa Code section 627.6(11)(a)([u](#)):

Oliver 1855D tractor	GMC ½ ton truck
IHC 300 tractor	3 Smidley hog feeders
Case 5-20 plow	* 6 Creep feeders
JD 1240 4-row planter	Acelutjin welder
Fox 2-row chopper	Lincoln arc welder
Gehl flail chopper	* JD 34 spreader
Knight forage wagon	2 bulk bins
Oliver disc	2 520 gal. gas barrels
IHC 4-row cultivator	2 water tanks
165 bu. gravity wagon	* 14 farrowing crates
160 bu. barge box wag	* Case 1816-B Uniloader
JD 8T gear wagon	* Agri Sprayer
* Keifer stock trailer	Oliver 770 tractor
Flatbed trailer	* Hutchensen 62' auger
Owatonna 401 elevator	* Fleet Store wagon
* F-S wagon	

- 3. On October 24, 1989, FmHA filed an objection to the exemption claimed by the Debtors for farm machinery and

equipment.

- 4. On January 19, 1990, Debtors filed a motion under 11 U.S.C. section 522(f)(2)(A) and (B) to avoid FmHA's liens against the livestock and farm machinery claimed as exempt.
- 5. On January 22, 1990, FmHA filed an objection to Debtors lien avoidance motion. FmHA contended that (1) its security interest in farm machinery and livestock predated the enactment of the 1978 Bankruptcy Code and could not be avoided by retroactive application of 11 U.S.C. section 522(f), and (2) the livestock lien could not be avoided because such property was no held primarily for the personal, family, or household use of the Debtors or their dependents.
- 6. FmHA's objection to exemptions and Debtors' motion to avoid liens were heard on February 21, 1990.
- 7. On February 22, 1990, this Court entered an order granting Debtors' lien avoidance motion as to two cows and one bull, and denying the motion as to all other livestock. The issues related to the farm machinery and equipment were taken under advisement.

Discussion and Conclusions of Law

Debtors seek to avoid FmHA's lien against the farm machinery and equipment listed in their bankruptcy schedules. FmHA contends that (1) such property is subject to a lien obtained before the enactment of the Bankruptcy Code on November 6, 1978, and (2) under United States v. Security Indust. Bank, 459 U.S. 70, 82, 103 S.Ct. 407, 414, 74 L.Ed.2d 235 (1982), such pre-Code liens may not be avoided by retroactive application of 11 U.S.C. section 522(f). Debtors contend that (1) the pre-Code lien was extinguished and replaced by way of novation in June, 1980, and (2) under In re Averhoff, 18 B.R. 198 (Bankr. N.D. Iowa 1982), the existing lien is subject to avoidance under section 522(f).

At issue is whether FmHA's security interest in farm machinery and equipment qualifies as a pre-Code lien for purposes of section 522(f)(2)(B)⁽²⁾ and the rule stated in United States v. Security Indust. Bank, supra. The following chronological summary of the parties' lending transactions is based upon the evidence presented on February 21, 1990.

On July 7, 1977, FmHA loaned \$49,000 to the Wickmans under a promissory note introduced into evidence as Debtors' Exhibit "E" and Government Exhibit 1. FmHA's copy contains the handwritten notation "Consolidated 6-2-8[0] Not Paid". The terms of the note provide for 8% interest with repayment in eight annual installments. FmHA took a real estate mortgage to secure the loan (Debtors' Exhibit "A"). Debtors also granted FmHA a security interest in farm machinery and equipment under a security agreement (Government Exhibit 3) and a financing statement filed with the Iowa Secretary of State on July 8, 1977 (Government Exhibit 2).⁽³⁾

The following items of farm machinery are listed in that security agreement:

Oliver 1855 Diesel tractor	JD 8-ton gear wagon
Oliver 770 tractor	Owatonna 40' elevator
JD 2010 tractor	GMC ½ ton truck
IHC 300 utility tractor	6 Smidley feeders
AC C2 gleaner combine	2 Smidley hog feeders
Case 520 5-20 plow	1 FS Pax creep feeder
JD 1240 4-row planter	Acelutjin welder
Fox 2-row chopper	Lincoln arc welder
Gehl 6' flail chopper	Manure loader
Knight 6 ton forage wagon	1 set duals for JD tractor
Oliver 191 disc	2 Brock bulk bins
IHC 4-row cultivator	2 520 gal. gas barrels

- 165 bu. gravity flare wagon 14 100 gal. water tanks
- 160 bu. barge box wagon 3 water tanks (1-300 gal. and 2-200 gal.)
- 4-wheel flatbed trailer

On March 20, 1978, FmHA loaned an additional \$2,000 to the Wickmans under a promissory note introduced into evidence as Debtors' Exhibit "F" and Government Exhibit 1. FmHA's copy contains the same handwritten notation which appears on the July 7, 1977 note. The terms of this note also provide for 8% interest with repayment in eight annual installments.

On June 16, 1978, the parties entered into another security agreement covering farm machinery and equipment (Government Exhibit 4).⁽⁴⁾ That security agreement covered the same machinery and equipment listed in the July 7, 1977 security agreement.

On March 26, 1979, FmHA loaned an additional \$30,700 to the Wickmans under a promissory note introduced into evidence as Debtors' Exhibit "G" and Government Exhibit 1. FmHA's copy contains a notation to indicate that the note was "Consolidated Not Paid." The terms of this note provide for 8.5% interest with repayment in eight annual installments.

On June 2, 1980, the parties executed a promissory note consolidating the notes executed on July 7, 1977, March 20, 1978, and March 26, 1979. This "consolidation" note was introduced into evidence as Debtors' Exhibit "H" and Government Exhibit 1. FmHA's copy also contains the stamped notation "Consolidated Not Paid." This loan was in the principal amount of \$71,244 with interest at 7% and repayment in eight annual installments. The following statement appears at page 2 of the note (with emphasis added):

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):

[Listing the 1977, 1978, and 1979 loans described above).

On June 5, 1980, FmHA released the real estate mortgage taken on July 7, 1977 (Debtors' Exhibit "B").

On June 6, 1980, the parties executed two new promissory notes (Debtors' Exhibits "I" and "J"). One note provides for an initial loan of \$52,700 at 12% interest with repayment in eight annual installments (Exhibit "I"). The other note provides for an initial loan of \$20,100 at 11% interest with repayment in forty-one annual installments (Exhibit "J"). FmHA took a new real estate mortgage (Debtors' Exhibit "C") to secure the two June 6th notes as well as the note executed on June 2nd.

On October 24, 1980, FmHA took a new security agreement (Debtors' Exhibit "L") covering the following farm machinery and equipment⁽⁵⁾:

- | | |
|-----------------------------|---|
| White 2-105 tractor | 1 Smidley 50 bu. hog feeder |
| Oliver 1855 Diesel tractor | 2 FS Pax 15 bu. creep feeders |
| IRC 300 utility tractor | Acelutjin welder |
| AC C-2 gleaner combine | Lincoln arc welder |
| Case 520 5-20 plow | Westdorf manure loader |
| JD 1240 4-row planter | 2 Brock bulk bins |
| Fox 2-row plateless chopper | 3 520 gal. gas barrel |
| Gehl 61 flail chopper | 2 100 gal. water tank |
| Knight 6 ton forage wagon | 3 water tanks (1 300 gal. and 2 200 gal.) |

Oliver 191 disc	14 FS farrowing crates
IHC 4-row cultivator	Case 1816-B Uniloader
165 bu. gravity flare wagon	Gehl 95 mixer
160 bu. barge box wagon	500 gal. Agri-sprayer
Flatbed 4-wheel trailer	1 Smidley 40 bu. hog feeder
JD 8 ton gear wagon	Kory 200 bu. wagon
Owatonna 40' elevator	6 Smidley 60 bu. feeders
2 FS Pax 10 bu. creep feeders	Oliver 770 tractor
GMC ½ ton truck	

On April 29, 1982, FmHA took a new security agreement (Government Exhibit 5) covering all of the items listed in the October 24, 1980 security agreement except the Kory 200 bu. wagon. The following items were added to the list of farm machinery and equipment: 1 JD 34 spreader, 1 Keifer 6/16 stock trailer, and 2 FS-Pax 10 bu. creep feeders.

On June 21, 1982, the parties executed a promissory note for an operating loan of \$14,000 (Government Exhibit 1). This note is also marked "Consolidated Not Paid." The terms of the note provide for 14.25% interest with repayment in two annual installments.

On September 19, 1983, the parties executed a promissory note for a "consolidation" operating loan of \$87,763.21 (Government Exhibit 1). The terms of the note provide for 7.25% interest with repayment in eight annual installments. There is a statement at page 2 of the note which indicates that it was given to consolidate, but not to satisfy, the notes executed on June 2, 1980 and June 21, 1982. FmHA also took a new real estate mortgage on September 19th (Debtors' Exhibit "D") to secure all outstanding indebtedness.

On September 26, 1985, FmHA took a new security agreement (Government Exhibit 6) covering all of the items listed in the April 29, 1982 security agreement except the AC C-2 gleaner combine, 2 water tanks, 5 Smidley hog feeders, and the Gehl 95 mixer. An AC M2 combine and a Hutchensen 621 auger were added to the list of equipment.

Debtors contend that FmHA's security interest in farm machinery and equipment lost its "pre-Code" character under a novation in June, 1980. A novation or substituted contract is "a contract that is accepted by the obligee in satisfaction of the obligor's existing duty." Sergeant v. Leonard, 312 N.W.2d 541, 546 (Iowa 1981), quoting Restatement (Second) of Contracts section 279 (1981). The elements of a novation are as follows:

(P)arties 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 a new one.

In re Hansen, 85 B.R. 821, 826 (Bankr. N.D. Iowa 1988), quoting Wade & Wade v. Central Broadcasting Co., 227 Iowa 422, 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., 240 Iowa 199, 35 N.W.2d. 875, 880 (1949).

It is Debtors' burden to demonstrate that all of the elements of lien avoidance under 11 U.S.C. section 522(f) have been satisfied. In re Hansen, supra, 85 B.R. at 825, citing In re Shands, 57 B.R. 49, 50 (Bankr. D.S.C. 1985); Matter of Weinbrenner, 53 B.R. 571, 578 (Bankr. W.D. Wis. 1985). Debtors contend that the debts created before the enactment of the 1978 Bankruptcy Code⁽⁶⁾ were extinguished and replaced with new obligations when FmHA refinanced their loans in June, 1980. To support their contention that a novation occurred as a result of the refinancing, Debtors emphasize that "[t]he duration of the [resulting] notes are different, the amounts owed are different, the amounts due each year are different, the interest rates are different, and additional collateral was added to the security agreement to support the refinancing of the Debtor's debt." Debtors' Brief at p. 5, citing In re Averhoff, supra.

FmHA contends that the parties never intended to effect a novation by refinancing the pre-code notes in June, 1980. FmHA argues that (1) it is FmHA's practice to stamp "Paid In Full" on satisfied notes and to return such notes to the

borrower; (2) all of the pre-Code notes were marked "Consolidated Not Paid" and were retained by FmHA; and (3) the June 2, 1980 consolidation note specifically stated that it was given to consolidate, but not to satisfy, the unpaid principal and interest on the notes executed in 1977, 1978, and 1979. FmHA contends that (1) the parties' intent to preserve the pre-Code obligations is expressed in clear and unambiguous language in the promissory notes; (2) there is no need to consider the extraneous factors identified by the Debtors; and (3) consideration of those factors also compels the conclusion that no novation resulted from the June, 1980 refinancing.

To sustain their burden of proof in this matter, the Debtors must demonstrate that the parties intended to substitute a new obligation for the pre-Code notes when those notes were consolidated in June, 1980. Tuttle v. Nichols Poultry & Egg Co., supra, 35 N.W.2d at 880. For the following reasons, the Court concludes that the Debtors have failed to meet their burden of proof:

1. FmHA correctly observes that the notes executed on July 7, 1977 and March 20, 1978 were marked "Consolidated Not Paid" and were retained by FmHA. Those facts indicate that FmHA and the Debtors did not intend to extinguish the pre-Code obligations under the June, 1980 refinancing.
2. The "consolidation" note executed on June 2, 1980 contains a clear statement to indicate that it was not given "in satisfaction of the unpaid principal and interest on" the 1977 and 1978 notes.
3. The "consolidation" note executed on September 19, 1983 contains a similar statement to indicate that the June 2, 1980 note (consolidating the 1977, 1978, and 1979 notes) was not extinguished by the consolidation.
4. The pre-Code obligations exist as identifiable components of Debtors' current obligation to FmHA. Those preCode debts can be traced from their origins in 1977 and 1978 through the consolidation/refinancing transactions in 1980 and 1983 and into the current outstanding indebtedness.
5. There is merit to Debtors' contention that the June, 1980 refinancing can be viewed as a single transaction between the Debtors and FmHA. Debtors' Brief at p. 4. It does not follow, however, that the transaction produced only one new obligation which extinguished the pre-Code notes. Instead, the evidence demonstrates that the refinancing involved the consolidation of three existing loans into one obligation on June 2, 1980, as well as the creation of two additional debts in the form of the notes executed on June 6, 1980.
6. Debtors' reliance on In re Averhoff, 18 B.R. 198 (Bankr. N.D. Iowa 1982), appears to be misplaced. Averhoff is distinguishable on the grounds that the "renewal notes" involved in that case did not contain any language expressing the parties' intent to preserve existing debts when new money was advanced to the debtors. 18 B.R. at 202-03.
7. The factors identified by the Debtors (different interest rates, payment terms, additional collateral, and new security agreements) are relevant to demonstrate the parties' intent with respect to a novation. In re Hansen, supra, 85 B.R. at 827, citing cases. See also In re Dukes, No. 87-83OW (Bankr. S.D. Iowa 2/29/89 slip op.); In re Scanlan, No. 86-0287OW (Bankr. S.D. Iowa 7/30/87 slip op.). Such factors are not controlling, however, when the notes contain a clear statement to indicate that a novation was not intended. See In re Yoder, 48 B.R. 744, 748 (W.D. Penn. 1984) (reversing In re Yoder, 32 B.R. 777, 781-82 (Bankr. W.D. Penn. 1983), on this point). Such statements appear at page 2 of the consolidation notes executed on June 2, 1980 and September 19, 1983.

For all of the reasons stated above, the Court concludes that the Debtors have failed to establish that their pre-Code debts to FmHA were extinguished under a novation. FmHA's security interest in farm machinery and equipment predates the enactment of the 1978 Bankruptcy Code and may not be avoided by retroactive application of 11 U.S.C. section 522(f)(2)(B). Debtors' motion to avoid liens is therefore overruled, except with respect to the following items acquired post-enactment:

Keifer stock trailer	Agri Sprayer
6 Creep feeders	Hutchensen 62' auger
JD 34 spreader	F-S wagon
14 farrowing crates	Fleet Store wagon
Case 1816-B Uniloader	

ORDER

Debtors' motion to avoid liens is granted as to those items marked with an asterisk in paragraph 2 at page 2 above. The objection to lien avoidance filed by the Farmers Home Administration is sustained as to all other items listed in paragraph 2 at page 2 above.

DONE AND ORDERED this 25th day of April, 1990.

Michael J. Melloy
Chief Bankruptcy Judge

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1. It is undisputed that the items marked by an asterisk were acquired after the enactment of the 1978 Bankruptcy Code. FmHA has withdrawn its objection with respect to those items.
 2. Section 522 provides in part that:
 - 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--

* * * *
 2. a nonpossessory, nonpurchase-money security interest in any-* * * *
 - B. implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor[.]
 3. The security agreement and financing statement also extended to livestock and crops. FmHA filed continuation statements with the Iowa Secretary of State on June 24, 1982 and June 16, 1987.
 4. This security agreement also extended to livestock and crops.
 5. This security agreement also extended to livestock and crops.
 6. The Bankruptcy Reform Act of 1978 was enacted on November 6, 1978, and became effective on October 1, 1979. In re Averhoff, 18 B.R. 198, 200 (Bankr. N.D. Iowa 1982).