

In the United States Bankruptcy Court

for the Northern District of Iowa

PAUL DAVID BISHOP, TERESA JANE
BISHOP
Debtor(s).

Bankruptcy No. 93-60176LW

Chapter 7

ORDER ON MOTION TO AVOID LIEN

On May 26, 1993, the above-captioned matter came on for hearing pursuant to assignment. Debtors Paul and Teresa Bishop appeared in person with Attorney Michael Dunbar. Objector First National Bank of West Union, Iowa was present and represented by Attorney Jefffrey E. Clements. Having considered the record, arguments, and briefs of counsel, the Court makes the following ruling.

STATEMENT OF THE CASE

Paul and Teresa Bishop filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code on February 5, 1993. They presently reside at RR #1, Oakville, Iowa with their two children. Mr. Bishop is employed by Mr. Wayne Gerst in a farming operation. Mrs. Bishop is not employed by Mr. Gerst although she does assist with various farm tasks.

Mr. and Mrs. Bishop have both come from farm backgrounds. Mr. Bishop purchased a farm in 1982, while he was still in high school. After completing high school, he farmed the land for three seasons. He then lost the farm because it was purchased at what was subsequently determined to be an inflated price. Thereafter, he rented a different farm for a period of time, and was involved in dairy farming at the time of filing. His income from the dairy operation was approximately \$600 per month from milk proceeds.

Subsequent to the filing of this bankruptcy, Mr. and Mrs. Bishop moved to Oakville and Mr. Bishop found employment with Mr. Gerst. Mr. Bishop is in charge of the farrowing, breeding, and marketing of the hog operation. He also does crop and field work. Mr. Bishop testified that there is the possibility of a farm partnership with Mr. Gerst in the future. However, he is now a salaried employee. He is provided a home on the property. He does not share in any profit arrangement nor have any business interest in Mr. Gerst's operation. Mrs. Bishop indicated that she has always been involved in farm work, with the exception of a very brief time in which she took employment off the farm.

Mr. and Mrs. Bishop testified that it is their eventual intention to rent farm ground and get involved in some type of grain or livestock operation. It appears they will remain working with Mr. Gerst into the immediate future.

Mr. and Mrs. Bishop retain possession of a substantial amount of farm machinery, listed in the exhibits, which is the subject of controversy in this case. It appears that little, if any, of the machinery

is presently located at Mr. Gerst's farm. A large portion of it is located near West Union. Some is on the property of Mr. Bishop's father and some remains on the property that the Bishop's rented before filing. The dairy herd is in the possession of secured parties. Mr. Bishop stated that it is his intention to take the tractor, baler, hay wagons, and mower to Mr. Gerst's property. He testified that he had a custom operating agreement with his father and brother. He also indicated it is his intention to do some custom work for Mr. Gerst.

The Debtors have claimed \$19,975 of this machinery exempt pursuant to 11 U.S.C. 522(b)(2)(A) and Iowa Code 627.6(11)(a). On March 31, 1993 they filed a Motion to Avoid Lien on the machinery claimed exempt pursuant to 11 U.S.C. 522(f)(2)(B). On April 6, 1993, the First National Bank of West Union, Iowa filed an objection to the Debtors' claim of exemption. The Objector raised two specific grounds. The Objector asserts that the Debtors are not engaged in farming and therefore not entitled to exemptions under 11 U.S.C. 522(b)(2)(A) and Iowa Code 627.6(11)(a). Secondly, the Objector stated that under Iowa Code 627.6(11)(a) the Debtors are allowed a maximum exemption of \$20,000, as joint debtors, and the value of the property in question exceeds this maximum. Additionally, between the time of the filing of the objection and the hearing, the Objector indicated that an issue had been raised as to whether the underlying loans for the machinery were purchase money loans, creating a purchase money security interest thereby excluding this from the effect of 11 U.S.C. 522(f)(2)(B). This issue was also tried without objection.

ISSUE I - Are Debtors engaged in farming?

Title 11 U.S.C. 522(b) allows individual debtors to exempt from property of the bankruptcy estate any property that is exempt under either 522(d) of the Bankruptcy Code or, in the alternative, State or local law, applicable at the date of filing, and any Federal exemptions other than 522(d). State preference determines which exemption scheme is available to debtors. 11 U.S.C. 522(b)(1) allows States to opt out of the federal scheme embodied in 522(d) and thereby entitle debtors to State and local exemptions. Iowa has done this by virtue of

Iowa Code 627(10). Therefore the Court must turn to Iowa law to determine whether the debtor is entitled to claimed exemptions.

Debtors claimed the machinery exempt pursuant to Iowa Code 627.6(11) which provides:

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:

a. Implements and equipment reasonably related to a normal farming operation.

Objector asserts that the Debtors are not engaged in farming since Mr. Bishop is a salaried employee of Mr. Gerst and Mrs. Bishop does incidental work on the same farm. Support for this proposition comes from Matter of Clausen, 81 B.R. 519 (Bankr. S.D. Iowa 1988) in which the court determined that a debtor who was merely an employee of a farm corporation was not engaged in farming for exemption purposes. Id at 521.

A temporary cessation of farming does not per se defeat the exemption, under Iowa law, if the debtor intends to return to farming. Matter of Myers, 56 B.R. 423, 426 (Bankr. S.D. Iowa 1985) (citing Pease v. Price, 101 Iowa 57, 59, 69 N.W. 1120 (1897)); Hickman v. Cruise, 72 Iowa 528, 529, 34 N.W. 316, 317 (1887); Matter of Hahn, 5 B.R. 242, 245 (Bankr. S.D. Iowa 1980). In Pease and Hickman, the court gave great weight to the debtors stated intentions. The Court is cognizant of the fact that the

particular language of the farm implements exemption was amended following the Pease and Hickman decisions, replacing the term "farmer" for "engaged in farming". However, in the present factual context, this modification does not deprecate the holding of Pease or Hickman.

The debtor in Clausen had stopped farming approximately eight years earlier with hopes of resuming farming in five to ten years. Clausen 81 B.R. at 522. The court concluded this did not constitute the temporary cessation for which the exemption would be intended. In contrast, Mr. and Mrs. Bishop continued their dairy operation until the time they filed bankruptcy. Farming continues to be a constant in both their lives and they have clearly expressed intentions to resume farming activities.

Although it is not clear when the Bishops will be able to resume farming activities independent of Mr. Gerst, they expressed an intention to engage in custom farming in the interim. This has been held to satisfy the engaged in farming requirement. Myers 56 B.R. at 427.

It is well settled that Iowa's Exemption Statute is to be liberally construed in favor of the Claimant. Hahn 5 B.R. 242, 245. Based on the foregoing, it is the conclusion of this Court that the Debtors intend to return to the active practice of farming in the near future and that their temporary cessation from farming should not defeat any claim of exemption. As such, on this issue, for the purposes of 11 U.S.C. 522(b)(2)(A) and Iowa Code 627.6(11)(a), these Debtors are engaged in farming and are thereby entitled to the statutory exemptions.

ISSUE II - Does the Bank have a nonpurchase money security interest in the farm machinery the Debtors are claiming exempt?

Mr. & Mrs. Bishop and the First National Bank of West Union Iowa have had an ongoing business relationship. Over the years since Mr. Bishop began his farming operation, he has executed a series of secured notes. The Bank now claims that all of the farm machinery which is listed in the exhibits is subject to a purchase money security interest. Mr. Bishop denies that all of this equipment was purchased as a result of purchase money security interest. The evidence on this issues is somewhat murky. Mr. Bishop testified that the Bank did lend him money to purchase some but not all of the farm machinery items in question. The Court will reconcile the factual conflicts subsequently in this opinion.

The Debtors seek to avoid the lien, pursuant to 11 U.S.C. 522(f). In order to avoid these liens, the Debtors must prove the existence of the following elements: The Debtor has an interest in the property in question; the creditor's lien impairs an exemption of the property to which the Debtor would have been entitled under 11 U.S.C. 522(b), in the absence of the lien; the lien is a nonpossessory, nonpurchase money security interest in the property; and the lien attaches to goods in either of the specific categories set forth in 522(f)(2)(A) and 522(f)(2)(B). In re Psick 51 B.R. 308 (Bankr. D. Minn. 1958) (citing In re LaFond, 45 B.R. 195, 198 (Bankr. D. Minn. 1984), aff'd, 61 B.R. 303 (Bankr. D. Minn. 1985), aff'd, 791 F.2d 623 (8th Cir. 1986)); In re Marian Hansen 85 B.R. 821, 825 (Bankr. N.D. Iowa 1988); In re Shands 57 B.R. 49, 50 (Bankr. D. S.D. 1985); Matter of Weinbrenner 53 B.R. 571, 578 (Bankr. W.D. Wis. 1985). Contra Geist v. Converse County Bank, 79 B.R. 939, 943 (Bankr. D. Wyo. 1987).

Before resolving the legal issues, the Court must resolve the remaining factual disputes by determining which, if any, of the machinery items are purchase money and which are not. The burden of proof is upon the Debtor to prove all of the requisite elements of 11 U.S.C. 522. In re Marian Hansen, 85 B.R. 821, 825 (Bankr. N.D. Iowa 1988); In re Shands, 57 B.R. 49, 50 (Bankr. D. S.C. 1985). As such, the burden of proof is upon the Debtor to establish that the lien on these machinery

items is a nonpossessory, nonpurchase money security interest. As previously stated, Mr. Bishop testified that certain of the items were acquired by purchase money security financing. While Mr. Bishop's responses were not completely clear, a fair interpretation of the evidence establishes that the skid loader, the tractor, the stacker and mover, and the combine, which are reflected in Exhibit C are items which constitute purchase money security interest machinery. Mr. Bishop testified that the mower, the 3 bale racks, and the baler were all purchased on separate contracts and that they were paid off prior to refinancing. It is the conclusion of this Court, in the absence of any contrary evidence, that these items were not purchase money security items. The status of the remainder of the machinery is undetermined by the evidence. Since the Debtors have the burden of proof and did not meet their burden on these items, the Bank's security interest on the remaining unspecified items is also deemed to be purchase money.

Therefore, the mower, the 3 bale racks, and the baler are determined to be nonpossessory, nonpurchase money items. For the reasons previously stated, the remainder of the machinery are determined to be the result of purchase money security financing. Based on the foregoing analysis, the Debtors are authorized to avoid the liens on the mower, the 3 bale racks, and the baler under 11 U.S.C. 522(f).

Ordinarily, the remaining items of machinery would not be subject to lien avoidance as the Bank retains a purchase money security interest in this property. However, the Debtor has asserted a novation as an additional issue for consideration. The Debtors claim that under the present facts there has been a novation of the original note and a new note created. They contend that the purchase money character of the original note does not continue into the new instrument.

A novation is a contract that is itself accepted by the obligee in satisfaction of the obligor's duty. In re Marian Hansen 85 B.R. at 826. It is a well settled rule in Iowa that there are four elements necessary for a novation. Eitzen's Estate v. Lauman, 231 Iowa 1169, 3 N.W.2d 546 (1942). There must have been a previous valid obligation, agreement of all the parties to the new contract, validity of the new contract, and the extinguishment of the old contract. "The critical elements is the intention of the parties to extinguish the existing debt." In re Marian Hansen, 85 B.R. at 826. The burden of proving the novation, by clear and satisfactory proof, and hence this intention, is born by the party asserting it. Eitzen's Estate v. Lauman, 3 N.W.2d at 550. This intention is drawn from all the surrounding circumstances and will not be presumed.

In determining this intention, the Courts have considered four factors: whether new money was advanced in the contract, whether the Debtors' payments were increased, whether additional collateral was provided, and whether a new security agreement was executed. In re Marian Hansen, 85 B.R. at 827.

In this case, explicit evidence revealing the parties intentions is lacking. Mr. Bishop gave no testimony in this regard. Additionally, none of the lending agreements were presented. These documents often contain language expressing such intentions or are marked "canceled" or "renewed", providing some insight into the parties' intent.

While the Court may infer (as opposed to presume) intent using the above factors in the absence of such explicit expressions of intent, it is simply not clear whether any of the above factors exist. The record does not resolve these issues. The Debtors were not even able to specify, with the exception of items previously noted, which pieces of machinery originally created purchase money security interests, and therefore the possibility of novation.

The burden of proof is upon the Debtor to establish a novation by clear and convincing evidence. As the evidence does not support such a finding, it is the ultimate conclusion of this Court that the Debtors have failed to establish and meet his burden of proof in establishing a novation which would alter the original character of the purchase money security interest.

It is the conclusion of this Court that the mower, the 3 bale racks, and the baler are nonpossessory and nonpurchase money items and are therefore subject to lien avoidance under 522 of the Code. The remaining items are nonpossessory purchase money security items. There is no novation which would alter the character of this purchase money security interest. As such, these remaining items are not subject to lien avoidance under 522 of the Code.

ISSUE III - Value of claimed exemptions.

The parties presented various appraisals of the machinery in question which were received into evidence. Additionally, Mr. Bishop testified as an owner as to the value of his equipment. Based on all of the considerations previously discussed in this opinion, it is only necessary to determine the value of those items which were determined to be nonpossessory and nonpurchase money for purposes of the exemption statute; the mower, the 3 bale racks, and the baler. The exemption is limited to the sum of \$10,000 for an individual Debtor or \$20,000 for joint Debtors. These limits are established under Chapter 627.6(11)(a) of the Iowa Code. As originally postured, there was an issue whether the claimed exemptions were of such a value as to exceed the total authorized exemption of \$20,000. This issue no longer exists.

However, for the purposes of this ruling, the Court accepts Mr. Baumler's opinion as to the value of these items. The Court values the mower in the sum of \$2,500; the 3 bale racks in the total sum of \$1,450; and the baler in the sum of \$600. The total value of the exempt items is therefore \$4,550 which is within the statutory exemption limit.

ORDER

IT IS HEREBY ORDERED that Debtors Paul David Bishop and Teresa Jane Bishop's Motion to Avoid Lien is denied in part and granted in part.

FURTHER, for reasons set forth in this opinion, Debtors' Motion to Avoid Liens as to the mower, the 3 bale racks, and the baler is granted.

FURTHER, the value of these items as set forth herein is \$4,550.

FURTHER, Debtors' Motion to Avoid Liens on the remainder of the machinery is denied for the reasons set forth herein.

SO ORDERED this 29th day of June, 1993.

Paul J. Kilburg, Judge
U.S. Bankruptcy Court

I certify that on _____ copies of this order were sent by U.S. mail to: