In the United States Bankruptcy Court

for the Northern District of Iowa

DEAN R. CALEASE and
BARBARA J. CALEASE
Debtor(s).

Bankruptcy No. 93-60698LW

Chapter 7

ORDER RE: OBJECTION OF USA TO DEBTORS' CLAIM OF EXEMPTIONS

This matter came on for hearing before the undersigned on August 18, 1993 on Objection of USA to Debtors' Claim of Exemptions. Ana Maria Martel appeared for the United States on behalf of its agency the Farmers Home Administration ("FmHA"). Habbo G. Fokkena appeared for Debtors Dean and Barbara Calease. After hearing evidence and arguments of counsel, the Court took the matter under advisement. The Court has also considered post-hearing briefs filed by both parties.

STATEMENT OF THE CASE

Debtors executed security agreements on October 7, 1977 and June 19, 1979 in favor of FmHA. These agreements contained after-acquired property clauses granting FmHA security interests in Debtors' equipment "now owned or hereafter acquired". Numerous other financing arrangements occurred between Debtors and FmHA since 1977 which are set out at length in FmHA's Objection. The October 7, 1977 agreement granted FmHA a first lien on all Debtors' farm machinery. At that time, Debtors owned a John Deere 730 tractor. In July 1979, Debtors traded in the 730 tractor for a John Deere 4020 tractor. The trade-in value was $1,200 to $1,400. Debtors also borrowed $6,180 from Iowa State Bank to pay for the balance of the purchase price. FmHA paid off the purchase money loan from Iowa State Bank after October 1, 1979 when Debtors executed another security agreement in favor of FmHA.

FmHA objected to Debtors' claim of exemptions to the extent it has security interests which were created prior to enactment of the Bankruptcy Code and/or purchase money security interests. It asserts that these types of security interests cannot be avoided under 11 U.S.C. § 522(f)(2). At hearing, FmHA limited its objection to Debtors' claim exempting the 4020 tractor. In its post-hearing brief, FmHA concedes that it does not have a purchase money security interest in the 4020 tractor by virtue of its pay-off of the Iowa State Bank loan. See In re Hansen, 85 B.R. 821, 825 (Bankr. N.D. Iowa 1988). It also concedes that the October 1, 1979 security agreement is not a pre-enactment lien. See United States v. Security Industrial Bank, 459 U.S. 70, 103 S. Ct. 407 (1982) (Bankruptcy Reform Act enacted November 6, 1978 became effective on October 1, 1979; § 522(f)(2) cannot be applied to avoid liens created prior to enactment).

Thus, the sole issue is whether FmHA has a security interest in the 4020 tractor 1) by virtue of the after-acquired property clauses in the October 7, 1977 and June 19, 1979 security agreements or 2) by virtue of the October 7, 1977 security agreement granting a first lien on the 730 tractor which Debtors traded in for the 4020 tractor. Debtors argue that the after-acquired property interest only amounted to a second lien subordinate to Iowa State Bank's purchase money security interest. They assert that FmHA has failed to present evidence of the value of that interest. Debtors state that the value of the second lien has long since evaporated by depreciation in the value of the tractor.

CONCLUSIONS OF LAW

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B).

By virtue of an after-acquired property clause, a lender's lien attaches to property when the debtor acquires such property. In re Zweibahmer, 25 B.R. 453, 457 (Bankr. N.D. Iowa 1982). If the lien attaches prior to enactment of the Bankruptcy Code, it cannot constitutionally be avoided under § 522(f)(2). Id.; Security Industrial Bank, 459 U.S. at 82, 103 S. Ct. at 414. A lien arising from a pre-enactment security agreement that attaches to post-enactment, after-acquired property is subject to § 522(f)(2) lien avoidance. Hansen, 85 B.R. at 825.

Debtors acquired the 4020 tractor in July 1979. Congress enacted the Bankruptcy Code on November 6, 1978 to become effective October 1, 1979. Security Industrial Bank, 459 U.S. at 71, 103 S. Ct. at 409. Under Zweibahmer, the after-acquired property clauses allowed FmHA's lien to attach to the 4020 tractor during the "gap period" between the enactment and the effective date of the Code. This Court has previously held that if a lien was created during the gap period, it is subject to avoidance under § 522(f)(2). In re McFarland, 38 B.R. 370, 373 (Bankr. N.D. Iowa 1983), aff'd sub nom., McFarland v. Farmers Production Credit Ass'n, 38 B.R. 374 (N.D. Iowa 1984); see also United States v. Eakes, 76 B.R. 681, 683 (Bankr. S.D. Iowa 1985) (Congress intended § 522(f)(2) to apply to "gap liens"). Therefore, FmHA's security interest which arose from after-acquired property clauses in the October 7, 1977 and June 19, 1979 security agreements and which attached during the gap period is subject to avoidance under § 522(f)(2).

FmHA's only possible remaining interest in the 4020 tractor is that which arises by virtue of the fact that Debtors purchased the tractor in part by trading in the 730 tractor on which FmHA had a first lien under the October 7, 1977 agreement. The evidence indicates that FmHA approved of the trade-in and subordinated its interest to Iowa State Bank's purchase money security interest. Thus, as Debtors point out, FmHA had a junior lien extending only to the amount by which the value of the 4020 tractor exceeded Iowa State Bank's purchase money lien. The value of this lien is not evident from the record. Also, the Court could find nothing in the record indicating that FmHA took any steps to preserve its security interest in proceeds (the 4020 tractor) from trade-in of its collateral (the 730 tractor). See Iowa Code § 554.9306(3). Therefore, it is questionable whether FmHA even has a perfected security interest in the 4020 tractor.

FmHA's objection to exemptions states that the October 7, 1977 promissory note was consolidated into a February 28, 1990 promissory note after being rescheduled in March 1983 and subsequently consolidated in May 1985. Pre-enactment liens can be avoided under § 522(f)(2) if they were extinguished or replaced by later loans. In re Carlson, No. X90-00641S, slip op. at 13 (Bankr. N.D. Iowa Nov. 7, 1990). Carlson considered the elements of novation in considering whether two pre-enactment loans and two post-enactment loans which FmHA consolidated were subject to avoidance. Id. The court concluded that, although no novation occurred, it was not feasible to grant pre-enactment status to the creditor's security interest because there was no way to allocate the present balance due between the various pre- and post-enactment loans. Id. at 17. The court held that the consolidation destroyed the pre-enactment character of the security interest. Id.

To the extent that FmHA has any security interest in the 4020 tractor, the status of this interest is similar to that in Carlson. There were many transactions between the parties from 1977 to the present as set out in FmHA's objection to exemptions. It is impossible from the record to discern to what extent the present balance due is secured by FmHA's interest, if any, in the 4020 tractor arising from trade-in of the 730 tractor. The pre-enactment status of FmHA's lien has been destroyed by the various consolidations.

WHEREFORE, FmHA does not hold a pre-enactment lien on Debtors' 4020 tractor by virtue of after-acquired property clauses.

FURTHER, FmHA does not hold a pre-enactment lien on Debtors' 4020 tractor by virtue of its first lien on the 730 tractor used as trade-in on the 4020 tractor.

FURTHER, § 522(f)(2) does apply to FmHA's lien on the 4020 tractor, allowing Debtors to avoid the lien as a post-enactment, nonpossessory, nonpurchase-money security interest.

FURTHER, the Objection of USA to Debtors' Claim of Exemptions is DENIED.

SO ORDERED this 20th day of September, 1993.

Paul J. Kilburg
U.S. Bankruptcy Judge