

In the United States Bankruptcy Court

for the Northern District of Iowa

JAYSON WADE COOK

Debtor.

Bankruptcy No. 95-10885KC

Chapter 13

ORDER RE CONFIRMATION OF PLAN AND MOTION TO DISMISS

On November 16, 1995, the above-captioned matter came on for hearing on confirmation of Debtor's Chapter 13 Plan and objections thereto. Debtor appeared with Attorney Jeff Taylor. Carol Dunbar appeared as Chapter 13 Trustee. Also present was Attorney Joseph Schmall for Farmers State Bank ("FSB"), an objector to Debtor's plan. The IRS filed an objection. Because of government furloughs, however, no one was present from the U.S. Attorney's Office on behalf of the IRS. Pursuant to prior agreement, the objection from the IRS was not considered and the IRS will be offered a subsequent opportunity to present its objection. Except for the IRS objection, the remaining confirmation process went forward.

STATEMENT OF THE CASE

FSB asserts that it has two separate claims against Debtor, each secured by separate mortgages on Debtor's residence. It argues that under the anti-modification provision of 11 U.S.C. 1322(b)(2), Debtor's Plan cannot be confirmed because the Plan improperly modifies its rights. FSB states that it is the holder of secured claims which are secured solely by security interests in Debtor's homestead.

Debtor acknowledges that FSB is the holder of claims secured by mortgages on Debtor's homestead. Debtor maintains, however, that the secured claims are also secured by "security interests in property" in addition to the homestead and that such additional security precludes FSB from benefitting from the anti-modification provision under 1322(b)(2). It is Debtor's position that a portion of the loan proceeds were used to purchase personalty for the newly constructed home and that FSB holds a security interest in such personal property under a security agreement executed at the time the loan was approved.

FSB initially loaned \$75,000 to Debtor and his then spouse in September of 1993 ("Initial Loan"). Debtor's Exhibit 1. This was a short-term loan to finance construction of their homestead located in Center Point, Iowa, with a maturity date of March 3, 1994. The loan matured and was rolled over into a subsequent loan in the amount of \$100,000 ("Rollover Loan"). The Rollover Loan and accompanying security agreements were executed on February 14, 1994 with a maturity date of August 14, 1994. FSB's Exhibit 5 and FSB's Exhibit 6. The Rollover Loan matured in August without payment being made. A Consent Decree of Foreclosure was entered, pursuant to an agreement, by the Linn County District Court in November of 1994. FSB's Exhibit 1.

As Debtor stipulated to the Decree of Foreclosure, FSB agreed that it would not attempt to enforce this foreclosure by sheriff's sale until the subsequent spring in order to allow Debtor to obtain independent financing to pay off FSB. In conjunction with this agreement, FSB agreed to advance up to \$20,000 to Debtor to allow Debtor to complete the home. Debtor granted FSB a second mortgage on the homestead as security for this new loan. The loan was made on November 7, 1994 with a maturity date of May 7, 1995 ("Second Mortgage Loan").

Debtor used funds from the Second Mortgage Loan to complete construction of the home. A portion of the final \$20,000 was used to buy a dishwasher, freezer, stove and entertainment center which were ultimately placed in the home ("Home Furnishings"). The Second Mortgage Loan was not paid at the maturity date. FSB then proceeded with plans to go through with the sheriff's sale of the homestead to satisfy the foreclosure decree judgment arising from Debtor's default on the Rollover Loan. Debtor filed for Chapter 13 protection one day before the sheriff's sale was to occur.

FSB asserts that the Plan is not confirmable because its rights are improperly being modified. That is, Debtor's plan does not provide for payment of Debtor's obligations to FSB under the terms of the notes negotiated between the parties. Under 1322(b)(2), the rights of a secured claim holder, whose claim is secured solely by a security interest in the debtor's homestead, may not be modified by a Chapter 13 plan. FSB asserts that its rights under the mortgage instruments are being modified in that Debtor now proposes in his Plan to pay the sum of \$700 per month throughout the course of the Plan with a final large balloon payment after completion of the Plan in five years. FSB contends that such payments are insufficient to even service the interest accruing on the secured loans/claims. It is FSB's position that confirmation of Debtor's plan would change his construction loan, which was intended to be repaid in a single payment at its maturity date, into a non-negotiated long-term mortgage obligation.

Debtor asserts that FSB's claim does not fall into the anti-modification exception of 1322(b)(2). He states that under the loan agreements and mortgages, Debtor granted a security interest in personal property in addition to the homestead. Debtor argues that since FSB's claim is not solely secured by the homestead, he can modify the terms of the underlying debt and cram down this Plan over FSB's objection.

Debtor's Exhibit 1 lists the security provided for the Initial Loan of \$75,000, executed on September 3, 1993. The document entitled Fixed Rate Revolving or Draw Note ("Draw Note") provides that Debtor agrees to grant FSB a security interest in "all monies, instruments, savings, checking and other deposits accounts" of Debtor's, that are now or in the future in FSB's custody or control. Additionally, the loan is also "secured by a lien on and/or security interest in the property described in the documents executed in connection with this note as well as any other property designated as security for this note now or in the future." It is Debtor's position that this language placed a security interest, not only on the real estate, but also on personal property described in the Fixed Rate Truth-in-Lending Disclosure Statement ("Disclosure Statement") executed contemporaneously with the note and attached as Debtor's Exhibit 1. The relevant portion of the Disclosure Statement provides that, "[a] security interest has been granted in: **Any deposit account maintained with the Lender; The goods or property being purchased;** Other: REM on 3089 Central City Road, Center Point, Iowa" (emphasis added).

Debtor maintains that the highlighted language conveys a security interest to FSB in not only the bank accounts which Debtor had at the Central City branch of FSB but also in any personal property which Debtor purchased with the loaned funds. FSB does not directly dispute this analysis. It does, however, observe that the Initial Loan and documents matured on March 3, 1994. At that time, Debtor's obligation under the Initial Loan was rolled over into the new \$100,000 Rollover Loan and mortgage which financed repayment of the original debt, as well as additional advances, interest and penalties. The Rollover Loan and mortgage were executed on February 14, 1994. FSB's Exhibit 5 and Exhibit 6.

FSB's Exhibits do not include the Draw Note or the Disclosure Statement which were the documents containing language regarding security interests in the personal property and bank accounts. Thus, the documents regarding the Rollover Loan, as presented in FSB's Exhibits, do not contain any security-granting language other than the real estate mortgage on Debtor's Homestead. FSB contends that this establishes that no security interest exists beyond the realty. Debtor, however, asserts that documents identical to those contained in Debtor's Exhibit 1 were prepared and executed contemporaneously with the Rollover Loan and mortgage but that FSB simply did not include such documents in its exhibits.

FSB agreed to loan up to an additional \$20,000, in the form of the Second Mortgage Loan, as a result of the Consent Decree of Foreclosure agreement of November 1994. FSB's Exhibit 1, FSB's Exhibit 2, Debtor's Exhibit 2. Debtor's Exhibit 2 includes the Disclosure Statement which contains the security granting language regarding any deposit account maintained with FSB, as well as any goods or property being purchased. Debtor again asserts that this language constitutes the grant of non-homestead security interests to secure the Second Mortgage Loan. He states that FSB obtained a security interest in (1) Debtor's accounts held with FSB and (2) the Home Furnishings which Debtor purchased with the Second Mortgage Loan proceeds. Debtor asserts that all such purchases were made with the knowledge and consent of FSB and that, as such, FSB consented to obtaining a security interest in the Home Furnishings.

FSB defines its security interests in the Second Mortgage Loan by asserting that there were always insubstantial funds in Debtor's bank accounts and, thus, the accounts were not intended to be security for repayment of the loan. FSB asserts that it did not consent to Debtor's purchase of the Home Furnishings because the loan was designed to complete the house. However, the testimony of Debtor on this issue is credible and the Court finds that Debtor was in contact with FSB and that he purchased the Home Furnishings only after having notified FSB that he intended to do so.

CONCLUSIONS OF LAW

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Section 1322(b)(2) of the Bankruptcy Code allows a Chapter 13 plan to:

modify the rights of holders of secured claims, **other than a claim secured only by a security interest in real property that is the debtor's principal residence . . .**

11 U.S.C. 1322(b)(2) (emphasis added). This exception to the general rule allowing modification of claim holder's rights is referred to as the "anti-modification" provision. Congress intended by this exception to encourage the flow of capital into the home lending market. Nobleman v. American Sav. Bank, 113 S. Ct. 2106, 2112 (1993).

Despite the brevity and apparent clarity of this exception, a substantial split of authority has developed concerning whether any and all security interests in addition to a homestead mortgage permit modification of the mortgagee's rights. One line of cases holds that any grant of an additional security interest, even as a result of common boilerplate home mortgage language, will exclude the mortgagee from the protection of the anti-modification provision. See In re Hammond, 27 F.3d 52, 57 (3d Cir. 1994). The alternative line holds that, given the Congressional intent to encourage creditors to participate in the home mortgage lending market, the additional security interest must rise to a certain qualitative, if not quantitative, level before the mortgagee loses the protection of the anti-modification provision. See In re Halperin, 170 B.R. 500, 502 (Bankr. D. Conn. 1994). Neither the Supreme Court nor the Eighth Circuit have addressed this issue directly. The factual setting of this case does not require the Court to decide which line of cases to follow.

Two Separate Secured Claims

Debtor's schedules as well as the Plan acknowledge that FSB has two separate secured claims. Although the documents creating the debt and security interests underlying the claims are nearly identical, the Court will analyze the claims separately to determine whether FSB is entitled to anti-modification protection as to either secured claim. If FSB is entitled to such protection for either claim, the Plan will be unconfirmable, as it concededly attempts to modify FSB's contractual rights concerning repayment of these currently mature secured debts.

Attachment of Security Interests Under Iowa Law

Whether a mortgagee holds a security interest in an asset of the debtor is a question of state law. In re French, 174 B.R. 1, 3 (Bankr. D. Mass. 1994). Whether having a non-homestead security interest is sufficient to preclude the mortgagee from protection under the anti-modification provision of 1322(b)(2) is a question of Federal Bankruptcy Law. Id. The Court must first interpret Iowa UCC law to determine whether FSB in fact holds particular security interests as security for repayment of either of its secured claims. Id. For the purpose of making a 1322(b)(2) determination, the relevant time to evaluate whether such a security interest exists is the commencement of the case. Id. at 7.

The criteria used to determine whether a security interest has attached to a given piece of personal property and whether such security interest is enforceable are delineated in Iowa Code sec. 554.9203. A security interest attaches as soon as all of the events specified in section 554.9203(1) have taken place. Iowa Code 554.9203(2). Subsection 1 specifies the following events:

- a. the debtor has signed a security agreement which contains a description of the collateral;
- b. value has been given: and
- c. the debtor has rights in the collateral.

Iowa Code 554.9203(1).

Thus, the Court will determine whether a security interest existed in specific personal property at the commencement of the case based upon whether the above three criteria are met with respect to that property. For the purpose of a 1322(b)(2) analysis, only security interests which have attached and are enforceable at the commencement of the case are relevant. In other words, the existence of potential and/or unenforceable non-homestead security interests would not be sufficient to exclude FSB from anti-modification protection because such security interests provide no presently cognizable security for repayment of the debt. See French, 174 B.R. at 7 (stating that inclusion of nonexistent "deposits" as additional collateral is immaterial for the purposes of 1322(b)(2)); In re Hirsch, 166 B.R. 248, 254 (E.D. Pa. 1994) (finding no value attributable to non-realty items listed as additional collateral).

Rollover Note Claim

Debtor asserts that the Rollover Loan Claim is secured by not only the mortgage on the homestead but also by bank accounts and the Home Furnishings. The critical language supporting Debtor's assertion of additional collateral is contained in the Disclosure Statement and the Draw Note. As noted in the Statement of the Case, neither document was included in FSB's Exhibits 5 and/or 6, in connection with the Rollover Loan transaction. Debtor maintains that these documents were executed in conjunction with the Rollover Loan but are simply not provided by FSB in its exhibits. Debtor provided these documents in exhibits pertaining to the Initial Loan as well as the Second Mortgage Loan, however, Debtor did not provide any documents regarding the Rollover Loan.

FSB does not deny the possible existence of additional documents but could not state what they might be or their contents. The Court notes that FSB's exhibits regarding the Rollover Loan did not contain a promissory note creating the in personam obligation upon which FSB's claim is based. Although the existence of this obligation is not in question in this case, the Court must conclude that there may well be additional documents regarding the Rollover Loan which are not in evidence. Without deciding which party bears the burden to produce these documents, the Court shall assume, for the purposes of the following analysis that the documents which Debtor claims to have been executed in conjunction

with the Rollover Loan, were in fact contemporaneously executed, and that the provisions of such documents are identical to those in the Disclosure Statements and Draw Notes which are in evidence.

Security Interest in Debtor's Bank Accounts with FSB

The Draw Note, which the Court assumes to exist with respect to this claim, if identical to the previous draw note, would provide that Debtor grants to FSB a security interest in Debtor's "rights, title and interest, in all monies, instruments, savings, checking and other deposit accounts of [Debtor] . . . that are now or in the future in Lender's custody or control." This provision sufficiently describes the collateral to which the security interest is to attach and thus satisfies the first requirement of Iowa Code sec. 554.9203(1), again assuming the existence of this document and that it was signed by Debtor. Further, there is no dispute that the Rollover Loan was extended to satisfy the Initial Loan, and to provide additional funds to Debtor to complete the construction of the homestead. Thus, value was given by FSB which satisfies the second requirement of subsection 1.

The critical issue is whether, at the commencement of the case, Debtor had rights in the collateral, i.e. bank accounts with FSB, such that the third requirement of subsection 1 is satisfied. Debtor's Schedule B, which was filed contemporaneously with the Debtor's voluntary Chapter 13 filing, gives a detailed listing of all of Debtor's personal property possessions, at the commencement of this case. Nowhere in Schedule B does Debtor list an account of any kind with FSB. The only bank account listed is a \$50 checking account with Firststar Bank in Cedar Rapids. It is the conclusion of the Court that, as of the commencement of the case, Debtor had no rights in any account with FSB. Thus, under Iowa law, no security interest in such an account attached.

Alternatively, even if there were monies in Debtor's accounts at the commencement of the case, such that FSB might be said to have a security interest in them, the granting of such a security interest merely confirms FSB's common law right of set-off in Debtor's deposits with FSB and as such does not secure the Rollover Loan in such a way as to exclude FSB from anti-modification protection. In re Loader, 128 B.R. 13, 16 (Bankr. D.Mass. 1991). As such, under either alternative, FSB's Rollover Loan claim is not secured by a bank account of Debtor for the purposes of 1322(b)(2).

Security Interest in Debtor's Home Furnishings

The language which purports to give FSB a security interest in Debtor's Home Furnishings is drawn from a combination of two documents. The Draw Note provides that the note is secured by a security interest in the property described in the documents executed in connection with the note. The Disclosure Statement, which, as noted above, is not in evidence but which the Court assumes to have been executed in connection with the note, provides "[a] security interest has been granted in: . . . ; **The goods or property being purchased;** . . ." (emphasis added).

Again, there can be no dispute that value was given by FSB to Debtor. The transaction, however, fails to satisfy the "debtor's rights in collateral" requirement. Debtor did not purchase the Home Furnishings with the funds from the Rollover Loan. The language of the Disclosure Statement may be slightly ambiguous as to the scope of the goods or property in which Debtor was granting a security interest, however, the provision implies that the assets in which Debtor was granting the security interest were goods or property purchased with funds from the Rollover Loan. As Debtor never purchased any Home Furnishings with the funds, he could not obtain rights in collateral which never existed.

If the provision granting the security interest is construed to include all subsequently acquired personal goods or property, purchased with funds from any source, the provision would be properly characterized as an after-acquired property clause. Iowa Code sec. 554.9204(2) prohibits a security interest from attaching under an after-acquired property clause to "consumer goods", unless the debtor acquires rights in the consumer goods within ten days of the secured party's giving of value. Section 554.9109(1) defines consumer goods as those which are used or bought for use primarily for personal, family or household purposes. Each item included in the Home Furnishings constitutes a

consumer good. The Rollover Loan transaction occurred on February 14, 1994. The loan matured on August 14, 1994. This date was the latest date on which FSB might have given value under the Rollover Loan. The evidence also establishes that the Home Furnishings were purchased with funds from the Second Mortgage Loan which was executed on November 7, 1994. Assuming Debtor bought the Home Furnishings on that date, Debtor still would not have acquired rights in the Home Furnishings within ten days of the last day on which FSB gave value to Debtor under the Rollover Loan, i.e. August 14, 1994. Even if the provision in the Disclosure Statement constitutes an after-acquired property clause granting a security interest in after-acquired Home Furnishings, the security interest did not attach since the Home Furnishings constitute consumer goods. Iowa Code 554.9205. It is therefore the conclusion of the Court that the Rollover Loan is not secured by a security interest in the Home Furnishings.

CONCLUSION

Having held that the Rollover Loan is not secured by an interest in Debtor's non-existent bank accounts with FSB or Debtor's after-acquired Home Furnishings, it is the conclusion of the Court that the Rollover Loan is secured only by a security interest in Debtor's homestead. As such, FSB's rights as a secured claim holder may not be modified under Debtor's Plan. 11 U.S.C. 1322(b)(2). Because Debtor's plan would in fact modify FSB's rights regarding the Rollover Loan, the plan is not in compliance with 1322(b)(2). As a result, the Plan is not confirmable. 11 U.S.C. 1325(a)(1). Because of this conclusion, the Court need not address whether the Second Mortgage Loan is secured by non-homestead collateral.

In order to present a confirmable plan, Debtor needs to satisfy the currently mature Rollover Loan obligation which is in excess of \$100,000. Given the history of this case, the Court finds it improbable that Debtor will be able to secure the financing required to accomplish the necessary elements of such a confirmable plan. Therefore, the Court shall sustain FSB's motion to dismiss, subject to the following provision. The Court shall grant Debtor 10 days leave in which to convert this case to Chapter 7. If after such time Debtor has failed to so convert, this case shall be dismissed without further notice or hearing.

WHEREFORE, Confirmation of Debtor's Plan is DENIED.

FURTHER, Debtor is granted 10 days leave in which to convert this case to Chapter 7.

FURTHER, if Debtor fails to convert to Chapter 7 within 10 days, this case shall be dismissed without further notice or hearing.

SO ORDERED this 8th day of December, 1995.

Paul J. Kilburg
U.S. Bankruptcy Judge