

In the United States Bankruptcy Court

for the Northern District of Iowa

REX LOREN HOWARD and JEANNETTE
MARIE HOWARD
Debtors.

Bankruptcy No. 96-22392

Chapter 7

ORDER RE: OBJECTION TO CLAIM OF EXEMPTIONS

On December 11, 1996, the above-captioned matter came on for hearing pursuant to assignment. Debtors appeared by Attorney Fran Henkels. Paul Fitzsimmons appeared as Chapter 7 Trustee. Attorney Richard Hansen appeared for Creditor Homeland Bank Oelwein. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(B), (K).

STATEMENT OF THE CASE

Trustee objects to exemption of a 1995 Ford Mustang and certain amounts due from Mid American Dairyman. Creditor Homeland Bank Oelwein joins in the Trustee's Objection to Claim of Exemptions, and additionally objects to exemption of a 1985 Mercury Lynx.

FINDINGS OF FACT

The parties have stipulated to most of the pertinent facts in this case. Debtors claim the 1995 Mustang exempt under Iowa Code sec. 627.6(9)(b). Trustee's initial objection to exemption was based on Debtors' valuation of the Mustang at \$10,000. Debtors and Trustee have now stipulated that the value of the car is \$12,000. If the Court determines that they may claim the Mustang exempt, Debtors intend to pay the difference between their combined \$10,000 statutory exemption allowance for vehicles and the value of the car, or the amount of \$2,000, to Trustee. Trustee accepts this arrangement.

Debtors withdraw their claim that the 1985 Mercury Lynx is exempt, pending the Court's resolution herein. They also withdraw their claim that amounts due from Mid American Dairyman are exempt as accrued wages. At this time, it appears that the parties agree that the amounts due from Mid American Dairyman do not constitute wages. If this determination is later revised, Debtors may raise the exempt status of these amounts at that time.

The remaining issue to be resolved is the status of the 1995 Ford Mustang. Homeland Bank asserts it has a security interest in the Mustang pursuant to a Feb. 8, 1996 note and security agreement. See Exhibit H. The remainder due on that note is \$15,554.58 in principal and \$609.29 in interest, according to Exhibit J submitted after the hearing. The Bank also asserts a March 27, 1995 Security Agreement grants it a security interest in the Mustang as equipment, including all vehicles, Debtors may own in the future. See Exhibit C.

As part of the February 1996 loan transaction, the Bank paid off Chrysler Credit Co.'s first security interest in the Mustang. That security interest was canceled on the Certificate of Title on 2-16-96. The Bank's interest is not noted on the Certificate of Title.

Although this matter is postured as an objection to exemptions, the parties have brought into issue the avoidability of the Bank's lien. At the hearing, the parties agreed to waive any procedural objections to the Court ruling on the validity of the Bank's lien at this time. The Court will, therefore, determine whether the Bank has a lien on the Mustang under Iowa law and, if so, whether the lien is avoidable. This is in addition to the original issue of whether Debtors are entitled to claim the Mustang exempt.

CONCLUSIONS OF LAW

The first question is whether the Bank has a lien on the Mustang. If the Bank's claim of more than \$15,000 is a lien on the Mustang, valued at \$12,000, Debtors have no equity in the vehicle to claim exempt under Iowa Code sec. 627.6(9)(b). Security interests in motor vehicles in Iowa are perfected by having such interest recorded on the vehicle's certificate of title. Iowa Code 321.45(2), 321.50; see also Iowa Code 554.9302(1)(d). Section 321.45(2) provides in relevant part:

No person shall acquire any right, title, claim or interest in or to any vehicle subject to registration under this chapter from the owner thereof except by virtue of a certificate of title issued or assigned to the person for such vehicle . . . nor shall any waiver or estoppel operate in favor of any person claiming title to or interest in any person claiming title to or interest in any vehicle against a person having possession of the certificate of title . . . for such vehicle . . . except in case of:

a. The perfection of a lien or security interest by notation on the certificate of title as provided in section 321.50 . . .

...

d. . . Except in the above enumerated cases, no court in any case at law or equity shall recognize the right, title, claim or interest of any person in or to any vehicle subject to registration sold or disposed of, or mortgaged or encumbered, unless evidenced by a certificate of title. . .

Debtor argues that Blessing v. Norwest Bank Marion N.A., 429 N.W.2d 142 (Iowa 1988), requires the conclusion that the Bank has no recognizable interest in the Mustang. In Blessing, the mother-in-law of the owner of a feed truck claimed a security interest in the truck in an action for conversion against a bank. The bank had repossessed the truck based on its perfected lien. 429 N.W.2d at 143-44. The court found that the plaintiff's security interest was not enforceable because it was not in writing as required by the U.C.C. Id. at 144. Furthermore, the plaintiff had failed to perfect her security interest by noting it on the certificate of title. Id. The court concluded that she had no property interest in the vehicle such as is required to support a claim for conversion against the bank. Id. at 145.

The Iowa Supreme Court previously addressed a situation more analogous to the one presented here. In Sandhorst v. Mauk's Transfer, Inc., 252 N.W.2d 393, 398 (Iowa 1977), the court stated that as between the two immediate parties to a transfer of a vehicle, the certificate of title is prima facie evidence, but not conclusive proof, of their respective ownership rights. It concluded that the buyer had an ownership interest in the vehicle even though it was not noted on the certificate of title. Id.

Blessing distinguished Sandhorst as relevant in two-party transactions and not applicable in respect to a third party's rights. 429 N.W.2d at 144.

This Court followed Sandhorst in In re Bierman, 133 B.R. 484, 486 (Bankr. N.D. Iowa 1991), to uphold a debtor's right to exempt an interest in a vehicle which was not noted on the certificate of title. The holding of Sandhorst is applied where third party rights are not implicated. State v. TeBockhorst, 305 N.W.2d 705, 708 (Iowa 1981).

In Blessing, an unperfected, unwritten security interest in a vehicle was not recognized in determining a party's ability to maintain an action for conversion against another secured party who had repossessed the vehicle. In this case, the Bank bases its interest on its secured transaction with Debtor, evidenced by a writing but unperfected. As between the Bank and Debtor, following Sandhorst, the security interest is recognizable. Failure to note the security interest on the certificate of title is not conclusive as to the validity of the Bank's interest. The security interest arises and is effective against Debtor because of the security documents, the notes and financing statements admitted into the record. This interest is sufficiently proved in this record and is enforceable against Debtor, even though it is unperfected under Iowa law.

Having determined that the Bank does have a security interest in the Mustang, the question of whether the Trustee may avoid the lien is easily answered. Generally, an unperfected security interest is a transfer avoidable by a trustee under 544(a). A creditor's unperfected security interest in a vehicle does not defeat trustee's interest as hypothetical judicial lien creditor under 544. First Nat'l. Bank v. Turley, 705 F.2d 1024, 1026 (8th Cir. 1983) (applying requirement that notation on certificate of title in South Dakota was required for perfection). In Iowa, where notation of a security interest is not placed on the title of a vehicle, the creditor does not have a perfected security interest in the vehicle. In re Product Design & Fabrication, Inc., 182 B.R. 803, 807 (Bankr. N.D. Iowa 1994); Iowa Code 554.9302(3)(b). Such an unperfected security interest in a vehicle is avoidable by the trustee pursuant to 11 U.S.C. 544. Id.

The final issue for resolution is whether Debtors may claim the Mustang exempt after the Trustee avoids the Bank's security interest. Any transfer avoided under 544 is preserved for the benefit of the estate. 11 U.S.C. 551. Notwithstanding 551, a transfer avoided under 544 "may be preserved for the benefit of the debtor to the extent that the debtor may exempt such property under [522(g) or 522(i) (1)]." 11 U.S.C. 522(i)(2).

Under 522(g)(1)(A), a debtor may only exempt property recovered by avoidance of a transfer if the debtor did not voluntarily transfer the property. Where a debtor voluntarily transfers property prepetition, the debtor is not entitled to exempt the property once it is returned to the estate. In re Beshears, 182 B.R. 235, 241 (Bankr. E.D. Ark. 1995). Such a voluntary transfer includes the grant of a security interest. In re Flitter, 181 B.R. 938, 941 (Bankr. D. Minn. 1995). A debtor cannot meet the 522(g)(1)(A) requirement when a trustee avoids an unperfected security interest, voluntarily granted by the debtor. Id.

Debtors voluntarily agreed that the 1995 Mustang would constitute secured collateral for the refinanced loan with the Bank. This voluntary grant of a security interest prevents Debtors from utilizing 522(g)(1) to claim the Mustang exempt. "[D]ebtors are not entitled to receive a windfall . . . because the secured creditor neglected to perfect its lien. . . . The benefit of such failure should enure to all unsecured creditors, including the lien holder who failed to perfect [the] lien, and not to the benefit of the debtors." In re Lamping, 8 B.R. 709, 712 (Bankr. E.D. Wis. 1981).

Under 522(g)(2), a debtor may claim property recovered under 544 exempt if the debtor could have avoided the transfer under 522(f). "For this source of secondary exemption rights, it is irrelevant whether the original transfer was voluntary or involuntary." Flitter, 181 B.R. at 942. The property included within 522(f), however, is limited to certain goods held primarily for personal, family or household use, tools of the trade, or health aids. 11 U.S.C. 522(f)(1)(B) (previously numbered subsection (f)(2) as referred to in 522(g)(2)). The Mustang does not fit within any of these categories of property. Therefore, Debtors may not claim it exempt under 522(g)(2).

Section 522(i)(1) is the only remaining provision available to Debtors to exempt the Mustang after the Trustee avoids the Bank's security interest. This alternative allows exemption if the debtor could avoid the transfer under 522(f) or (h). As previously discussed, the Mustang does not fit within the property enumerated in subsection (f). Reference to subsection (h) incorporates the requirement of nonvoluntariness found in subsection (g)(1)(A). 2 William L. Norton, Jr., Norton Bankruptcy Law and Practice 46:27 (2d ed. 1994). Debtors may not utilize 522(i)(1) to claim the Mustang exempt because they voluntarily granted the Bank its security interest in the Mustang.

WHEREFORE, Homeland Bank Oelwein holds an unperfected security interest in Debtors' 1995 Ford Mustang.

FURTHER, the Bank's security interest is avoided by the Trustee pursuant to 11 U.S.C. 544.

FURTHER, objections to exemption of the 1995 Ford Mustang are sustained. After avoiding the Bank's security interest in the Mustang, the value of the Mustang is preserved for the benefit of the estate pursuant to 551.

FURTHER, Debtors may not claim the Mustang exempt under 522.

SO ORDERED this 7th day of March, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge