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Section 522(f): A Proposal for the Survival of Purchase Money Security Interests Following Refinancing

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NOTES AND COMMENTS

SECTION 522(f): A PROPOSAL FOR THE SURVIVAL OF PURCHASE MONEY SECURITY INTERESTS FOLLOWING REFINANCING

I. INTRODUCTION

Refinancing¹ is an everyday occurrence that can dramatically affect the treatment of consumer debt in bankruptcy proceedings. Traditionally, courts have held that refinancing transforms a purchase money security interest into a nonpurchase money security interest.²

1. Refinancing arises when a sequence of loans is made by a vendor or lender to a buyer. When the creditor takes a security interest in the property of the debtor to secure the first loan, a total repayment amount and a time frame for repayment are fixed. Two broad types of refinancing arrangements exist. The first type consists of "'add-on' or future advances contracts which secure several items under a single, ongoing instrument." *In re Conn*, 16 Bankr. 454, 459 (Bankr. W.D. Ky. 1982). The second type is primarily "consolidation loans, which involve two or more separate loan instruments." *Id.* In consolidation loans, three events occur: (1) the time for repayment of the initial debt is extended, (2) the balance due on the initial debt is consolidated or carried forward to be included with a new loan of money; this new loan can vary from the first in either the total repayment amount, the property encumbered by the creditor's security interest, or both, and (3) the initial debt is marked "paid by renewal," at which time it is considered refinanced. *See, e.g., Averhoff v. Peoples Fin. Co. (In re Averhoff)*, 18 Bankr. 198 (Bankr. N.D. Iowa 1982) (nonpurchase money loan, then purchase money loan, with new collateral taken and new debt issued); *In re Conn*, 16 Bankr. 454 (Bankr. W.D. Ky. 1982) (purchase money loan, then nonpurchase money loan, with new debt issued and new collateral taken); *In re Haus*, 33 U.C.C. REP. SERV. (CALLAGHAN) 695 (Bankr. D.S.C. 1982) (a charge-all or add-on clause in a seller's contract, which allows the seller to retain a purchase money security interest in merchandise until total indebtedness corresponding to merchandise is paid in full, allows a series of purchase money loans with new debt issued and new collateral taken); *Credithrift of Amer. v. Littlejohn (In re Littlejohn)*, 20 Bankr. 695 (Bankr. W.D. Ky. 1982) (original purchase money loan refinanced to extend time for repayment; no new collateral taken but new debt issued); *In re Jones*, 5 Bankr. 655 (Bankr. M.D.N.C. 1980) (future advance clause in seller's contract whereby collateral served to secure any future advance made; new debt issued and new collateral taken). *See generally*, McLaughlin, "Add-On" Clauses in Equipment Purchase Money Financing: Too Much of a Good Thing, 49 FORDHAM L. REV. 661 (1981) (thorough analysis of three general circumstances in which purchase money financing can occur); B. CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 12.2, at 12-8 to -10 (1980) (discussing development of case law; arguing that under U.C.C. § 9-107(a)(1978) language, a vendor can retain security interest to secure debt arising out of past or future purchases); Donaldson, *An Analysis of Retail Sales Legislation*, 19 ROCKY MTN. L. REV. 135, 148 (1947) (discussing add-on clauses as method of obtaining additional security in installment sales contracts).

2. *See Roberts Furniture Co. v. Pierce (In re Manuel)*, 507 F.2d 990 (5th Cir. 1975); *In re*

The recharacterization of a purchase money security interest³ into a nonpurchase money security interest⁴ allows a debtor in bankruptcy to avoid creditors' claims in certain household goods.⁵

This approach, however, has recently been rejected by an increasing number of courts which hold that a security interest retains its purchase money character following refinancing.⁶ This approach pre-

Coronado, 7 Bankr. 53 (Bankr. D. Ariz. 1980); *Ashworth v. McMahan's Furniture* (*In re Ashworth*), 16 Bankr. 645 (Bankr. C.D. Cal. 1981); *King v. Citizens & S. Nat'l Bank* (*In re King*), 19 Bankr. 409 (Bankr. M.D. Ga. 1982); *In re Booker*, 31 U.C.C. Rep. Serv. (Callaghan) 285 (Bankr. M.D. Ga. 1981); *W.S. Badcock Corp. v. Banks* (*In re Norrell*), 426 F. Supp. 435 (M.D. Ga. 1977); *Mulcahy v. Indianapolis Morris Plan Corp.* (*In re Mulcahy*), 3 Bankr. 454 (Bankr. S.D. Ind. 1980); *Averhoff v. Peoples Fin. Co.* (*In re Averhoff*), 18 Bankr. 198 (Bankr. N.D. Iowa 1982); *In re Calloway*, 17 Bankr. 212 (Bankr. W.D. Ky. 1982); *In re Brouse*, 6 U.C.C. Rep. Serv. (Callaghan) 471 (W.D. Mich. 1969); *In re Simpson*, 4 U.C.C. Rep. Serv. (Callaghan) 243 (W.D. Mich. 1966); *In re Jackson*, 9 U.C.C. Rep. Serv. (Callaghan) 1152 (W.D. Mo. 1971); *In re Jones*, 5 Bankr. 655 (Bankr. M.D.N.C. 1980); *In re Snyder*, 16 Bankr. 380 (Bankr. S.D. Ohio 1982); *In re Lay*, 15 Bankr. 841 (Bankr. S.D. Ohio 1981); *In re Scott*, 29 U.C.C. Rep. Serv. (Callaghan) 1038 (Bankr. M.D. Pa. 1980); *Kawasho Internat'l (U.S.A.), Inc. v. Alper* (*In re Mid-Atlantic Flange Co.*), 26 U.C.C. Rep. Serv. (Callaghan) 203 (E.D. Pa. 1979); *In re Haus*, 33 U.C.C. REP. SERV. (CALLAGHAN) 695 (Bankr. D.S.C. 1982); *Rosen v. Associates Fin. Serv.* (*In re Rosen*), 18 Bankr. 723 (Bankr. D.S.C. 1981), *aff'd on rehearing*, 17 Bankr. 436 (Bankr. D.S.C. 1982); *In re Bechen*, 32 U.C.C. Rep. Serv. (Callaghan) 324 (Bankr. D.S.D. 1981); *Kelley v. United Am. Bank of Knoxville* (*In re Kelley*), 17 Bankr. 770 (Bankr. E.D. Tenn. 1982); *McLemore v. Simpson County Bank* (*In re Krulik*), 6 Bankr. 443 (Bankr. M.D. Tenn. 1980); *Aalgaard v. Public Fin.* (*In re Aalgaard*), 18 Bankr. 990 (Bankr. E.D. Wash. 1982); *In re Luczak*, 16 Bankr. 743 (W.D. Wis. 1982).

3. The requirements for a purchase money security interest are delineated in U.C.C. § 9-107 (1978). See generally B. CLARK, *supra* note 1, ¶ 3.9[2], at 3-55 to -57, ¶ 2.7[1]-[2], at 2-18 to -21 (discussing purchase money security interests); CREDIT MANUAL OF COMMERCIAL LAWS (L. Nelson ed. 1981) (discussing purchase money security interests); 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 29.2, at 779-84 (1965) (discussion of purchase money security interests); W. DAVENPORT & D. MURRAY, SECURED TRANSACTIONS § 2.05, at 32-34 (1978) (discussing purchase money security interests).

4. Nonpurchase money security interest is not defined in the U.C.C. or the Bankruptcy Code. However, since this is the opposite of purchase money security interest, the term appears to exclude those transactions which secure an obligation that finances the acquisition of the collateral, whether taken by a vendor or lender.

5. The Bankruptcy Reform Act of 1978 (Bankruptcy Code), 11 U.S.C. § 522(f)(2)(A) (Supp. IV 1980) provides:

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—

(A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor.

6. See *Mid-Eastern Electronics, Inc. v. First Nat'l Bank of S. Maryland*, 455 F.2d 141 (4th Cir. 1970); *Goodyear Tire & Rubber Co. v. Staley* (*In re Staley*), 426 F. Supp. 437 (M.D. Ga. 1977); *In re Rivet*, 299 F. Supp. 374 (E.D. Mich. 1969); *In re Conn*, 16 Bankr. 454 (Bankr. W. D. Ky. 1982); *Credithrift of Am. v. Littlejohn* (*In re Littlejohn*), 20 Bankr. 695 (Bankr. W.D. Ky. 1982); *In re Georgia*, 22 Bankr. 31 (Bankr. S.D. Ohio 1982); *General Elec. Corp. v. Scott* (*In re Scott*), 17 Bankr. 375 (Bankr. W.D. Mo. 1982); *Holland v. Associates Fin.* (*In re Holland*), 16 Bankr. 83 (Bankr. N.D. Ohio 1981); *In re Gibson*, 16 Bankr. 257 (Bankr. D. Kan. 1981); *In re*

vents the debtor from avoiding the creditor's purchase money security interest pursuant to section 522(f)(2)(A)⁷ of the Bankruptcy Code and leaves the creditor with a stake in the debtor's bankrupt estate.⁸

The original transaction is made when credit is extended by a vendor⁹ or a loan is made by a lender¹⁰ to the debtor to enable the purchase of household goods. To insure repayment, both vendors and lenders take purchase money security interests in the goods purchased. These purchase money loans can be refinanced in three ways:¹¹ when the original collateral secures additional debt or credit,¹² when additional collateral¹³ is secured,¹⁴ or when additional debt and collateral, or credit and collateral, are taken.¹⁵

This Comment examines the characterization of refinanced purchase money security interests in household goods. First, pertinent sections of the Uniform Commercial Code (U.C.C.) and the Bankruptcy Reform Act of 1978 (Bankruptcy Code)¹⁶ are examined. Next, a historical development of the characterization of purchase money security interests following refinancing is summarized, followed by analysis of the policies behind section 522(f)(2)(A) of the Bankruptcy Code and section 9-107 of the U.C.C. Finally, this Comment suggests that the correct view is the more recent one that a purchase money security interest in household goods retains its purchase money character following refinancing.

James, 7 Bankr. 73 (Bankr. D. Maine 1980); *In re Coomer*, 8 Bankr. 351 (Bankr. E.D. Tenn. 1980); *Slay v. Pioneer Credit Co. (In re Slay)*, 8 Bankr. 355 (Bankr. E.D. Tenn. 1980); *Union Nat'l Bank of Pittsburgh v. Northwest Marine, Inc.*, 27 U.C.C. Rep. Serv. (Callaghan) 563 (Pa. Ct. of C.P., Erie County 1979); *Bank of Austin v. Barnett*, 549 S.W.2d 428, 430 (Tex. Ct. App. 1977); *Index Store Fixture Co. v. Farmers' Trust Co.*, 19 U.C.C. Rep. Serv. (Callaghan) 284 (Mo. Ct. App. 1976).

7. 11 U.S.C. § 522(f)(2)(A) (Supp. IV 1980).

8. *Id.* § 541 provides that the bankruptcy estate is created upon the filing of the debtor's bankruptcy petition. If a debtor defaults, four identifiable classes compete for the collateral: (1) unsecured creditors, (2) purchasers, (3) secured creditors, and (4) the debtor's trustee.

9. U.C.C. § 9-107(a)(1978) (applies to sales on credit).

10. *Id.* § 9-107(b) (applies to loan to purchase goods).

11. See McLaughlin, *supra* note 1, at 663.

12. See *King v. Citizens & S. Nat'l Bank (In re King)*, 19 Bankr. 409, 410 (Bankr. M.D. Ga. 1982).

13. U.C.C. § 9-105(1)(c) (1978) defines collateral as the property encumbered by the security interest.

14. See *Union Nat'l Bank of Pittsburgh v. Northwest Marine, Inc.*, 27 U.C.C. Rep. Serv. (Callaghan) 563, 565 (Pa. Ct. of C.P., Erie County 1979).

15. See *Roberts Furniture Co. v. Pierce (In re Manuel)*, 507 F.2d 990 (5th Cir. 1975).

16. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended in scattered sections of the U.S.C. (Supp. II 1978, Supp. III 1979 & Supp. IV 1980)).

II. THE BACKGROUND OF THE CONTROVERSY

Prior to the adoption of the U.C.C., and its provision for purchase money security interests,¹⁷ two methods of establishing purchase money security interests existed:¹⁸ conditional sales and chattel mortgages. A conditional sale¹⁹ was used when a vendor, desiring to insure payment of an installment sales price, retained title in the goods until full repayment.²⁰ A chattel mortgage²¹ was used by a lender who took a security interest in the goods purchased with the proceeds of the loan.²² Conditional sales and chattel mortgages were replaced by the U.C.C. provisions²³ for purchase money security interests, which are created by satisfying one of the two-pronged definitional requirements of section 9-107.²⁴ These two prongs specify different requirements for

17. U.C.C. § 9-107 (1978).

18. See generally 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 3.3, at 68-73, § 10.2, at 297-301 (1965) (discussing conditional sales theory and pre-U.C.C. security devices); E. REILEY, GUIDEBOOK TO SECURITY INTERESTS IN PERSONAL PROPERTY § 1.2, at 1-8 (1981) (discussing pre-U.C.C. security devices); 68 AM. JUR. 2d *Secured Transactions* § 108, at 994 (1973) (discussing history of purchase money security interests).

19. Conditional sales, in which title is reserved in the vendor until the purchase price has been paid in full, were desirable at common law because the vendor retained the title without the necessity of filing a lien. See, e.g., *First State Bank v. Harter*, 30 Ill. App. 234, 22 N.E.2d 393 (1939). See generally H. BAILEY, SECURED TRANSACTIONS IN A NUTSHELL 46-47 (1976) (discussing general characteristics of conditional sale); W. DAVENPORT & D. MURRAY, *supra* note 3, § 2.05, at 32 n.96 (conditional sale contract was pre-U.C.C. security device used by sellers).

20. A general assumption was that "the only obligation which could be secured was the purchase price of the goods plus expenses connected with, or incidental to, the sale or the financing transaction." 1 G. GILMORE, *supra* note 18, at 71.

21. See generally W. DAVENPORT & D. MURRAY, *supra* note 3, § 2.05, at 32 n.95 (chattel mortgage was pre-U.C.C. security device). Two cases illustrating this position are *Lonoke Prod. Credit Ass'n v. Bohannon*, 379 S.W.2d 17 (Ark. 1964), and *Western United Dairy Co. v. Continental Mortgage Co.*, 28 Ill. App. 2d 132, 170 N.E.2d 650 (1960).

22. See generally E. REILEY, *supra* note 18, § 1.2(b), at 1-9 to -10 (discussing chattel mortgages).

23. U.C.C. § 9-102(2) (1978) states that Article Nine "applies to security interests created by contract including pledge, assignment, chattel mortgage . . . conditional sale . . . intended as security." Comment 1 to U.C.C. § 9-102 states, "The Article does not . . . abolish existing security devices." However, "even though [they are] used, the rules of [Article Nine] govern." These pre-Code devices are preserved by U.C.C. § 9-105(l) (1978) which broadly defines a security agreement as "an agreement which creates or provides for a security interest." Some of the concepts behind conditional sales and chattel mortgages have been retained in the U.C.C.'s purchase money security interest; for example, U.C.C. § 9-302(2) (1978) permits perfection of a purchase money security interest in consumer goods without filing.

24. U.C.C. § 9-107 (1978) provides:

A security interest is a "purchase money security interest" to the extent that it is

- (a) taken or retained by the seller of the collateral to secure all or part of its price; or
- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

vendors²⁵ and lenders.²⁶

Under the U.C.C., a purchase money security interest²⁷ arises in favor of a vendor or his assignee²⁸ upon a sale of goods on credit. A vendor's security interest will be characterized as purchase money "to the extent that it is [1] taken or retained by the seller of the collateral [2] to secure all or part of the price."²⁹ This language limits the purchase money character of the vendor's security interest to all or part of the price of the collateral.

A purchase money security interest also arises when proceeds of a loan are subsequently used by the borrower to purchase goods. A lender's purchase money security interest will be a purchase money security interest "to the extent that it is [1] taken by a person who by making advances or incurring an obligation gives value [2] to enable the debtor to acquire rights in or the use of the collateral [3] if such value is in fact so used."³⁰

To preserve the purchase money character of a security interest, the lender must insure that the loan enables the debtor to acquire rights in or the use of the collateral.³¹ Comment two to section 9-107³² points out that if a purchase money security interest is claimed by a lender, the language excludes security interests taken in satisfaction of, or as security for, a pre-existing claim or an antecedent debt.³³ Although the

To create a security interest under Article Nine, the debtor must have rights in the collateral, there must be a security agreement, and value must be given. U.C.C. § 9-203 (1978).

25. *Id.* § 9-107(a).

26. *Id.* § 9-107(b).

27. *Id.* § 9-107.

28. The continuity of a purchase money security interest is assumed after assignment. *See, e.g., In re King-Porter Co.*, 446 F.2d 722, 726 n.4 (5th Cir. 1971).

29. U.C.C. § 9-107(a) (emphasis added).

30. *Id.* § 9-107(b) (emphasis added).

31. *In re Manuel*, 18 Bankr. 403, 405 (Bankr. D.S.C. 1981); *Fedders Fin. Corp. v. Chiarelli Bros.*, 221 Pa. Super. 224, —, 289 A.2d 169, 171-72 (1979) (when lender that financed borrower's purchase provided new money, as distinguished from a pre-existing claim or antecedent debt, the lender provided advances within statutory meaning of U.C.C. § 9-107(b)). *See generally Gilmore, The Purchase Money Priority*, 76 HARV. L. REV. 1333, 1370-76 (1963) (discussing the Article Nine purchase money security interest).

32. U.C.C. § 9-107 comment two (1978) provides:

When a purchase money security interest is claimed by a secured party who is not a seller, he must of course have given present consideration. . . . [T]he purchase money party must be one who gives value "by making advances or incurring obligation": [this] language excludes from the purchase money category any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt.

33. *See, e.g., In re Culp*, 18 Bankr. 621 (Bankr. M.D. Pa. 1982) (security interest in refrigerator granted to creditor in return for loan proceeds, which debtor used to pay balance owed to seller of appliances, was not purchase money security interest because refrigerator was in debtor's possession prior to the loan transaction); *In re Dameron*, 5 Bankr. 357 (Bankr. W.D. Ky. 1980) (tak-

U.C.C. does not define "antecedent debt," section 9-107(b) and its comments indicate that a security interest will not be in satisfaction of an antecedent debt if the loan and purchase of the collateral are closely related.³⁴ In addition, the collateral must be purchased with the funds advanced; i.e., there must be an actual sale in which the borrower acquires new goods with the funds.³⁵

To determine if a purchase money security interest retains its purchase money character after refinancing, one must look to the law of the state in which the security interest is created.³⁶ Once the security interest is characterized as either purchase money or nonpurchase money under state law, federal bankruptcy law determines if the security interest can be enforced.³⁷

ing security interest in property previously owned by debtor results in creation of nonpurchase money security interest).

34. 2 G. GILMORE, *supra* note 3, § 29.2, at 782. Professor Gilmore comments:

No doubt the language of paragraph (b) [of § 9-107] assumes the sequence of loan first and acquisition second or assumes that the loan and acquisition take place simultaneously. Suppose, however, that debtor acquires goods on Monday (on unsecured credit from his seller) and secured party advances the price on Tuesday. Let us assume that there is no question about the money being "in fact so used"; the question would be whether a loan made after acquisition could be fairly described as one made "to enable" the acquisition. Or, to make the case harder, assume that the buyer pays the price (or writes a check) on Monday and borrows that amount from the second party on Tuesday. Now there is trouble both on the "to enable" side and on the "in fact so used" side. Nevertheless, it is suggested that in both the hypothetical cases just put a court could reasonably find that the secured party had acquired a purchase-money interest. If the loan transaction appears to be closely allied to the purchase transaction, that should suffice. The evident intent of paragraph (b) is to free the purchase-money concept from artificial limitations; rigid adherence to particular formalities and sequences should not be required.

Id. (footnote omitted).

35. *Id.* at 783. Professor Gilmore states that U.C.C. § 9-107 is restricted to property acquired by the debtor with the purchase money loan.

36. See *In re Manuel*, 507 F.2d 990, 992-93 (5th Cir. 1975) (state law applies in bankruptcy court to allocate priorities among creditors); *In re Conn*, 16 Bankr. 454 (Bankr. W.D. Ky. 1982). The *Conn* court found that "the precondition [to a § 522(f)(2)(A)] lien avoidance, nonpurchase money status, derives from state statute. State courts, however, have seldom addressed the issue." *Id.* at 456. The *Conn* opinion stated that the "single state court addressing the issue . . . in a single paragraph, citing no authority, found that a second financing that did not supply additional funds to the debtor did not extinguish a purchase money security interest." *Id.* n.4 (citations omitted); see also *In re Culp*, 18 Bankr. 621 (Bankr. M.D. Pa. 1982) (character of security interest in household goods determined by state U.C.C. law); *In re Manuel*, 18 Bankr. 403, 405 (Bankr. D.S.C. 1981) (court looked to state U.C.C. law to determine if creditor had purchase money or nonpurchase money security interest in household goods).

37. See *Lewis v. Manufacturers Nat'l Bank of Detroit*, 364 U.S. 603 (1960) (state law determines priority of creditors' claims, then federal bankruptcy law applies to enable trustee to avoid certain security interest claims); *In re Conn*, 16 Bankr. 454 (Bankr. W.D. Ky. 1982) (under state U.C.C. law, purchase money security interest retained its purchase money character following refinancing, then the debtor avoided the security interest by federal bankruptcy law); *Booker v. Commercial Credit Corp.* (*In re Booker*), 9 Bankr. 710 (Bankr. M.D. Ga. 1981) (under state

III. SECTION 522(f)(2)(A) OF THE BANKRUPTCY CODE

The Bankruptcy Code³⁸ has two key objectives. As a creditor's remedy, the act marshalls the debtor's³⁹ assets and provides a mechanism for distribution of the debtor's estate to creditors. As a debtor's remedy, it provides the debtor with a "fresh start"⁴⁰ in his economic affairs by discharging his debts. Historically, bankruptcy law exempted certain debtor property from attachment by creditors.⁴¹ Under section six of the Bankruptcy Act of 1889,⁴² exemptions⁴³ were determined by state law. Recognizing the unsatisfactory results of this diverse system of exemptions, which had become disparate and antiquated, Congress prescribed a uniform set of federal exemptions by enacting section 522 (b) and (d) of the Bankruptcy Code.⁴⁴ The report from the House Committee on the Judiciary describes the reasons behind these sections.

Most [state exemption laws] are outmoded, designed for more rural times, and hopelessly inadequate to serve the needs of and provide a fresh start for modern urban debtors. The historical purpose of these exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his non-exempt property, the debtor will not be left destitute and a

U.C.C. law, creditor had nonpurchase money security interest which was avoided by application of federal bankruptcy law).

38. U.S. CONST. art. 1, § 8, cl. 4 provides that Congress has the power to establish uniform laws "on the subject of bankruptcies throughout the United States." The Supreme Court has held that, "The subject of 'bankruptcies' includes the power to discharge the debtor from his contracts and legal liabilities, as well as to distribute his property." *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 188 (1902).

39. The Bankruptcy Code does not use the term "bankrupt" but instead uses the term "debtor" to mean the person or municipality for whom bankruptcy relief is at issue. 11 U.S.C. § 101(12) (Supp. IV 1980). The use of "debtor" was felt to carry less of a stigma. H.R. REP. NO. 595, 95th Cong., 1st Sess. 310 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6267.

40. Debtors have historically been given a fresh start.

One of the primary purposes of the bankruptcy act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes" [The debtor should be provided a fresh start with] a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.

Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

41. *See* 3 COLLIER ON BANKRUPTCY ¶ 522.01, at 522-7 to -9 (15th ed. 1981) (citations omitted).

42. Act of July 1, 1898, ch. 6, 30 Stat. 544 (amended 1938), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 598, 92 Stat. 2549.

43. Exemptions are defined as "a right given by law to a debtor to retain a portion of his personal property free from seizure and sale by his creditors under judicial process." 31 AM. JUR. 2d *Exemptions* § 1, at 329 (1967) (citations omitted).

44. 11 U.S.C. § 522(b), (d) (Supp. IV 1980).

public charge. The purpose has not changed, but neither have the level of exemptions in many States. Thus, the purpose has largely been defeated.⁴⁵

At the same time, Congress recognized that "circumstances do vary in different parts of the country"⁴⁶ and allowed debtors to elect between state exemptions or federal exemptions. Under section 522(b),⁴⁷ the debtor can elect exemptions allowed under the law of the state of his domicile,⁴⁸ and non-bankruptcy federal law,⁴⁹ or he may take advantage of the more liberal uniform federal exemptions;⁵⁰ the debtor, however, is not permitted to combine state and federal exemptions.⁵¹ Although federal bankruptcy law is supreme,⁵² a state may "opt out" of the federal exemptions.⁵³ If a state opts out, however, the debtor retains certain exemptions.⁵⁴

45. H.R. REP. NO. 595, *supra* note 39, at 126, 1978 U.S. CODE CONG. & AD. NEWS at 6087.

46. *Id.*

47. 11 U.S.C. § 522(b)(2)(A) (Supp. IV 1980).

48. *Id.* State bankruptcy laws range from liberal to conservative in their exemptions. See 3 COLLIER ON BANKRUPTCY ¶ 522.22, at 522-60 (15th ed. 1981); 31 AM. JUR. 2d *Exemptions* § 37, at 361 (1967).

49. See 1 BANKR. SERV. (L. ED.) ¶¶ 4:99, 4:100 (1979). Some items that may be exempted under federal non-bankruptcy law are civil service retirement benefits, social security payments, and veterans' benefits.

50. 11 U.S.C. § 522(b) (Supp. IV 1980) provides:

Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate either—

(1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

(2) (A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable non-bankruptcy law.

Section 522(d) provides its own set of exemptions for a debtor: home, motor vehicle, personal use items, jewelry, interest in property, professional books or tools of trade, life insurance contracts, health aids, certain future earnings benefits, certain rights for compensation for losses. *Id.* § 522(d).

51. 3 COLLIER ON BANKRUPTCY ¶ 522.02, at 522-22 (15th ed. 1981) (citations omitted).

52. When Congress exercises the bankruptcy power, it is "unlimited and supreme." *Sturges v. Crowninshield*, 14 U.S. (4 Wheat.) 122, 192 (1819).

53. Under 11 U.S.C. § 522(b)(1) (Supp. IV 1980), a state may proscribe the availability of § 522(d) (Supp. IV 1980) federal exemptions.

54. 3 COLLIER ON BANKRUPTCY ¶ 522.29, at 522-68 to -69 (15th ed. 1981) (citations omitted); see, e.g., Pickard, *The New Bankruptcy Code, Part II: The Interests of Secured Creditors Under the New Bankruptcy Code*, 10 MEM. ST. U.L. REV. 215, 224-29 (1980) (section 522(f) is an example of an exemption the debtor retains when a state opts out).

Section 522(f) allows the debtor to avoid⁵⁵ certain security interests which would otherwise impair his exemptions.⁵⁶ The debtor can avoid security interests to the extent that they impair the exemptions he would have been entitled to under section 522(b).⁵⁷ Specifically, section 522(f)(2)(A) allows a consumer-debtor to avoid a nonpurchase money nonpossessory lien on otherwise exempt household goods and personal items.⁵⁸ This lien avoidance provision preserves the exemptions provided by section 522(b) against certain creditor interests in consumer goods.⁵⁹ The legislative history indicates that the purpose of this section is to protect the unsuspecting consumer-debtor from over-reaching by creditors.⁶⁰

55. 11 U.S.C. § 522(h) (Supp. IV 1980). The trustee and the debtor share the powers of avoidance. The debtor must take affirmative action to exercise his power of avoidance rather than to automatically avoid the lien by operation of law. S. REP. No. 989, 95th Cong., 2d Sess. 51, 77, reprinted in 1978 U.S. CODE & AD. NEWS 5787, 5863.

56. 11 U.S.C. §§ 522(f)(1), (2), 101(27)-(28) (Supp. IV 1980). A review of decisions considering the constitutionality of § 522(f) reveals a great divergence of opinions. Several courts have found that the lien avoidance provision of § 522(f), as applied to security interests which vested prior to the enactment date of the Bankruptcy Reform Act on November 6, 1978, is unconstitutional. See *Rodrock v. Security Indus. Bank*, 642 F.2d 1193 (10th Cir. 1981); *In re Carroll*, 11 Bankr. 45 (Bankr. E.D.N.Y. 1981); *In re Bailey*, 10 Bankr. 567 (Bankr. E.D. Tenn. 1981); *In re Parker*, 10 Bankr. 562 (Bankr. M.D. Ala. 1981); *In re Sams*, 9 Bankr. 479 (Bankr. N.D. Ohio 1981); *In re Hammer*, 9 Bankr. 343 (Bankr. N.D. Iowa 1981); *In re Schulte*, 8 Bankr. 12 (Bankr. D. Kan. 1980); *In re Oldham*, 7 Bankr. 124 (Bankr. D.N.M. 1980). In contrast, other courts have held that § 522(f) is constitutional as applied to security interests created prior to November 6, 1978. See *In re Paden*, 10 Bankr. 206 (Bankr. E.D. Pa. 1981); *In re Stump*, 8 Bankr. 516 (Bankr. D.S.D. 1981); *In re Campbell*, 8 Bankr. 425 (Bankr. S.D. Ohio 1981); *In re Pillow*, 8 Bankr. 404 (Bankr. D. Utah 1981); *In re Goodrich*, 7 Bankr. 590 (Bankr. S.D. Ohio 1980); *In re Middleton*, 7 Bankr. 3 (Bankr. N.D. Ga. 1980); *In re Primm*, 6 Bankr. Rep. 142 (Bankr. D. Kan. 1980).

57. See *Pickard*, *supra* note 54, at 226-27. 11 U.S.C. § 522(f)(2)(A) (Supp. IV 1980) does not apply to goods which do not otherwise qualify as exempt property under § 522. See also *Kennedy*, *Secured Creditors Under the Bankruptcy Reform Act*, 15 IND. L. REV. 477, 491-92 (1982) (discussing debtor's right under § 522(f) to avoid liens against exempt property for the debtor's own benefit).

58. Section 522(f)(2)(A) provides that a debtor can avoid a security interest in any household furnishings, household goods, and appliances held primarily for personal, family, or household use.

59. See *Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st & 2d Sess. (1975-1976), reprinted in 1978 U.S. CODE CONG. & AD. NEWS, 6127, 6138 (1978) (remarks of David H. Williams, Attorney, Division of Special Projects, Bureau of Consumer Protection, Federal Trade Comm'n).

60. Specifically, the legislative history states,

Frequently, creditors lending money to a consumer debtor take a security interest in all of the debtor's belongings, and obtain a waiver by the debtor of his exemptions. In most of these cases, the debtor is unaware of the consequences of the form he signs

The exemption provision allows the debtor, after bankruptcy has been filed, . . . to undo the consequences of a contract of adhesion, signed in ignorance, by permitting the invalidation of *nonpurchase* money security interests in household goods. Such security interests have too often been used by over-reaching creditors. The bill eliminates any unfair advantage creditors have.

H.R. REP. No. 595, 95th Cong., 2d Sess. 127, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 6088 (emphasis added; citation omitted).

Section 522(f) comports with the exemption scheme provided in section 522(b) for a debtor's "fresh start." Only if the creditor shows that his right to reclaim is based on a purchase money security interest will he prevail over the debtor's exemption claim.⁶¹ Without the ability to avoid certain encumbrances on exempt property, the debtor would be denied a fresh start. A Tennessee federal court found that section 522(f)(2)(A) was enacted by Congress to allow consumer debtors to avoid nonpurchase money security interests taken by creditors in household goods owned and used by debtors.⁶² The court emphasized that section 522(f)(2)(A) was not enacted to avoid security interests in collateral purchased with advanced money.⁶³ The court also found that one policy behind avoidance of nonpurchase money security interests in consumer goods is to release the debtor's property from worthless security interests.⁶⁴

IV. JUDICIAL DEVELOPMENT

A. *Judicial Treatment Prior to the Bankruptcy Code*

Prior to the Bankruptcy Code,⁶⁵ the significance of the characterization of purchase money security interests in consumer goods⁶⁶ and farm equipment,⁶⁷ following refinancing, depended solely on whether filing was required for perfection.⁶⁸ The majority of pre-Bankruptcy Code cases denied purchase money status to refinanced purchase money security interests and required filing for perfection.⁶⁹

61. The creditor has the burden of proof to show that a security interest in household goods is not voidable. *Culp v. Commercial Credit Plan Consumer Discount Co. (In re Culp)*, 18 Bankr. 621 (Bankr. M.D. Pa. 1982); *Lanadaus of Plymouth, Inc. v. Scott (In re Scott)*, 5 Bankr. 37 (Bankr. M.D. Pa. 1980).

62. *In re Coomer*, 8 Bankr. 351, 354 (Bankr. E.D. Tenn. 1980).

63. *Id.*

64. *Id.*

65. The Bankruptcy Code was enacted on November 6, 1978, but was not effective until October 6, 1979. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 402(a), 92 Stat. 2682.

66. U.C.C. § 9-302(1)(d) (1978) provides for automatic perfection of purchase money security interests in household goods. Kansas and Oklahoma have not adopted this section.

67. U.C.C. § 9-302(1)(c) (1978) provides for automatic perfection purchase money security interests in farm equipment.

68. One consequence of the purchase money loan being transformed by refinancing was subordination of the creditor's security interest, unperfected for lack of filing, to the interest of the bankruptcy trustee. If the loan was not a purchase money loan in consumer goods, it could not perfect automatically under U.C.C. § 9-302(1)(d) (1978). Filing by the creditor was thus required to maintain purchase money status.

69. See *Kawasho Internat'l (U.S.A.), Inc. v. Alper (In re Mid-Atlantic Flange Co.)*, 26 U.C.C. Rep. Serv. (Callaghan) 203 (E.D. Pa. 1979); *W.S. Badcock Corp. v. Banks (In re Norrell)*,

The pivotal case interpreting U.C.C. section 9-107 and comment two in relation to the issue of purchase money survival is *In re Simpson*,⁷⁰ decided shortly after the enactment of the Uniform Commercial Code. In *Simpson*, the vendor attempted to create a purchase money security interest,⁷¹ by executing a security agreement containing a future advance clause.⁷² Upon the debtor's bankruptcy, the court denied the lender's⁷³ claim to priority, finding that the future advance clause precluded the lender from having a purchase money security interest. The court noted that when a security agreement contains a future advance clause, the agreement can remain in effect even after the purchase price of the original collateral has been fully paid. Finding no distinction between the prohibition in comment two against a purchase money security interest taken as security for an antecedent debt and one taken for a future advance,⁷⁴ the *Simpson* court resolved the issue by stating that "the obligation in a purchase money security interest must be in the purchase price alone."⁷⁵ Although this statement was dictum,⁷⁶ subsequent courts have followed it.⁷⁷ A case in point is *In re Manuel*,⁷⁸ in which a vendor made two sales under a

426 F. Supp. 435 (M.D. Ga. 1977); *Roberts Furniture Co. v. Pierce (In re Manuel)*, 507 F.2d 990 (5th Cir. 1975); *In re Jackson*, 9 U.C.C. Rep. Serv. (Callaghan) 1152 (W.D. Mo. 1971); *In re Brouse*, 6 U.C.C. Rep. Serv. (Callaghan) 471 (W.D. Mich. 1969); *In re Simpson*, 4 U.C.C. Rep. Serv. (Callaghan) 243 (W.D. Mich. 1966).

70. 4 U.C.C. Rep. Serv. (Callaghan) 245 (W.D. Mich. 1966).

71. The vendor initially characterized his security interest as purchase money and relied on U.C.C. § 9-302(1)(c) to automatically perfect his security interest in farm equipment, but the court held that the security interest was not a purchase money security interest and therefore the automatic perfection provisions of this section did not apply. The basis for the court's finding that the security interest was of a nonpurchase money character stems from the fact that the collateral secured a debt greater than its price. 4 U.C.C. Rep. Serv. at 247.

72. 4 U.C.C. Rep. Serv. at 246. The security agreement stated that the security interest in the farm equipment secured not only the payment of the purchase price, but also "any future indebtedness not to exceed the sum of \$1,200,000." *Id.*

73. Before the debtor filed for bankruptcy, the seller assigned his purchase money security interest to a lender. *Id.* See *supra* note 28.

74. U.C.C. § 9-107(b) (1978) was drafted narrowly. First, the lender must give "value" by making advances or incurring an obligation. Comment two to U.C.C. § 9-107 states that "this requirement excludes from the purchase money category 'any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt.'" J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 25-5, at 1045 (2d ed. 1980). See generally Note, *The Value of "Value" in a Purchase Money Security Interest*, 28 BAYLOR L. REV. 667, 670-85 (1976) (discussing concept of value).

75. 4 U.C.C. Rep. Serv. at 247.

76. The *Simpson* court denied automatic perfection under U.C.C. § 9-302(1)(c), but ultimately held that a purchase money security interest existed because the lender perfected by taking possession of the secured collateral. 4 U.C.C. Rep. Serv. at 247.

77. See *supra* note 2.

78. 507 F.2d 990 (5th Cir. 1975).

“charge-all” agreement.⁷⁹ In the first sale, the vendor took a purchase money security interest in household furniture; in the second sale, the vendor took a purchase money security interest in a television set and household furniture from the previous sale. After the buyer filed for bankruptcy, the court resolved the priority claims of the creditors by utilizing the *Simpson* rationale that a purchase money security interest is limited to the purchase price of the collateral.⁸⁰

Another basis for the court’s decision in *In re Manuel* was the presence of the charge-all clause. The court focused on the fact that the security agreement failed to indicate the order in which payments were to be applied in paying off the purchases. Because the vendor’s purchase money security interest had a likelihood of being greater than the price of the collateral, the court held that the automatic perfection provision did not apply and that the vendor lacked a perfected security interest.⁸¹ Other courts have applied this reasoning in the charge-all context.⁸²

In situations where it is possible to determine the extent of purchase money status, several courts have rejected the *Simpson* rationale. The court in *In re Brouse*⁸³ held that purchases made after the effective date of Michigan’s Retail Installment Act⁸⁴ retained their

79. A “charge-all” agreement ensures that title to all goods purchased by the debtor does not pass to him until all the outstanding indebtedness has been paid to the creditor. “[A charge-all agreement ensures] that title to nothing passed until title to all passed.” *Id.* at 992; *cf.* *Kawasho Internat’l (U.S.A.), Inc. v. Alper (In re Mid-Atlantic Flange Co.)*, 26 U.C.C. Rep. Serv. (Callaghan) 203, 204 (E.D. Pa. 1979).

80. The court noted,

A plain reading of the statutory requirements would indicate that they require a security interest to be in the item purchased, and that . . . purchase money security interest[s] cannot exceed the price of what is purchased in the transaction wherein the security interest is created, if the vendor is to be protected

507 F.2d at 993. Courts have referred to this as a situation in which the “debt secures more than its price.”

81. *Id.*

82. *See, e.g., In re Jackson*, 9 U.C.C. Rep. Serv. (Callaghan) 1152 (W.D. Mo. 1971) (charge-all agreement was held unconscionable and enforcement denied).

83. 6 U.C.C. Rep. Serv. (Callaghan) 471 (W.D. Mich. 1969). The debtor made a series of purchases (“string purchases”). Among the first items purchased was a stereo and one of the last items purchased was a cupboard. The court held that since the stereo acted as security not only for its purchase price, but also for future indebtedness; the seller did not have a purchase money security interest. However, the cupboard, purchased after the enactment of the Retail Installment Act, retained its purchase money character because the Act provided a method for allocation of the debt. *Id.* at 474-76.

84. MICH. COMP. LAWS §§ 445.851-.872 (1970). The Act provided,

When subsequent purchases are made, if the seller has retained title or taken a lien or other security interest in any of the goods purchased under any 1 of the contracts included in the consolidation, the entire amount of all payments made prior to such subsequent purchases shall be deemed to have been applied to the unpaid time balances of the

purchase money character. The court reasoned that since the pro rata allocation provisions⁸⁵ of that Act were part of the security agreement, the extent to which payments were applied to prior purchase money security interests could be determined.⁸⁶ Applying the same rationale, the court in *In re Staley*⁸⁷ held that purchase money status was not lost following refinancing. In *Staley*, after purchasing a stereo, the debtor bought a freezer under the same security agreement, which provided a method for apportionment of payments.⁸⁸ The court reasoned that because a method was provided to determine when the security interest in each item of collateral terminated by full payment, the collateral secured its price.⁸⁹ The same rationale was applied in *In re Mid-Atlantic Flange Co.*⁹⁰ which concerned a charge-all clause in a commercial context. The court implied that the first-in-first-out method of payment could be employed to determine the extent of purchase money status.⁹¹ The court also stated "we cannot conclude that the presence of the 'add-on' clause [charge-all clause] alone can prevent the security interest in question from being 'taken or retained by the seller of the collateral to secure all or part of its price.'" ⁹²

Courts have disregarded the *Simpson* rule in other situations. In *Index Store Fixture Co. v. Farmers' Trust Co.*,⁹³ the court advanced a

previous purchases; and each payment after the subsequent purchase made on the consolidated contract shall be deemed to have been allocated to all of the various purchases in the same ratio as the original cash sale prices of the various purchases bear to the total of all. Where the amount of each installment payment is increased in connection with subsequent purchases, at the seller's option, the subsequent payments may be deemed to be allocated as follows: an amount equal to the original periodic payment to the previous purchase, the balance to the subsequent purchase. However, the amount of any down payment on the subsequent purchase shall be allocated in its entirety to the subsequent purchase. The provisions of this subsection shall not apply to cases where such previous and subsequent purchases involve equipment, parts or other goods attached or affixed goods previously purchased and not fully paid, or to services in connection therewith rendered by the seller at the buyer's request.

Id. § 445.861(c). The effective date of the Act was Mar. 10, 1967.

85. See 6 U.C.C. Rep. Serv. at 475.

86. *Contra In re Norrell*, 426 F. Supp. 435 (M.D. Ga. 1977).

87. 426 F. Supp. 437 (M.D. Ga. 1977).

88. The security agreement provided, "[I]n the case of items purchased on the same date, the lowest priced item shall be deemed paid for first." *Id.* (emphasis deleted). This method of payment is known as the first-in-first-out allocation method.

89. *Id.* at 438.

90. 26 U.C.C. Rep. Serv. (Callaghan) 203 (E.D. Pa. 1979).

91. See *id.* at 208-09.

92. *Id.* at 208 (citation omitted). The court left open the issue of whether the actual extension of credit under the charge-all agreement would totally prohibit the characterization of the security interest as a purchase money security interest or whether this would merely limit the purchase money character of the security interest to the portion taken to secure the purchase price of the collateral. *Id.*

93. 19 U.C.C. Rep. Serv. (Callaghan) 284 (Mo. Ct. App. 1976).

renewal argument. There the vendor, after taking a purchase money security interest in new collateral, sold additional equipment to the buyer and executed a new purchase money security interest, which included the balance due from the original note. The court found that the addition of the balance due to the new purchase money agreement did not realistically change the character of the transaction; therefore, the subsequent "new" note did not extinguish the prior security interest.⁹⁴ Similarly, when renewal notes were executed and additional collateral given, or additional credit or cash advances made, the court in *Bank of Austin v. Barnett*⁹⁵ held that "the giving of a new note for a debt evidenced by a former note does not extinguish the original indebtedness unless such is the intention of the parties."⁹⁶

B. *Judicial Treatment Under the Bankruptcy Code*

Under the Bankruptcy Code,⁹⁷ the importance of purchase money status has increased because section 522(f)(2)(A) gives the debtor power to avoid nonpurchase money nonpossessory security interests in household goods.⁹⁸ Therefore, if the creditor's purchase money security interest in such goods is transformed into a nonpurchase money security interest following refinancing, the debtor can avoid the creditor's security interest.

Post-Bankruptcy Act cases continued to rely on the *Simpson* rationale that a purchase money security agreement is transformed into a nonpurchase money security agreement after refinancing when the collateral secures a debt other than the purchase price of the collateral. In one case,⁹⁹ the vendor executed a purchase money security agreement with a future advance clause, but upon each refinancing, an additional sum of money was advanced to the debtor and the prior loan stamped "paid by renewal."¹⁰⁰ The court ruled that the presence of the future

94. *Id.* at 291.

95. 549 S.W.2d 428 (Tex. Civ. App. 1977); *accord* State Bank of Young Am. v. Vidmar Iron Works, Inc., 292 N.W.2d 244 (Minn. 1980).

96. 549 S.W.2d at 430 (citing Schwab v. Schlumberger Well Surveying Corp., 145 Tex. 379, 198 S.W.2d 79 (1946)).

97. *See supra* note 65.

98. The debtor has the power to avoid nonpurchase money security interests in household goods to the extent that such a security interest impairs the § 522(b) exemption.

99. *In re Jones*, 5 Bankr. 655 (Bankr. M.D.N.C. 1980).

100. The initial purchase money security interest was refinanced several times in order to cure delinquency and bring the account current. Refinancing which cures a delinquency has been termed "flipped." *See In re Ellis*, 1 BANKR. CT. DEC. (CRR) 798, 800 (Bankr. S.D.N.Y. 1975). Each refinancing note contained variations from the prior note in amounts financed, payment amounts, finance rates, and total number of payments.

advance clause extinguished the purchase money character. The court quoted the policy argument of *Simpson*.

One of the purposes of the Code is to "simplify, clarify, and modernize the law governing commercial transactions." One of the few exceptions to the requirement that notice by filing be a prerequisite to perfection of a security agreement is the purchase money security interest under certain conditions. If a vendor or lender desires to take advantage of this non-filing requirement, the burden should be on him to prepare a simple instrument which shall be a pure purchase money security agreement without attempting to burden it with complicated and ambiguous impedimenta. Much of the litigation which filled our courts under pre-code law was due to the effort of adroit drafters to determine how far they could go in concocting instruments that would give maximum rights to vendors and lenders while still qualifying as conditional sales contracts and thus avoiding the necessity of filing. It is to be hoped that such antics will not occur under the Code.¹⁰¹

Almost as an afterthought, the court relied on U.C.C. section 9-107(b) and comment two to make an alternative argument for the loss of purchase money status.

It is unnecessary . . . to hold that the future advance clause destroys the purchase money character of the security interest since the refinancing alone extinguishes the purchase money character [N]either the cash advances nor the renewal note enabled the Debtor to acquire rights in the collateral. The purpose of the renewal note was to payoff the original note, an antecedent debt. The purchase money character of the security interest was extinguished when the proceeds from the first renewal note were used to satisfy the original note.

. . . .
 . . . Therefore, the security interest held under the renewal note is nonpurchase money . . . and is avoidable under 11 U.S.C. § 522(f).¹⁰²

The antecedent debt argument for transformation of purchase money security interests following refinancing was extended to lenders

101. 5 Bankr. at 657 (citing *In re Simpson*, 4 U.C.C. Rep. Serv. at 248 (citations omitted)).

102. *Id. Contra Meadows v. Household Retail Serv. (In re Meadows)*, 9 Bankr. 880, 881 (Bankr. N.D. Ga. 1981) (purchase money status is not defeated by existence of unexercised future advance clause).

in *In re Mulcahy*.¹⁰³ The court noted that there was no justification for applying a different rule to lenders as opposed to sellers as either situation creates the same problem, an "inability to determine when any one item is paid off and freed of the security agreement."¹⁰⁴

In re Coomer,¹⁰⁵ however, rejected the *Simpson* rationale on two bases.¹⁰⁶ First, U.C.C. section 9-107 does not require transformation of a purchase money security interest upon refinancing. The court interpreted the "to the extent that" language of section 9-107 as creating a security interest which is characterized as purchase money to the extent that the security interest meets the requirements of section 9-107.¹⁰⁷ The court found that section 9-107 allows a security interest to have two parts: a purchase money part to the extent that it is secured by collateral and a nonpurchase money part.¹⁰⁸

Second, the court looked to the practical effects of transformation following refinancing.¹⁰⁹ If purchase money status in household goods was lost following refinancing, the debtor would keep exempt property

103. *Mulcahy v. Indianapolis Morris Plan Corp. (In re Mulcahy)*, 3 Bankr. 454 (Bankr. S.D. Ind. 1980).

104. *Id.* at 457. The court noted that U.C.C. § 9-107 (1978) comment 2 may be more properly applicable to a lender than to a seller. *Id.* (citing *Kawasho Int'l (U.S.A.), Inc. v. Alper (In re Mid-Atlantic Flange Co.)*, 26 U.C.C. Rep. Serv. (Callaghan) 203 (Bankr. E.D. Pa. 1979)).

105. *Coomer v. Barclay's Am. Fin. (In re Coomer)*, 8 Bankr. Rep. 351 (Bankr. E.D. Tenn. 1980).

106. *Cf. In re Slay*, 8 Bankr. 355 (Bankr. E.D. Tenn. 1980), a companion case to *Coomer*, holding that when a purchase money and nonpurchase money loan were consolidated and no subsequent payments made, then regardless of whether contractual or statutory apportionment methods were present, a purchase money security interest existed. Since no payments were made after the consolidation, the court could determine the extent of purchase money and nonpurchase money debt. *Id.* at 358. *Contra Rosen v. Associates Fin. Serv. Co. (In re Rosen)*, 18 Bankr. 723 (Bankr. D.S.C. 1981), *aff'd on rehearing*, 17 Bankr. 436, 438 (Bankr. D.S.C. 1982) ("Regardless of whether the purchase money and nonpurchase money facets of the second loan can be disentangled, 'the refinancing alone extinguishes the purchase money character of the security interest.'") (citing *In re Jones*, 5 Bankr. 655, 657 (Bankr. M.D.N.C. 1980)).

107. 8 Bankr. at 354. The court reviewed the purpose of § 522(f)(2).

The Commission took the view that non-purchase-money security interests in household goods generally have no value to the creditor, except as a means of coercing payment by threatening repossession. The Commission concluded that debtors should not be denied the benefit of their exemptions in household goods because of valueless security interests. That idea led to § 522(f)

The main reason [for § 522(f)(2) was that] household goods securing nonpurchase money debts generally have no substantial market value. That conclusion is most appropriate when the debtor . . . [put up as collateral] *used household goods*. The conclusion is less appropriate for new or used goods bought . . . with the proceeds of a purchase money loan.

. . . [T]he purpose of § 522(f)(2)(A) generally is to avoid security interests that debtors grant in their already owned, used household goods.

Id. (citations omitted; emphasis added).

108. *Id.* at 353-54.

109. *Id.* at 354.

free of the creditor's claim. In contrast, if the court enforced the purchase money security interest, the debt would consist of two parts, purchase money and nonpurchase money. A method was needed, absent statutory or contractual provisions, for apportioning the security interest between these two parts and for applying the payments to each part. The court expressed its reluctance to follow prior case law based on U.C.C. section 9-107, as prior decisions may not always properly reflect the policy behind section 522(f)(2)(A).¹¹⁰ However, it concluded that prior decisions must be followed unless some method existed for determining the extent to which each item of collateral secured its own purchase price.¹¹¹ The court refused to judicially determine the extent of purchase money status,¹¹² stating, "[T]he administration of bankruptcy cases demands a workable and clear rule. Without some guidelines, legislative or contractual, the court should not be required to distill from a mass of transactions the extent to which a security interest is purchase money."¹¹³

Numerous courts have advanced a renewal-novation argument.¹¹⁴ Renewal includes,

the idea that an obligation is renewed when the same obligation is carried forward by the new paper There may be a change of parties. There may be an increase of security, but there is no renewal unless the obligation is the same. What makes the renewal is an extension of time in which to discharge the obligation. If the obligation changes, there can be no renewal, because there can be no such thing as the re-establishment of an old obligation by the creation of a new obligation different in character.¹¹⁵

110. *Id.* at 355.

111. *Id.* at 353.

112. *Cf. In re Booker*, 31 U.C.C. Rep. Serv. (Callaghan) 285 (Bankr. M.D. Ga. 1981). Basing its refusal to make a judicial determination of the extent of purchase money status on policy grounds, the court held that recognition of U.C.C. § 9-107 "to the extent that" language would unduly complicate the application of the relevant code provisions. The allocation of the debt between purchase money and nonpurchase money status would be violative of one of the stated purposes of the code, "to simplify, clarify, and modernize the law governing commercial transactions." *Id.* at 290-91.

113. 8 Bankr. at 355.

114. For a renewal argument, see *Credithrift of Amer. v. Littlejohn (In re Littlejohn)*, 20 Bankr. 695 (Bankr. W.D. Ky. 1982). *Contra King v. Citizens & S. Nat'l Bank (In re King)*, 19 Bankr. 409 (Bankr. M.D. Ga. 1982). For a novation argument, see *Aalgaard v. Public Fin. Co. (In re Aalgaard)*, 18 Bankr. 990 (Bankr. E.D. Wash. 1982); *Averhoff v. Peoples Fin. Co. (In re Averhoff)*, 18 Bankr. 198 (Bankr. N.D. Iowa 1981); *Snyder v. Household Fin. Corp. (In re Snyder)*, 16 Bankr. 380 (Bankr. S.D. Ohio 1982).

115. *King v. Citizens & S. Nat'l Bank (In re King)*, 19 Bankr. 409, 412 (Bankr. M.D. Ga. 1982) (quoting *Lowry Nat'l Bank v. Fickett*, 122 Ga. 489, 492, 50 S.E. 396, 398 (1905)).

Some courts have held a renewal occurs upon refinancing.¹¹⁶ The court held in *In re All-Brite Sign Service Co.*¹¹⁷ that when a note was paid by renewal, the new note did not constitute payment of the prior note agreeing that "it is a narrow and mistaken view to regard the [chattel] mortgage as a transaction independent of the prior mortgage"¹¹⁸ Other courts have held that "the giving of a new note for a debt evidenced by a former note does not extinguish the original indebtedness unless such is the intention of the parties."¹¹⁹

In contrast to renewal, novation is the "substitution of a new obligation for an old one, with the intent to extinguish the old one, or . . . a new debtor . . . with the intent to release [the old one], or a new creditor, with the intent to transfer the rights of the old one to him."¹²⁰ Some courts have held that a novation occurs upon refinancing of a purchase money security interest.¹²¹ For example, in *In re Calloway*,¹²² the court held that each consolidation was not only characterized as satisfaction of an antecedent debt, but could also be characterized as "an entirely new loan."¹²³ The court reinforced this novation argument by stating that even though each prior loan was stamped "made again," no reference was made to the original financing statement.¹²⁴ Novation of a purchase money security interest has been held to occur upon refinancing when by state statute¹²⁵ a new obligation is deemed to arise.¹²⁶

116. See, e.g., *Westinghouse Credit Corp. v. Southwest Pa. Nat'l Resources (In re Southwest Pa. Nat'l Resources)*, 11 Bankr. 901 (Bankr. W.D. Pa. 1981). The court stated,

Even where the parties originally contemplate a single debt, secured by a single item . . . or . . . group of items, the secured party and the debtor may enter into further transactions whereby the debtor obtains additional credit and the secured party is granted more security. The validity of such agreements as against creditors, trustees in bankruptcy and other secured parties has been widely recognized

Id. at 903 (quoting *James Falcott, Inc. v. Franklin Nat'l Bank*, 10 U.C.C. Rep. Serv. (Callaghan) 11, 25 (Minn. 1972)).

117. 11 Bankr. 409, 410 (Bankr. W.D. Ky. 1981).

118. *Schreiber v. Colt*, 80 F.2d 511, 511 (10th Cir. 1935); accord *In re All-Brite Sign Serv. Co.*, 11 Bankr. 409 (Bankr. W.D. Ky. 1981).

119. *Bank of Austin v. Barnett*, 549 S.W.2d 428, 430 (Tex. Civ. App. 1977) (citing *Schwab v. Schlumberger Well Surveying Corp.*, 145 Tex. 379, 198 S.W.2d 79 (1946)).

120. *Truscon Steel Co. v. Thirlwell Elec. Co.*, 96 S.W.2d 1023, 1025 (Ky. Ct. App. 1936).

121. See *infra* notes 125 & 129.

122. 17 Bankr. 212 (Bankr. W.D. Ky. 1982).

123. *Id.* at 215.

124. *Id.*

125. *E.g.*, WASH. REV. CODE § 31.08.170(4) (1974) which provides,

Upon payment of the loan in full, mark indelibly every obligation signed by the borrower with the word "paid" or "cancelled" and release any mortgage and restore all notes and collateral which no longer secures a loan and to which the borrower may be lawfully entitled: *Provided, however*, That in case any such document or obligation is in custodia legis these requirements shall not be applicable

See *Aalgaard v. Public Fin. Co. (In re Aalgaard)*, 18 Bankr. 990 (Bankr. E.D. Wash. 1982).

126. See *Aalgaard*, 18 Bankr. 990; *Averhoff v. Peoples Fin. Co. (In re Averhoff)*, 18 Bankr. 198 (Bankr. N.D. Iowa 1982).

In re Conn,¹²⁷ decided in 1982, rejected the *Simpson* rationale and prior purchase money transformation theories. In *Conn*, the vendor¹²⁸ executed a purchase money security interest to secure the purchase price of the collateral. When the purchase money obligation was refinanced, the lender issued new debt¹²⁹ and took new collateral.¹³⁰ Upon the debtor's bankruptcy,¹³¹ the court followed a two tier analysis to hold that purchase money character was not changed by refinancing.¹³²

The first level of analysis focused on a fundamental error in the reasoning of *In re Simpson*.¹³³ The court pointed to the fact that *Simpson* did not recognize the explicit statutory language of the purchase money requirement, "to the extent that."¹³⁴ Relying on the interpretation given to this language by the court in *In re Coomer*,¹³⁵ the *Conn* court held that security interests may consist of two parts, purchase money and nonpurchase money. It also held that the U.C.C. does not require purchase money status to be lost in its entirety if the collateral secures both its price and an antecedent debt or future advance.¹³⁶ Comment two to section 9-107 merely prohibits purchase money status to be found "to the extent that" an item secures antecedent debt. The court reasoned the substance of the transaction, not the form, should be the basis of the decision.

Though in form the original note is cancelled, its balance is absorbed into the refinancing loan. To the extent of that balance, the purchase money security interest taken under the original note likewise survives, because what is owed on the original note is not eliminated, it is merely transferred to, and increased in amount by, another obligation. The refinancing changes the character of neither the balance due under the first loan nor the security interest taken under it.¹³⁷

The second level of analysis focused on the method of apportion-

127. 16 Bankr. 454 (Bankr. W.D. Ky. 1982).

128. The vendor subsequently assigned the indebtedness to a lender. *Id.* at 455. See *supra* note 28.

129. The lender issued approximately \$700 in new debt. 16 Bankr. at 455.

130. *Id.* The lender took additional security in household goods.

131. When the debtor filed for bankruptcy, a balance of \$138.39 was owed on the household goods. *Id.* at 459.

132. *Id.*

133. 4 U.C.C. Rep. Serv. (Callaghan) 243 (W.D. Mich. 1966).

134. 16 Bankr. at 457.

135. 8 Bankr. 351; see *supra* notes 107-11 and accompanying text.

136. 16 Bankr. at 457.

137. *Id.* at 459.

ment used to separate the purchase money and nonpurchase money parts of the debt.¹³⁸ The court rejected prior holdings, stating that purchase money status should not hinge on the presence of a statutory or contractual method of apportionment; rather the court should give effect to the rule that a security interest is purchase money to the extent that property secures its price, and apportion the debt by the first-in-first-out method.¹³⁹ The court reasoned that even with legislative or contractual guidelines to assist in apportioning the debt, the determination of the extent of purchase money security interest would be complex. The difficulty of dividing a security interest into purchase money and nonpurchase money parts does not prohibit a court from allowing both parts to exist.

V. DISCUSSION

Although the controversy over the character of purchase money security interests following refinancing began before the enactment of the Bankruptcy Code, the effect of such characterization under section 522(f)(2)(A) magnifies its importance.¹⁴⁰

The transformation of a purchase money security interest into a nonpurchase money security interest upon refinancing can have three

138. *Id.* at 458-59.

139. *Id.* For an example of a statutory method of apportionment, see OKLA. STAT. tit. 14A, § 2-409 (1981) (Consumer Credit Code provides for first-in-first-out method of allocation of consumer related debts). Section 2-409 provides,

(1) If debts arising from two or more consumer credit sales, other than sales primarily for an agricultural purpose or pursuant to a revolving charge account, are secured by cross-collateral (Section 2-408) or consolidated into one debt payable on a single schedule of payments, and the debt is secured by security interests taken with respect to one or more of the sales, payments received by the seller after the taking of the cross-collateral or the consolidation are deemed, for the purpose of determining the amount of the debt secured by the various security interests, to have been first applied to the payment of the debts arising from the sales first made. To the extent debts are paid according to this section, security interests in items of property terminate as the debts originally incurred with respect to each item is [sic] paid.

(2) Payments received by the seller upon a revolving charge account are deemed, for the purpose of determining the amount of the debt secured by the various security interests, to have been applied first to the payment of credit service charges in the order of their entry to the account and then to the payment of debts in the order in which the entries to the account showing the debts were made.

(3) If the debts consolidated arose from two or more sales made on the same day, payments received by the seller are deemed, for the purpose of determining the amount of the debt secured by the various security interests, to have been applied first to the payment of the smallest debt.

Id.; see also *In re Staley*, 426 F. Supp. 437 (M.D. Ga. 1977) (contractual apportionment of debt by first-in-first-out method).

140. See *supra* notes 97-98 and accompanying text.

consequences. First, the creditor loses purchase money status;¹⁴¹ second, the creditor loses in a priority dispute with other perfected creditors;¹⁴² and third, the creditor loses to the trustee in bankruptcy.¹⁴³

Prior to the Bankruptcy Code, the transformation of a purchase money security interest resulted in the creditor losing the right to automatic perfection. Thus the creditor's stake in the debtor's estate became subject to the priority rules of the U.C.C.¹⁴⁴ The transformation of a purchase money security interest may now result in the creditor's purchase money security interest being totally voided,¹⁴⁵ divorcing the creditor from the general priority rules of U.C.C.¹⁴⁶

The cumulative effect of loss of purchase money status following refinancing is to jumble the priorities among creditors and to defeat the following reasons for a priority system:

- (1) [to assure] [c]ommercial certainty . . .
- (2) [to assure that] [c]reditors . . . know with precision what their rights are relative to the collateral . . .
- (3) [to protect] the reliance interest . . . [of creditors]
- (4) [to] encourage the flow of commerce . . .
- (5) to protect [the purchase money lenders] whose credit enables the debtor to acquire . . . assets . . .
- (6) [to promote] a policy of fairness¹⁴⁷

The courts have not articulated whether they will recognize the "to the extent that" language in section 9-107, and the interpretation given this section has produced conflicting results. Some courts have ignored the express "to the extent that" language.¹⁴⁸ Other courts have given effect to the express language and have acknowledged that a purchase money security interest may have two parts, which may be apportioned into purchase money and nonpurchase money by either contractual, statutory, or judicial methods.¹⁴⁹

Before the enactment of the U.C.C., collateral from a conditional sale could not secure a debt owed to a vendor that was unrelated to the

141. U.C.C. § 9-302 (1978).

142. *Id.* § 9-312(5).

143. 11 U.S.C. § 544 (Supp. IV 1980).

144. Article Nine priority rules are found primarily in U.C.C. §§ 9-201, -301, -306 to -316 (1978). See *Special Project: The Priority Rules of Art. 9*, 62 CORNELL L. REV. 834 (1977).

145. A creditor's nonpurchase money security interest in household goods can be avoided by a debtor pursuant to § 522(f)(2)(A) (Supp. IV 1980) of the Bankruptcy Code.

146. See *supra* note 144.

147. B. CLARK, *supra* note 1, ¶ 3.1[2](a), (c), (d), (e), (f), at 3-4 to -6 (1980).

148. See *In re Simpson*, 4 U.C.C. Rep. Serv. (Callaghan) 243 (W.D. Mich. 1966).

149. See *In re Conn*, 16 Bankr. 454 (Bankr. W.D. Ky. 1982).

purchase price of the collateral.¹⁵⁰ In contrast, collateral from a chattel mortgage could secure debt that was owed to the lender even though it was unrelated to the mortgaged sale.¹⁵¹ Section 9-107 of the U.C.C. combined these two concepts in subsections (a) and (b), creating a new concept for securing the debt.¹⁵² It can be argued that by combining these two concepts and their historical allowances and prohibitions into one conceptual mechanism, the drafters wanted to strictly define the circumstances in which a vendor or a lender could use collateral acquired through borrowed money to secure a debt that was unrelated to the purchase price. It can be further argued that the "to the extent that" language of section 9-107 was inserted not to void purchase money status when collateral secures a debt that is unrelated to and greater than the collateral's purchase price, but merely to limit availability of purchase money status.

Courts have not viewed the history of purchase money security interests as decisive in the determination of whether purchase money status should survive refinancing. Since both the arguments for and against transformation of a purchase money security interest following refinancing have merit, the purposes of the U.C.C. and the Bankruptcy Code must be reviewed to see which characterization is most desirable.

The congressional intent in enacting section 522(f)(2)(A) was to give the debtor a fresh start by permitting avoidance of nonpurchase money obligations which held used household goods as their collateral.¹⁵³ Therefore, section 522(f)(2)(A) is improperly used when purchase money security interests on newly acquired household goods are transformed into nonpurchase money security interests and avoided under the section.

Section 1-102(1) of the U.C.C. states that the provisions of the Code should be liberally construed. The underlying purposes include, "(a) to simplify, clarify and modernize the law governing commercial transactions; (b) to permit the continued expansion of commercial practices through custom, usage and agreement of parties; (c) to make uniform the law among various jurisdictions."¹⁵⁴ *In re Simpson*¹⁵⁵ argued that a purchase money security interest should be transformed

150. See *supra* note 19 and accompanying text.

151. See *supra* note 21 and accompanying text.

152. See *supra* notes 23-25 and accompanying text.

153. See *supra* notes 40-45 & 60 and accompanying text.

154. U.C.C. § 1-102(2) (1978).

155. 4 U.C.C. Rep. Serv. (Callaghan) 243 (W.D. Mich. 1966).

into a nonpurchase money security interest following refinancing to promote the simplicity required in commercial transactions under U.C.C. section 1-102(2)(a).¹⁵⁶ The court reasoned that transformation freed the security agreement from "complicated and ambiguous impedimenta."¹⁵⁷ However, section 102(2)(b) of the U.C.C. offers a competing policy favoring retention of purchase money status following refinancing, "to permit the continued expansion of commerce."¹⁵⁸ Commerce is benefited in two ways. First, from the borrower's point of view, purchase money status makes expansion easier, because the creditor will be more likely to advance funds to help purchase an asset if the creditor can have the debt secured by the acquired property. If purchase money status is lost upon refinancing, creditors will have to make each purchase money security interest a separate transaction which results in additional costs for both debtor and lender.¹⁵⁹ From the creditor's point of view, purchase money survival encourages sales by giving the creditor purchase money priority over other pre-existing creditors. If the creditor's purchase money status is transformed, the sale "will be discouraged rather than encouraged, and the Code policy of purchase money priority will be undermined."¹⁶⁰ The transformation of purchase money security interests discourages loans and the use of those loans to acquire new assets.¹⁶¹

Second, section 1-102(2)(a) and (c) of the U.C.C. offers the following policies that support retention of purchase money status following refinancing: "[T]o simplify [and] clarify . . . the law governing commercial transactions . . . [and] to make uniform the law among various jurisdictions."¹⁶² If purchase money status is permitted to survive refinancing, the courts will acknowledge the "to the extent that" language of section 9-107. This will achieve the above mentioned goals to simplify, clarify, and unify the law. If court decisions follow one interpretation of the language, creditors and debtors will have the ability in advance to better determine their respective rights under the refinanc-

156. *Id.*

157. *Id.* at 248.

158. U.C.C. § 1-102(2)(b) (1978).

159. McLaughlin, *supra* note 1, at 670. Perfection by filing for purchase money security interests in consumer goods has three adverse effects: (1) clutters filing system; (2) inconveniences those involved in filing system; (3) results in expenses disproportionate to the amount of credit given. *See generally* J. WHITE & R. SUMMERS, *supra* note 74, § 23-7, at 920 (automatic perfection of consumer goods spares the filing system considerable burden).

160. McLaughlin, *supra* note 1, at 671.

161. De Koven, *Secured Transactions*, 37 BUS. LAW. 1011, 1030-31 (1982).

162. U.C.C. § 1-102(2)(a), (c) (1978).

ing agreement. This should lead to more settlements by negotiation. Another advantage of a clear and uniform law is the prevention of forum shopping by a party in an effort to find a court which will support its position. In addition, this solution comports with general business practice and understanding.¹⁶³

Addressing the problems created by conflicting decisions, one court stated, "[A]bsent specific congressional legislation to the contrary, the rules applicable to priorities in commercial law must be consistent whether in the context of bankruptcy or everyday commercial transactions [T]he Bankruptcy Code is designed to interact with the Uniform Commercial Code" ¹⁶⁴ Allowing purchase money status to be transformed following refinancing potentially allows two different systems of priorities, one in bankruptcy proceedings and the other in nonbankruptcy proceedings. Although it can be argued that a legislative remedy is needed,¹⁶⁵ until the differences in basic assumptions of the Bankruptcy Code and U.C.C. are legislatively resolved,¹⁶⁶ a uniform rule is needed to decide this issue to produce the desired outcomes and support the underlying policies. Presently, various courts adopt the divergent views of either *In re Simpson*, which precludes any purchase money security interest when refinancing occurs, or the view advanced by *In re Conn*. By holding that a security interest can be divided into two parts and that purchase money status following refinancing is not dependent on the presence of some method of allocation,

163. See McLaughlin, *supra* note 1, at 669.

164. *In re Gibson*, 16 Bankr. 257, 267 (Bankr. D. Kan. 1981).

165. See *supra* text accompanying notes 111-13.

166. Some argue that the interaction between the Bankruptcy Code and the U.C.C. creates an inherent conflict due to the difference in basic assumptions on which each is grounded.

It can be argued that the Bankruptcy Code is grounded in pre-twentieth century economic conditions. Credit used to be based principally on assets. To obtain credit a debtor had to pledge assets; if the debtor didn't pay, he lost his assets. Traditional consumer bankruptcy relief is predicated on that experience. Today, however, all consumer credit is extended upon a consumer's ability to repay out of future income, not through liquidation of assets. Yet, while the creditor looks to income, the Bankruptcy Code looks only to assets. Not surprisingly, virtually no assets are available for distribution to creditors in consumer cases; property exemptions and security interests in the consumer's most valuable assets . . . come first.

In short, it is possible to conclude that the code approach contradicts the basic assumption on which credit was extended—the consumer's future income

Evans & Johnson, *Proposals for Consumer Bankruptcy Reform*, 37 BUS. LAW. 1117, 1124-25. Additionally, S. 2000, 97th Cong., 1st Sess., 127 CONG. REC. S15712-15 (daily ed. Dec. 16, 1981) has been introduced into Congress and would make substantive changes in the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101, 92 Stat. 2549 (codified in scattered sections of the U.S.C.). The bill would amend the Bankruptcy Reform Act to make "bankruptcy relief consistent with transactional assumptions underlying the grant of consumer credit." 72 BANKR. L. REP. (CCH) 35. Section 522(f) would be repealed by S. 2000.

Conn allows the creditor to retain purchase money status on newly acquired household goods used as collateral for the indebtedness. This analysis confirms that *Conn* is the better view because it allows a purchase money security interest to survive refinancing to the extent of the actual value of the collateral, which promotes the policies of both the U.C.C. and Bankruptcy Code.

VI. CONCLUSION

This Comment has traced the history of purchase money transformation following refinancing from *In re Simpson* to *In re Conn*. It has argued that the more recent decision, *Conn*, is based upon a more reasonable interpretation of the statutory rules. Transformation of non-purchase money security interests upon refinancing, which is inherent in the *Simpson* rationale, does not fairly balance the interests of the parties involved in bankruptcy proceedings. Good faith creditors lend purchase money in reliance that their security interests will have purchase money priority; this should not be avoided by refinancing. If courts continue to follow the *Simpson* rationale and deny creditors purchase money status, debtors will find refinancing difficult to obtain. The interests of both creditors and debtors will be advanced if the lead taken by *Conn* is followed and *Simpson* is ultimately rejected.

J. Devereaux Jones