

In the United States Bankruptcy Court
for the Northern District of Iowa
Western Division

DeLOSS CLARK RENCH and MARILYN LEONA
RENCH
Debtors.

Bankruptcy No. 92-52020XS

Chapter 7

**ORDER RE: OBJECTION TO EXEMPTION and
MOTION TO AVOID LIEN**

The matters before the court are objections to the Rences' claimed exemption in their homestead and the Rences' motion to avoid liens impairing that exemption. Hearing was held on June 30, 1993 in Sioux City, Iowa. The court now issues its findings of fact and conclusions of law as required by Fed.R.Bankr.P. 7052. This is a core proceeding under 28 U.S.C. 157(b)(2)(B) and (K).

Findings of Fact

The Rences filed a chapter 7 petition on November 4, 1992. They claimed their homestead property exempt. The homestead is known as 815 East Lakeshore Drive in Storm Lake, Iowa. The Rences began residing at that address in approximately mid-September 1991. They purchased the home in mid-May, 1991. At about that time, the Rences hired Jerry Strandberg, d/b/a Strandberg Construction, to remodel the home before they moved in. Strandberg prepared an estimate for the Rences to present to their lender in order to obtain a loan to finance the remodeling project. Exhibit 11. Strandberg estimated the project would cost \$72,300.00.

Strandberg hired most of the subcontractors who supplied labor and materials for the project. DeLoss Rench approved Strandberg's choice of subcontractors. The subcontractors Strandberg hired included Jones-Laursen Masonry, D & S Enterprises, Alta Lumber Co., and United Building Centers (UBC) (the "four subcontractors").

Strandberg began work on the project in approximately mid-May, 1991. When he began the work, he discovered that portions of the house were in poor condition. It was necessary to make major changes from the original plans for the job. The work on the project ultimately included adding a three-car garage, adding a second story to the house, installing two new furnaces and a new water heater, and building the frame and rough-in for a beauty salon adjoining the house. After they remodeled, the Rences had 2,700 square feet of living space in their home.

Strandberg's practice was to collect bills from the subcontractors as the work progressed and submit a bill to the Rences. The Rences would then submit the bill to their lender for issuance of a check. The following amounts were paid to Strandberg during the time he was working on the project:

Date	Amount	
6/26/91	\$29,380.00	Exhibits 12 & 5
7/23/91	25,000.00	Exhibits 13 & 6
8/1/91	9,770.00	Exhibits 16 & 7
8/20/91	8,000.00	Exhibit 8

8/30/91	17,860.00	Exhibit 9
Total	\$90,010.00	

Strandberg submitted to the Rences a bill dated September 29, 1991 for \$28,708.95. Exhibits 17 and B. This bill was not paid. Strandberg pulled off the job on October 10, 1991. This was the last date on which labor and materials were supplied for the project. Strandberg submitted a final bill dated October 18, 1991 for \$40,308.94 and filed a mechanic's lien for this amount. Exhibit 1, attachments.

On November 22, 1991, Strandberg filed a petition to foreclose the mechanic's lien. Exhibit 1. The parties agreed to entry of a stipulated judgment of foreclosure. Strandberg had not given the notice provided in Iowa Code 572.13(2). Therefore, the judgment included only amounts owing for Strandberg's labor and not amounts owed to the subcontractors. Strandberg reserved his rights in reference to amounts owing for labor and materials supplied by the subcontractors. Exhibit 2. The judgment was paid. Strandberg filed a satisfaction of judgment on November 13, 1992. Exhibit 3. Strandberg filed an action on October 29, 1992 to collect the amounts owing to the four subcontractors.

The subcontractors Alta Lumber Co. and D & S Enterprises did not file mechanic's liens. UBC filed a mechanic's lien on May 4, 1992 in the amount of \$5,644.72. UBC gave the Rences the written notice prescribed under Iowa Code 572.14(2) and (3). Exhibit G. The notice was sent by regular mail. Jones-Laursen Masonry filed a mechanic's lien on October 30, 1992 in the amount of \$2,261.00. Jones-Laursen did not provide the statutory notice to the Rences.

The items from the final bill submitted by Strandberg which remained unpaid were:

Subcontractor	Amount
D & S Enterprises	\$12,307.64
D & S Enterprises	830.00
Jones-Laursen Masonry	2,261.00
UBC	1,388.02
Alta Lumber Co.	4,320.00
Total	\$21,106.66

In order to keep everyone moving on the job, Strandberg applied amounts received for prior bills differently from the amounts owed to specific contractors for labor and materials supplied. Therefore, the actual amounts owed to individual subcontractors differ from the amounts indicated on the final bill. The four subcontractors filed claims in the approximate amounts as follows:

Subcontractor	Amount
D & S Enterprises	\$ 7,807.64
Jones-Laursen Masonry	2,261.00
UBC	5,644.72
Alta Lumber Co.	13,790.34
Total	\$29,503.36

The subcontractors objected to the Rences' claim of exemption in their homestead. On January 27, 1993, Alta Lumber and D & S Enterprises filed a Notice of Intent to Perfect Mechanic's Lien Pursuant to 11 U.S.C. 546(b). On March 31, 1993, the Rences filed a motion to avoid the liens of Alta Lumber, D & S Enterprises and Jones-Laursen Masonry.

Discussion

The Rences' motion to avoid the liens of Alta Lumber,

D & S Enterprises and Jones-Laursen Masonry is brought pursuant to the authority under 11 U.S.C. 522(h), which allows a debtor to avoid certain transfers in order to preserve exemptions if the transfer is avoidable by the trustee and the trustee does not attempt to avoid the transfer. The lien avoidance motion is more appropriately an adversary proceeding pursuant to Fed.R.Bankr.P. 7001(1) and/or (2). In re Centolella, 142 B.R. 624, 625 (Bankr. N.D. N.Y. 1992); In re Klingbeil, 119 B.R. 178, 181 (Bankr. D. Minn. 1990). However, none of the subcontractors has objected to this procedural defect and all appear to have had a full opportunity to prepare and present their cases. In re Alliance Properties, Inc., 104 B.R. 306, 310 (Bankr. S.D. Cal. 1989). The court will decide the avoidance dispute on the Rences' motion.

The four subcontractors object to the Rences' claim of exemption in their homestead pursuant to Iowa Code 561.21(3), because the debt owed to them is for work done and materials furnished for the improvement of the Rences' homestead. The Rences argue that 561.21 must be applied together with the mechanic's lien provisions in Iowa Code Chapter 572. They argue that the subcontractors do not have perfected liens under the mechanic's lien statute. They conclude that the subcontractors would not be able to execute against the homestead, and therefore that the exceptions to the exemption under 561.21 are not available to the subcontractors. The Rences further argue that even if 561.21 may be applied independently from the mechanic's lien statute, the exception under 561.21 does not apply because the Rences do not owe "debt" to the subcontractors.

Iowa Code 561.21(3) provides:

The homestead may be sold to satisfy debts of each of the following classes:

...

(3) Those incurred for work done or material furnished exclusively for the improvement of the homestead.

The homestead is not exempt as to a creditor owed "debt" of the types listed in 561.21, regardless of whether the creditor has reduced its claim to judgment before the debtor's bankruptcy filing. In re Wooten, 82 B.R. 84, 86-87 (N.D. Iowa 1986). Acquiring a mechanic's lien that subjects the homestead to an in rem obligation is one way of establishing debt for purposes of 561.21. However, the remedy provided by the mechanic's lien statute is cumulative and not exclusive. Frontier Properties Corp. v. Swanberg, 488 N.W.2d 146, 149 (Iowa 1992). If the subcontractors can show there is debt under 561.21 either through a mechanic's lien or under other remedies, the homestead is not exempt.

A general contractor may pursue common law remedies it has under its contract with the owner to recover the value of the labor and materials supplied whether or not it is entitled to a mechanic's lien. Id.; Moffitt v. Denniston & Partridge Co., 229 Iowa 570, 294 N.W. 731, 733-34 (1940). The mechanic's lien remedy is independent from 561.21. Moffitt, 294 N.W. at 733. The homestead is not exempt as to a contractor owed debt for materials and labor furnished for the improvement of the homestead even if the contractor has lost the right to obtain or enforce a mechanic's lien. Id. at 734.

A general contractor may be owed debt by virtue of an express or implied contract with the owner. See Frontier, 488 N.W.2d at 149-50. The Rences were personally liable to Strandberg for the balance due on the contract, but Strandberg did not object to the exemption. The four subcontractors' contract was with Strandberg. None of the subcontractors had a contract with the owner. No personal liability against an owner is created under the mechanic's lien statute. See Capitol City Drywall Corp. v. C. G. Smith Construction Co., Inc., 270 N.W.2d 608, 613 (Iowa 1978).

The subcontractors argue that they have claims against the Rences personally under implied contract or third-party beneficiary theories. Iowa law does not support this argument. In Guldborg v. Greenfield, 259 Iowa 873, 146 N.W.2d 298 (1966), the court held that the subcontractor was not allowed to obtain personal judgment against the homeowners under implied contract theories. An implied contract is a contract implied in fact when the parties show their assent by acts. Id., 146 N.W.2d at 301. A contract implied in law, also called quasi-contract, restitution or quantum meruit, is based upon the principle of unjust enrichment. Id. at 301, 305. A subcontractor may not recover from the owner on implied contract or unjust enrichment theories, because the subcontractor has an express contract with the general contractor covering the same subject matter. Id. at 304, 305; see also Chariton Feed & Grain, Inc. v. Harder, 369 N.W.2d 777, 791 (Iowa 1985) (express and implied contract cannot co-exist on same subject matter and the former

supersedes the latter); Clemens Graf Droste Zu Vischering v. Kading, 368 N.W.2d 702, 712 (Iowa 1985) (contractors with express contract with vendor of property could not recover against purchaser on unjust enrichment theory); but see Ringgenberg v. Wilmsmeyer, 253 N.W.2d 197, 202 (S.D. 1977) (statute construed to allow subcontractors to proceed against owners on theory of unjust enrichment). Any implied agreement by the Rences to pay for work performed and materials supplied by the subcontractors is superseded by their contract with Strandberg to pay for the same work and materials.

The third-party beneficiary theory requires the subcontractors to show that the Rences and Strandberg intended the contract to confer a direct benefit on the subcontractors. The intent to benefit a third person must be clear from the express agreement. Peter Kiewit Sons' Co. v. Iowa Southern Utilities Co., 355 F.Supp. 376, 392-93 (S.D. Iowa 1973); Iowa Power & Light Co. v. Abild Construction Co., 144 N.W.2d 303, 312-13 (Iowa 1966). The evidence does not indicate that the subcontractors are other than incidental beneficiaries of the contract between Strandberg and the Rences. The most that can be inferred from the oral contract is that someone would necessarily benefit indirectly from the contract because Strandberg would have to hire others to perform work and provide materials. The court concludes that none of the subcontractors are owed debt based upon the personal liability of the Rences.

The court will next determine whether the subcontractors are owed an in rem obligation through perfected mechanic's liens that survive bankruptcy. A mechanic's lien attaches at the time that a contractor or subcontractor furnishes material or begins work. Iowa Code 572.2; Green v. Saxton, 196 Iowa 1086, 196 N.W. 27, 28 (1923). When the mechanic's lien is perfected, the lien relates back to the date of the original commencement of work on the property. Iowa Code 572.18; Lovell-Scholfield Lumber Co. v. Carter, 198 Iowa 238, 199 N.W. 405, 407 (1924).

UBC and Jones-Laursen Masonry filed mechanic's liens, but Alta Lumber and D & S Enterprises did not file liens. The subcontractors argue that they have valid liens that survive bankruptcy even if they did not file pre-petition liens because a mechanic's lien filed post-petition would relate back to the date of commencement of the work.

The Bankruptcy Code provides that the filing of a petition does not operate as a stay:

(3) . . . of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title. . . .

11 U.S.C. 362(b)(3). Bankruptcy Code 546(b) provides:

(b) The rights and powers of a trustee under sections 544, 545 and 549 of this title are subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection. If such law requires seizure of such property or commencement of an action to accomplish such perfection, and such property has not been seized or such action has not been commenced before the date of the filing of the petition, such interest in such property shall be perfected by notice within the time fixed by such law for such seizure or commencement.

The trustee's powers relevant to this case are the rights and powers of a bona fide purchaser of real property under 11 U.S.C. 544(a)(3) and 545(2). Section 544(a)(3) provides:

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by--

. . .

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

11 U.S.C. 544(a)(3).

Under 545(2), the trustee may avoid the fixing of a statutory lien on the debtor's property to the extent that the lien:

(2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists.

11 U.S.C. 545(2).

If 11 U.S.C. 546(b) were applicable to the subcontractors, post-petition perfection of their mechanic's liens would not be a violation of the automatic stay. The subcontractors could then perfect the lien by filing a claim and giving written notice as provided in Iowa Code 572.10 for perfecting subcontractors' liens after the lapse of 90 days from the date on which the last material was furnished or the last labor was performed. See In re Continental Country Club, Inc., 64 B.R. 177, 182-83 (Bankr. M.D. Fla. 1986) (if 546(b) applies, creditor perfects under non-bankruptcy law). On January 27, 1993, subcontractors Alta Lumber and D & S Enterprises filed a notice of intent to perfect mechanic's liens pursuant to 11 U.S.C. 546(b). Because Iowa law does not require seizure of property or commencement of an action to perfect the mechanic's lien, it is not clear that the notice itself was effective as an act of perfection. However, assuming that this would be an appropriate method to perfect a mechanic's lien post-petition, the court finds that the notice was not effective because 546(b) is not applicable to the subcontractors.

A creditor may perfect an interest in property post-petition if state law allows perfection to relate back pre-petition to defeat the status of the trustee. Perfection of a mechanic's lien relates back to the time that work commenced even if the mechanic's lien is filed after the 90 days prescribed in Iowa Code 572.9. Lovell-Scholfield, 199 N.W. at 407-08. However, the lien would not be effective as against the trustee's status as a bona fide purchaser of real property. Under Iowa law, a bona fide purchaser without notice who acquires rights in property after the expiration of the 90-day period prescribed in 572.9 has rights superior to a subcontractor who has not yet filed a claim for a mechanic's lien. Iowa Code 572.18.

The subcontractors argue that post-petition perfection would defeat the trustee's bona fide purchaser status because under Iowa law, the trustee had notice of the subcontractors' claims. The trustee's status as a bona fide purchaser is "without regard to any knowledge of the trustee." 11 U.S.C. 544(a). Cases have found that this language does not nullify state law regarding constructive notice of the rights of third parties in real property. McCannon v. Marston, 679 F.2d 13,

15-17 (3d Cir. 1982). A trustee may not be a bona fide purchaser of real property if under state law a particular fact would be notice to all the world, so that there could be no bona fide purchaser in that situation. See McCannon v. Marston, 679 F.2d at 16 (possession of real property constitutes constructive notice to subsequent purchasers); Saghi v. Walsh (In re Gurs), 27 B.R. 163, 165 (9th Cir. BAP 1983) (filing of lis pendens gives constructive notice to subsequent purchasers); Watkins v. Watkins, 922 F.2d 1513, 1514 (10th Cir. 1991) (purchaser has constructive notice of security interest granted by divorce decree.)

The subcontractors argue that under Iowa law, commencement of work is constructive notice of the claims of subcontractors, citing Diversified Mortgage Investors v. Gepada, Inc., 401 F.Supp. 682 (S.D. Iowa 1975). In Gepada, the date on which work commenced determined priorities between a contractor's lien and a recorded mortgage. The case did not involve a bona fide purchaser. The court in Gepada stated that

commencement of actual operations on the ground for the erection of a building is constructive notice to all persons who propose to purchase or acquire liens upon the property, of claims for mechanic's liens for work or material contributed for the building.

401 F.Supp. at 685. The case cited by the Gepada court for that proposition was not a mechanic's lien case. The point at which work commences is significant because certain lien priorities are measured from that time. The general rule is that commencement of work must be visible and significant in order to make it reasonably apparent to others that work has commenced. See generally, 56 C.J.S. Mechanic's Liens 206, 226; 53 Am.Jur.2d Mechanic's Liens 249. In Gollehon, Schemmer & Associates, Inc. v. Fairway-Bettendorf Associates, 268 N.W.2d 200, 201, the court explained that the notice given by work being done justifies the mechanic's lien statute:

The fact that the building or improvement is being made is notice to the world, open enough for all to have warning of

the mechanics and material men's rights. It is entirely competent for the legislature to so provide and to direct that all persons shall be chargeable with such notice for ninety days after the last item of labor or materials is furnished.

268 N.W.2d at 201. Thus, the notice given by commencement of work does not last indefinitely, but appears to correspond with the 90-day time to file liens.

In any event, the court does not consider the rule of commencement of work as constructive notice applicable in this case, and finds that it does not defeat the trustee's status as bona fide purchaser of real property. The trustee acquired bona fide purchaser status as of the date of the commencement of the case, more than a year after the last date work was done on the project. Iowa Code 572.18 contemplates that there may be good faith purchasers after the expiration of the 90-day period for filing a mechanic's lien. The trustee acquires the highest status as a bona fide purchaser that there may be under Iowa law. If the subcontractors were allowed to perfect their liens post-petition, the liens would be filed after the 90-day time for filing and would be subject to the rights of a bona fide purchaser. Iowa Code 572.18. The subcontractors' liens would not be effective as against the trustee's status as bona fide purchaser. Therefore, the subcontractors may not perfect their liens post-petition as they are stayed by 11 U.S.C. 362(a)(4). The unperfected liens of Alta Lumber and D & S Enterprises should be avoided as transfers avoidable by the trustee under 544 or 545(2) and avoidable by the Renches under 522(h). Also, because these subcontractors are owed no debt by the Renches, the Renches' homestead may not be sold to satisfy the subcontractors' unpaid bills.

Jones-Laursen Masonry filed its mechanic's lien on October 30, 1992. The Renches filed their chapter 7 petition on November 4, 1992. The court finds the lien is avoidable as a preference under 547 and avoidable by the Renches under 522(h). The lien was a transfer which would enable Jones-Laursen Masonry to receive more than it would receive if the transfer had not been made because without the lien Jones-Laursen Masonry would be in the same position as Alta Lumber and D & S Enterprises. Because the lien is avoidable, Jones-Laursen Masonry is owed no debt within the meaning of 561.21, and the homestead is exempt as to its claim.

UBC filed its mechanic's lien on May 4, 1992. This lien was filed after the 90-day time for filing a mechanic's lien under 572.9 but within the time allowed for filing an enforceable mechanic's lien. Iowa Code 572.27. UBC's lien is enforceable to the extent of the balance due from the owner to the general contractor. Iowa Code 572.11. The amount owed to Strandberg is the entire amount owed to the four subcontractors. Therefore, UBC has a lien for the full amount owing to it.

The Renches admit that UBC's lien is not avoidable in bankruptcy but argue the lien is not enforceable under Iowa law. The Renches argue that UBC is not entitled to object to the homestead exemption because it did not properly serve the notice prescribed in Iowa Code 572.14(2) and (3). The court finds that 572.14 is applicable only to liens perfected within the 90-day time for filing allowed under 572.9. Subsection 572.14(2) creates an exception to the general rule that an owner may still be liable for a subcontractor's full claim if the owner pays the general contractor within the 90-day period for filing liens and the subcontractor files within the 90 days. Under 572.14(2), mechanic's liens for labor and materials supplied for a homestead are enforceable only to the extent of the balance due from the owner to the general contractor. Section 572.14 is not applicable to a lien perfected after the 90 days. After 90 days, a lien is limited to the balance due from the owner to the general contractor whether the labor and materials supplied are for a homestead or otherwise. Iowa Code 572.11.

The court finds that the UBC mechanic's lien is valid against the homestead under Iowa law and survives bankruptcy. The manager of UBC testified that after Strandberg pulled off the job, DeLoss Rench set up another account at UBC for materials for finishing the project. Any debt owing on that contract between the Renches and UBC for materials for the homestead is a debt under 561.21. The Renches' homestead is not exempt as to UBC's claims.

ORDER

IT IS ORDERED that the Renches' motion to avoid the liens of Alta Lumber Co., D & S Enterprises and Jones-Laursen Masonry is granted.

IT IS FURTHER ORDERED that the objection of Alta Lumber Co., D & S Enterprises and Jones-Laursen Masonry to

the Rences' claim of exemption in their homestead is overruled.

IT IS FURTHER ORDERED that the objection of United Building Center to the Rences' claim of exemption in their homestead is sustained.

SO ORDERED THIS 1st DAY OF FEBRUARY, 1994.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order by U. S. mail to: Donald H. Molstad, A. Frank Baron, David Jennett and U. S. Trustee.