

In the United States Bankruptcy Court

for the Northern District of Iowa

EMILY JEAN VERSLUIS,
a/k/a JEAN VERSLUIS,
a/k/a MRS. JAMES VERSLUIS,
a/k/a E. JEAN VERSLUIS,
a/k/a EMILY VERSLUIS,
Debtor.

Bankruptcy No. 94-61420KW

Chapter 7

ORDER RE CREDITOR'S OBJECTION TO EXEMPTION CLAIM OF DEBTOR

On November 30, 1994, the above-captioned matter came on for hearing pursuant to assignment. Attorney L. Don Snow appeared on behalf of Debtor Emily J. Versluis. Attorney H. Raymond Terpstra II appeared on behalf of Creditor Tom E. Versluis. The matter before the Court is Creditor's Objection to Exemption Claim of Debtor and Debtor's response thereto. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B).

FINDINGS OF FACT AND STATEMENT OF THE CASE

Debtor Emily Jean Versluis and her then husband, James Versluis, borrowed \$30,000 from James Versluis' brother, Tom E. Versluis, in 1980. No written documents were executed at that time. The money was borrowed from Tom E. Versluis so that Mr. and Mrs. James Versluis could purchase a home. The transaction was completed and Debtor and her husband, James Versluis, purchased this home which ultimately became their homestead.

None of the underlying indebtedness to Tom Versluis was paid during subsequent years and eventually this indebtedness was reduced to a promissory note executed December 1, 1985. The promissory note was in the amount of \$30,000 with interest payable at a rate of 10% per annum.

Debtor and James Versluis were granted a dissolution of marriage on September 18, 1992. The dissolution decree awarded each of the parties a one-half interest in the homestead and assigned each of the parties one-half of the liability for the preacquisition debt balance. The dissolution decree further directed a sale of the homestead and application of the proceeds towards satisfaction of Debtor's obligation. The property was listed and closing on the sale of this homestead occurred on May 1, 1993.

After entry of the dissolution decree and prior to closing on the sale of the homestead, Creditor Tom E. Versluis commenced an independent lawsuit against Debtor based upon her obligation to him for one-half of the obligation owing to him as a result of the dissolution decree. This independent lawsuit was reduced to judgment on May 2, 1993. This judgment is in favor of Creditor Tom E. Versluis and against Debtor Emily Jean Versluis in the amount of \$20,538.95 with interest at a rate of 10% per annum with court costs being assessed to Debtor.

Debtor received her half of the proceeds from the sale of the parties home in the approximate amount of \$20,000. Though the dissolution decree directed that these proceeds be applied to the preacquisition debt balance, Debtor instead applied a portion of the proceeds toward attorney's fees and various other expenses. The remaining \$7,000 was applied toward the purchase of a house on May 27, 1993. This house constitutes Debtor's current homestead.

Debtor filed this Chapter 7 Bankruptcy Petition on September 2, 1994, claiming the property purchased in May of 1993 as her exempt homestead pursuant to Iowa Code sec. 561.16. Creditor Tom E. Versluis filed the presently pending objection to exemption on September 22, 1994 pursuant to Federal Rule of Bankruptcy Procedure 4003(b). The

objection asserts that Debtor's homestead is encumbered by a preacquisition debt which was reduced to judgment on May 2, 1993. Creditor argues that Debtor's homestead is not exempt from this obligation as specifically provided in Iowa Code sec. 561.21(1) which states:

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

1. Those contracted prior to its acquisition, but then only to satisfy a deficiency remaining after exhausting the other property of the debtor, liable to execution.

Debtor relies upon Iowa Code sec. 561.20 by asserting in her resistance that she used proceeds from the sale of her previous homestead to purchase her current homestead and, therefore, this homestead is exempt. Iowa Code sec. 561.20 states that:

Where there has been a change in the limits of the homestead, or a new homestead has been acquired with the proceeds of the old, the new homestead, to the extent in value of the old, is exempt from execution in all cases where the old or former one would have been.

The foregoing recitation of facts is uncontroverted. The amount of the debt and the underlying obligation are undisputed. In addition, the parties stipulated that no other exempt property exists. The schedules reflect that this property is known locally as 815 Ainsworth St., Jesup, Iowa, and is legally described as Lot 37, Original Plat of Jesup, Buchanan County, Iowa. The schedules further reflect that Debtor lists the current market value of this property at \$26,000 with an indebtedness to Farmers State Savings Bank in Independence, Iowa in the amount of \$17,558. The net equity and the value, therefore, claimed as exempt is \$8,442.

Creditor Tom E. Versluis asserts that the exemption claim of Debtor should be denied based on two separate theories: First, Creditor alleges that the previous homestead was not exempt from Creditor's claim as the debt was contracted prior to acquisition of the homestead. Because the previous homestead was not exempt from Creditor's debt, Creditor therefore claims that, under Iowa law, Debtor's current homestead is not exempt from this preacquisition obligation. In other words, because the new homestead is exempt "to the extent in value of the old," and because there was no homestead exemption value in the previous homestead, no portion of the new homestead is exempt from the preacquisition debt. Second, Creditor asserts that even if the homestead or a portion of the current homestead is determined to be exempt, the proceeds from the sale of the first homestead which were to be applied towards satisfaction of Creditor's debt pursuant to the dissolution decree, were wrongfully applied toward purchase of Debtor's current homestead. Creditor, therefore, seeks invocation of the Court's equitable powers. He asks the Court to deny the claimed homestead exemption because allowance of the claimed homestead exemption would unjustly benefit Debtor for her wrongful actions in misapplying the sale proceeds.

CONCLUSIONS

The first issue to be addressed is the significance to be afforded the oral agreement, the execution of the promissory note, and the entry of judgment in this case. The record reflects that the oral agreement creating this obligation and the actual transfer of funds occurred in 1980. This obligation was reduced to a written promissory note in 1985 and the debt was reduced to a judgment in 1993. The law is clear in this District that the fact that the debt was reduced to a writing or that a judgment was entered after acquisition of the homestead is inconsequential. In re Shanahan, No. 94-11127KC, slip op. at 5 (Bankr. N.D. Iowa Nov. 17, 1994); In re Reinders, 138 B.R. 937, 941 (Bankr. N.D. Iowa 1992)(rejecting the debtor's claim that the oral agreement was merged into the promissory note and was therefore not a preacquisition debt for purposes of sec. 561.21(1)). "The date of contracting the debt is the test, and not that of the rendition of the judgment...." Bills v. Mason, 42 Iowa 329, 334 (1876); In re Streeper, 158 B.R. 783, 788 (Bankr. N.D. Iowa 1993). The judgment lien relates back to the contracting date for purposes of determining the application of sec. 561.21(1). Bills, 42 Iowa at 334. As a result of the foregoing analysis, the oral agreement creating a preacquisition lien can be enforced by general execution and sale of the property. Bills, 42 Iowa at 334. As such, the creation of the original obligation by way of oral agreement is the controlling obligation and will, therefore, form the basis for subsequent analysis in this opinion.

Under Iowa law, a debtor's homestead is exempt from judicial sale where there is no special declaration of statute to the

contrary. Iowa Code § 561.16. However, this homestead exemption is subject to several restrictions. Iowa Code sec. 561.21(1) operates as an exception to the homestead exemption, providing that the exemption does not operate against debts contracted prior to the acquisition of the homestead. In re Streeper, 158 B.R. at 788; In re Shanahan, No. 94-11127KC, slip at 3. The debtor in Shanahan, as here, contracted a debt prior to acquiring his home. This Court held that the debtor was not entitled to an exemption. Here, it is stipulated that Debtor and her ex-husband, James Versluis, borrowed money from Creditor, Tom E. Versluis, to purchase a homestead in 1980. That debt preceded acquisition of the homestead. It is undeniable that this debt is a preacquisition debt for purposes of Iowa Code sec. 561.21(1). See Streeper, 158 B.R. at 788. Accordingly, the previous homestead could have been sold to satisfy the preacquisition debt.

This conclusion is enhanced because the debt was incurred for the express purpose of acquiring the previous homestead. "The homestead is liable for all debts contracted before its purchase, and *for the money agreed to be paid for it*. Bills, 42 Iowa at 331 (emphasis added).

Debtor acquired her current homestead with \$7,000 in proceeds from the sale of the previous home. Iowa Code sec. 561.20 provides for a transfer of exemption rights when there is a change of homestead. See In re Ersepke, No. 2-92-00541D, slip op. at 4 (Bankr. N.D. Iowa Nov. 30, 1993). If a debtor's first homestead is exempt from sale for a particular debt, his second homestead is also exempt. Streeper, 158 B.R. at 788; Bills, 42 Iowa at 329. The reverse is also true. "If the first homestead is not exempt as to that debt, the second homestead exemption is limited to that extent." Streeper, 158 B.R. at 788. See also Millsap v. Faulkes, 20 N.W.2d 40, 42 (Iowa 1945)(defining "proceeds" from the sale of the previous homestead, as contemplated by sec. 561.20, as "the balance of proceeds over and above the amount of the debt" for which the previous homestead was liable). Because Debtor's previous homestead was subject to sale for satisfaction of Creditor's preacquisition debt, that liability was transferred to Debtor's new homestead when she exchanged properties. Therefore, Debtor's current homestead may be sold to satisfy the preacquisition obligation to this Creditor.

Creditor alternatively argues that even if the homestead law, as it relates to exemptions, prevented invasion of the new homestead for preacquisition obligations, equitable considerations preclude attachment of a homestead exemption. The facts in the present case are similar to those addressed in In re Graham, 28 B.R. 928 (Bankr. N.D. Iowa 1983). In Graham, the debtor was ordered to sell certain securities and apply the proceeds against specific debts pursuant to a state court dissolution decree. The debtor sold the securities. However, he used the proceeds to purchase real estate and later claimed this real estate as his homestead and exempt in a subsequent bankruptcy proceeding. The bankruptcy court in Graham determined that it would be both inequitable and unconscionable "to allow the Debtor in this case to reap the benefits of the securities when the State Court obviously intended that they be used to satisfy a debt on which both the Debtor and [his ex-spouse] were liable." Id. at 931. A debtor's homestead exemption claim has also been denied when Debtor utilized the proceeds from the sale of his previous homestead and applied them toward the purchase of a new homestead when this conduct was in direct violation of existing bankruptcy law. In re Wooten, 82 B.R. 84, 87 (Bankr. N.D. Iowa 1986).

While admittedly not identical factually or legally, the foregoing establish that in appropriate circumstances the equitable powers of the Court can be invoked to deny a homestead exemption when it would be inequitable and unconscionable to allow a homestead exemption claim. Here, Debtor applied proceeds from the sale of the home toward purchase of a new homestead, contrary to the specific mandate of the dissolution decree that the proceeds be applied toward Creditor's claim. It is alternatively the holding of the Court that it would be inequitable under the present circumstances to allow Debtor to reap benefits associated with violating the dissolution decree by investing proceeds in the new homestead. The new homestead should, therefore, be held subject to sale for satisfaction of Creditor's judgment. See Graham, 28 B.R. at 931. To hold otherwise, would be to condone Debtor's attempt to "use the homestead statute as a sword against her ex-spouse in order to undo the equitable division of property...." In re Adams, 29 B.R. 452, 454 (Bankr. N.D. Iowa 1982).

It is the conclusion of this Court, on two alternative grounds, that Debtor's current homestead may be sold to satisfy the obligation to this Creditor. The only issue unresolved is the amount for which this new homestead can be invaded. The dissolution decree recognized the existence of the Creditor's claim against the original homestead and assigned each of the spouses one-half of the liability. This division of property interest and accompanying debt constitutes a valid exercise of the State Court's authority. In re Marriage of Tierney, 26 N.W.2d 533, 534 (Iowa 1978). It is uncontested

that Creditor's judgment lien against Debtor totals \$20,538.95 plus interest and costs. It is this amount which constitutes Debtor's portion of the original liability from the previous homestead which transferred to Debtor's new homestead in accordance with Streeper and Bills. As the previous homestead would have been subject to sale in order to satisfy this obligation under sec. 561.21(1), the current homestead is also subject to sale in that amount as well. It appears that the total equity in the current homestead is between \$8,000 and \$9,000 and will, therefore, be consumed by this obligation.

WHEREFORE, for all of the reasons set forth in this opinion, the Creditor's objection to exemption claim of Debtor is **SUSTAINED**.

FURTHER, also for the reasons set forth in this opinion, Debtor's resistance to objection to exemption claim of Debtor is **DENIED**.

FURTHER, the Court enters judgment that Debtor's homestead is not exempt from Creditor Tom E. Versluis' judgment lien.

SO ORDERED this 5th day of January, 1995.

Paul J. Kilburg
U.S. Bankruptcy Judge