

IN THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF
IOWA

IN RE:)

) Chapter 7

JEFF JAMES NEHL)

AMY LYNN NEHL) Bankruptcy No. 97-60192

aka Amy Lynn Fuller)

)

Debtors.)

ORDER RE TRUSTEE'S FINAL REPORT AND ACCOUNT

This matter was heard telephonically on April 10, 2002. Debtors Jeff and Amy Nehl were represented by Attorney Peter Riley. Attorney Eric Johnson represented Creditor Community Wholesale Co. Chapter 7 Trustee Habbo Fokkena appeared personally. The Court took the matter under advisement after hearing arguments of counsel. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (K), (O).

STATEMENT OF THE CASE

Community Wholesale asserts that it has a secured claim. It objects to Trustee's Final Report which allows the claim as unsecured. Community Wholesale presented its proof of claim, including a copy of its Notice of Lien, as evidence of its secured claim. It seeks treatment of its claim as secured. Trustee argues that Community Wholesale does not have a secured claim because Community Wholesale's Notice of Lien does not include the waiver for homestead exemptions in agricultural land required by Iowa Code sec. 561.22. Alternatively, he argues that regardless of Community Wholesale's lien status, it did not object to the settlement agreement and is now foreclosed from objecting to its treatment in the Final Report.

FINDINGS OF FACT

Trustee and Community Wholesale have agreed to stipulated facts which the Court now adopts. Debtors Jeff and Amy Nehl filed a joint Chapter 7 petition for relief on January 28, 1997. They claimed a homestead exemption for real property located at 3287 R. Ave., Oelwein, Iowa. The real estate is used for a dairy cow operation and other farm work. It has been their homestead since 1992.

On March 14, 1997, Trustee filed an objection to the homestead exemption based on his discovery that a home improvement debt under Iowa Code sec. 561.21(3) existed in the case which attached to the homestead. This Court sustained Trustee's objection on June 15, 1997.

Trustee then filed a Final Report, which concluded that the estate's assets did not exceed \$1,500, and that the \$759.54 in total receipts of the estate would be disbursed to pay administrative expenses. At this time, Trustee learned that there was a lien "previously undisclosed" on file. It was not discovered due to an inaccuracy in the legal description of the real estate in the Chapter 7 petition. The discovery of the lien, nevertheless, supported Trustee's conclusion that Debtors had no equity in real estate. The bankruptcy case was closed on November 11, 1997.

On March 26, 1996, Community Wholesale filed a Notice of Lien in the Fayette County Recorder's Mortgage Book #379 at page 705. The Notice of Lien states that on March 1, 1996, Debtors were granted a "Home Improvement Loan" by Community Wholesale.

It further states that said loan would allow Community Wholesale a lien on Debtors' real estate for the unpaid balance of the loan "as though the same were evidenced by a mortgage or trust or deed." The Notice of Lien was signed by both Debtors and Community Wholesale.

In April or May, 2001, Trustee learned that Debtors had more equity in the real estate than previously thought. Trustee filed a motion to reopen the case which was granted on May 30, 2001. Subsequent to the reopening, Trustee and Debtors entered into a settlement agreement whereby Debtors paid the bankruptcy estate \$10,000 to satisfy the judgment entered on the prior homestead exemption objection. Community Wholesale and other creditors were sent notice of the proposed settlement agreement. No party objected to the settlement and this Court approved it on August 13, 2001.

On February 4, 2002, Trustee filed a Final Report. Trustee allowed the claim of Community Wholesale as an unsecured, tardily-filed claim. Community Wholesale filed a proof of claim on October 9, 2001 which stated that the claim was for goods and services performed. It further stated that Debtors' real estate was the security for the claim. Based on Trustee's allowance of the unsecured claim, the report calculated that Community Wholesale would be paid \$1,693.38. Community Wholesale objects to the Final Report, disputing the characterization of its claim as unsecured.

CONCLUSIONS OF LAW

Trustee has alternative theories for his argument that Community Wholesale's objection to the final report should be denied. Trustee argues that Community Wholesale is unsecured as its consensual lien evidenced by the Notice of Lien is unenforceable as it does not conform to Iowa Code sec. 561.22. In addition, Trustee asserts that Community Wholesale did not object to the settlement agreement and has no standing to object now.

HOMESTEAD EXEMPTION WAIVER

The Iowa homestead exemption statute provides: "The homestead of every person is exempt from judicial sale where there is no special declaration of statute to the contrary. . ." Iowa Code § 561.16 (1996). In Iowa Code sec. 561.21, there are four "declarations of statute to the contrary," or exceptions to the homestead exemption, whereby a debtor's homestead may be sold to satisfy debts in limited circumstances. Two of the four exceptions are relevant to this case. Section 561.21(2) allows the sale of a homestead to satisfy debts created by written contracts which expressly stipulate that the homestead is liable. Iowa Code § 561.21(2) (1996). This may occur only if some deficiency remains after exhausting the debtor's other property. *Id.* In addition, sec. 561.21(3) states that the homestead is liable for debt "incurred for work done or material furnished exclusively for the improvement of the homestead." Iowa Code § 561.21(3) (1996).

For a debtor to waive his right to a homestead exemption in agricultural land, the contract that purports to waive that right must contain certain language mandated in Iowa Code sec. 561.22. This section provides specific requirements for an enforceable homestead waiver on agricultural land as follows:

If a homestead exemption waiver is contained in a written contract affecting agricultural land as defined in section [9H.1], or dwellings, buildings, or other appurtenances located on the land, the contract must contain a statement in substantially the following form, in boldface type of a minimum size of ten points, and be signed and dated by the person waiving the exemption at the time of the execution of the contract: **"I understand that homestead property is in many cases protected from the claims of creditors and exempt from judicial sale; and that by signing this contract, I voluntarily give up my right to this protection for this property with respect to claims based upon this contract."**

Iowa Code § 561.22 (1996) (emphasis in original).

A written contract providing for a waiver of homestead rights in agricultural land is only effective if the contract contains a written homestead

waiver in compliance with the statute. In re Wagner, 259 B.R. 694, 699 (B.A.P. 8th Cir. 2001). This law was enacted to address concerns that mortgagees were not making mortgagors fully aware of the legal effects of a note and mortgage on an ordinarily exempt agricultural homestead. Peoples Bank & Trust Co. v. Lala, 392 N.W.2d 179, 190-91, n.2 (Iowa App. 1986). In addition, sec. 561.22 was enacted to give extra protection to farmers and agricultural land by requiring the waiver of the homestead exemption to be written "conspicuously and concisely." Wagner, 259 B.R. at 699- 700. This law can, therefore, invalidate an otherwise valid exception to the homestead exemption if the contract does not satisfy the requirements pursuant of sec. 561.22 when the homestead property is agricultural land.

Iowa law defines "agricultural land" by referencing Iowa Code sec. 9H.1 which provides: "[a]gricultural land means land suitable for farming." Iowa Code § 9H.1 (1996). The definition of "farming" is "the cultivation of land for production of agricultural crops . . ., grazing or the production of livestock." Iowa Code § 9H.1(11) (1996).

An additional requirement of sec. 561.22 is that the waiver must be within a written contract. Iowa Code § 561.22 (1996). A mortgage is a contract. Wagner, 259 B.R. at 700. Therefore, mortgages which do not contain the waiver language pursuant to sec. 561.22 are unenforceable.

It is necessary to first determine what type of lien, if any, Community Wholesale has to secure a claim to determine if Community Wholesale is secured or unsecured. The parties have stipulated that a lien was discovered by Trustee after this Court granted his objection to Debtors' homestead exemption on June 5, 1997. The lien is described as a mechanic's lien in the stipulated facts. In its Objection to Trustee's Final Report, Community Wholesale does not assert that it has a mechanic's lien but asserts it is a secured party based on the Notice of Lien dated March 26, 1996.

Based upon Community Wholesale's Notice of Lien, this Court concludes that it is a consensual lien, or a mortgage, between Debtors and Community Wholesale for a home improvement loan. It is recorded in the Mortgage Book for Fayette County, and states that the lien is to be treated "in like manner as though the [lien] were evidenced by a mortgage." The collateral for supporting the lien is Debtors' homestead real estate.

As Community Wholesale contracted with Debtors for a lien, any assertion of a mechanic's lien is irrelevant. Section 572.3 of the Iowa Code provides that "[n]o person shall be entitled to a mechanic's lien who, at the time of making a contract for furnishing material or performing labor, or during the progress of the work, shall take any collateral security on such contract." Iowa Code § 572.3 (2002). Under this statute a creditor cannot have both a mechanic's lien and a mortgage. The Court concludes that Community Wholesale has a consensual lien or mortgage against Debtors' real estate.

The remaining question is whether this lien is valid. Iowa Code sec. 561.22 unambiguously sets out the requirements for valid contracts with waivers of the homestead exemption in agricultural land. The parties do not dispute that the land in question is suitable for farming. It is stipulated that Debtors use this land for a dairy cow operation, and "other farm work." The homestead is agricultural land as defined under sec. 9H.1, making the requirements of sec. 561.22 applicable. The lien in question is a consensual lien, which is a mortgage, and therefore is a contract for sec. 561.22 purposes.

The Notice of Lien does not substantially follow the form required by sec. 561.22 for a homestead exemption waiver of agricultural land in a written contract. It lacks language which would indicate that Debtors waived any rights to a homestead exemption. As the contract does not conform to the requirements in sec. 561.22, the mortgage is unenforceable. Community Wholesale retains only an unsecured claim as provided in Trustee's

Final Report.

SETTLEMENT AGREEMENT

Trustee alternatively asserts that Community Wholesale is precluded from objecting to the Final Report's treatment of its claim as unsecured because it failed to object to the settlement agreement. This Court has found Community Wholesale's mortgage to be unenforceable, and, therefore, unsecured. Regardless of the outcome of a ruling on the merits of a failure to object to a settlement agreement, the claim is unsecured. The focal point in this case is not Community Wholesale's failure to object, but rather where it stands in line at the "pay window."

The settlement agreement binds the parties to the claims that have already been allowed. The only issue is what type of claim did Community Wholesale have at the time of the settlement. Community Wholesale did not have a lien on Debtors' homestead prior to the settlement. As that issue has been decided, the Court need not determine what effect Community Wholesale's failure to object to the settlement has on this case.

CONCLUSION

Debtors' homestead is agricultural land, which makes the requirements of sec. 561.22 applicable in this case. The Notice of Lien evidences a mortgage between Community Wholesale and Debtors pursuant to sec. 561.2(2). The mortgage is a contract affecting agricultural land requiring the statutory homestead exemption waiver required by sec. 561.22. Community Wholesale's Notice of Lien does not contain any language indicating a waiver of the homestead in agricultural land. Therefore, it is unenforceable against Debtors' homestead.

WHEREFORE, for all of the reasons set forth herein, the Court finds Community Wholesale Co.'s Motion to Object to Trustee's Final Report is DENIED.

FURTHER, the Court concludes that Community Wholesale's mortgage is not enforceable against Debtors' exempt homestead.

FURTHER, the Court finds that Community Wholesale has an unsecured claim as properly treated in Trustee's Final Report and Distribution.

FURTHER, Trustee's Final Report and Distribution is approved by the Court.

SO ORDERED this 14 day of May, 2002.

PAUL J. KILBURG
CHIEF BANKRUPTCY JUDGE