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CLERK SUPREME COURT

IN THE COURT OF APPEALS OF IOWA

No. 9-457 / 88-1832

LEONA W. FOLKERS, MYRNA K. FOLKERS, and H.W.G. FOLKERS,

Plaintiffs-Appellants,

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vs.

TERRY BRITT, DIANE BRITT, DON BRITT, VELMA BRITT, and CITIZENS STATE BANK,

Defendants-Appellees,

and

MONTICELLO STATE BANK,
Defendant.

Appeal from the Iowa District Court for Jones County, Van D. Zimmer, Judge.

Plaintiffs appeal a district court judgment determining defendant bank's claim to proceeds of a sale of livestock was prior to theirs. **AFFIRMED IN PART AND MODIFIED IN PART.**

David F. McGuire, Cedar Rapids, for appellants.

Jay A. Willems of Remley, Heiserman & Willems, Anamosa, for appellee Citizens State Bank.

Michael W. Fay of Fay & Weller, Cedar Rapids, for appellees Britts.

Considered by Schlegel, P.J., and Sackett and Habhab, JJ.

SACKETT, J.

Plaintiffs-appellants Folkers appeal a district court judgment determining priorities between plaintiff and defendant-appellee Citizens Bank to proceeds of a sale of livestock and other farm property owned by defendants Diane Britt, Don Britt, and Velma Britt and providing security for loans made to the Britts by plaintiffs and defendant bank. The trial court determined defendant bank's lien was first and the bank was entitled to the proceeds until its debt was satisfied. Plaintiffs appeal, contending they should have been awarded amounts from the escrow account to compensate them for livestock they owned. Plaintiffs further contend the bank either subordinated its lien to that of the plaintiffs or waived its right to claim priority. Plaintiffs also contend the district court incorrectly allowed the bank interest on the proceeds from the sale of secured property, the interest to be taken from the escrow account holding the proceeds, pending the outcome of this litigation. Our scope of review in this equity matter is de novo. Iowa R. App. P. 4. We affirm in part and modify in part.

The plaintiffs entered into a stock share lease with defendants Terry and Diane Britt in November 1979 for the operation of a farm owned by the plaintiffs. The Britts owned no farm property at that time. In order to fulfill a requirement of the lease, the Britts agreed to purchase

machinery and equipment, and a half-interest in livestock and feed, from plaintiffs for $25,276.33. A promissory note in that amount, payable to the plaintiffs, was executed by the Britts on December 1, 1979. The note drew interest at the rate of eight percent per annum, and was unpaid at the time of trial. On December 20 plaintiffs filed a financing statement with the secretary of state to secure their interest in the property. The Britts later signed two additional promissory notes for funds borrowed from plaintiffs.

The Britts borrowed money through various loans from defendant Citizens State Bank from 1980 to mid-1985. The bank secured these loans through security agreements on grain, livestock, and machinery, some of which was jointly owned by the Britts and plaintiffs. Two security agreements, dated February 18, 1983, and March 26, 1984, stated: "Livestock subject to prior lien to landlord H.W.G. Folkers." The bank perfected these security agreements by filing financing statements with the secretary of state. The lease between plaintiffs and the Britts prohibited the Britts from encumbering jointly owned livestock without plaintiffs' written consent. At the time of trial, the Britts owed defendant bank $51,859.43 on four separate promissory notes.

In December 1984 the financing statement filed by plaintiffs lapsed when they failed to file a continuation

statement. The Britts continued to receive loans from the bank, which did not know plaintiffs' financing statement had lapsed. The financing statements filed by the bank remained in effect at the time of trial.

Plaintiffs served the Britts with a notice of termination of farm tenancy in September 1986. All secured property was sold and the proceeds placed in escrow, pending the determination of priority between plaintiffs and defendant bank. The total amount placed in escrow was $53,590.78, which included proceeds from the sale of livestock of $41,729.65 and $11,861.13 in proceeds from the sale of other property. Plaintiffs do not challenge the trial court except as to its disposition of the livestock proceeds. Therefore, the portion of the decree granting defendant bank a first claim to the $11,861.13 is affirmed and that part of the proceeds in the escrow account should be set aside to defendant bank. The obligation of the Britts to the bank clearly exceeds this amount.

The first issue we need to address is whether the Britts owned all the livestock sold or whether some livestock was owned by plaintiffs. Plaintiffs contend they bought four of the cows sold and owned them independently of the Britts. Plaintiffs contend they bought thirteen cows in 1984 and 1985 that were owned wholly by the plaintiffs, as opposed to being jointly owned with the Britts, as was the rest of the livestock in question. Testimony by plaintiff H.W.G.

Folkers indicated the plaintiffs never received either the thirteen cows or payment for them. Testimony by defendant Terry Britt indicated plaintiffs were given nine cows before the remainder of the herd was separated and split between the Folkers and the Britts. The district court found nine of these cows had been returned to plaintiffs, but made no mention of the remaining four.

While not bound by them, we give ample weight to the trial court's findings of fact. Iowa R. App. P. 14(f)(7). We find the plaintiffs did in fact purchase thirteen cows independently from the Britts, and that nine of these cows were returned to them before the sale of the secured property. Plaintiffs were never compensated for the remaining four cows. A determination needs to be made as to the sale price of the four cows.

The next issue involves the sale of hogs jointly owned by plaintiffs and the Britts. These hogs were sold in March 1987 for a total of $4,262.27, all of which was placed into the escrow account. Plaintiffs contend, and the defendant bank agrees, half of this amount should have been paid to the plaintiffs instead of being deposited in the escrow account. We therefore determine $2,131.13 from the escrow fund, representing proceeds from the sale of livestock, is plaintiff's money.

We now address plaintiffs' contention the district court erred in granting the defendant bank priority in the secured

livestock. Plaintiffs' perfected security interest was superior to the bank's when the bank made its original loans to the Britts. By the time of the sale of the secured property, however, the plaintiff's interest was no longer perfected. Once a security interest becomes unperfected due to lapse, it is considered unperfected as against one who became a lien creditor before lapse. Iowa Code § 554.9403(2) (1987); see State Sav. Bank v. Onawa State Bank, 368 N.W.2d 161, 166 (Iowa 1985).

Plaintiffs contend, however, the bank subordinated its lien to that of the plaintiffs by acknowledging plaintiffs' superior lien in the bank's security agreements with the Britts. As support they cite Iowa Code section 554.9316, which states: "Nothing in this Article prevents subordination by agreement by any person entitled to priority." Plaintiffs claim they are third-party beneficiaries of the agreements between the bank and the Britts. The bank contends error was not preserved on the issue of subordination. We disagree.

We find the security agreement between the Britts and the bank gave the bank a lien in the livestock, subject to the plaintiffs' preexisting liens. Thus the bank's security interest in the livestock was subordinate to that of the plaintiffs', irrespective of the perfected status of the financing statements. At no time did the bank loan any money to the Britts in reliance on the plaintiffs' lien and

financing statement not being in full force and effect. The bank did not make its interest in the Britts' equipment subject to plaintiffs' preexisting lien as it did with the livestock. The bank, by taking a security interest subject to the plaintiffs' prior liens, subordinated its liens in the Britts' livestock to those of the plaintiffs.

Plaintiffs also contend the bank waived its priority by acknowledging the plaintiffs' prior lien in the later security agreements between the bank and the Britts. Because of our holding on the subordination issue, we need not address plaintiffs' waiver claim. The decision of the district court granting the defendant bank priority in the secured livestock is reversed. We determine plaintiff has first priority in the funds representing the sale of livestock. We must next determine the amount necessary to repay the Britts' debts to plaintiffs that were secured by livestock. Proceeds from the sale of livestock amount to $41,729.65 of the escrow account.

We have determined the first $2,131.13 shall go to plaintiffs, representing the sale of their hogs. We have determined plaintiffs are entitled to that part of the escrow account representing proceeds from the sale of their four cows. The amount of the sale is not ascertainable from this record. Because the promissory note and accrued interest secured by the livestock will exhaust the funds available from the sale, we find it unnecessary to remand for resolution of this issue.

We also find the livestock stood as security for the $25,276.33 note given to plaintiffs on December 12, 1979, together with interest at the rate of eight percent, compounded annually. Plaintiffs have not proven the other two promissory notes given to them by the Britts were secured by the livestock. However, even if they were, there would be insufficient money to apply to them.

The note of $25,276.33 drew interest compounded at the rate of eight percent. No interest or principal was paid. We determine plaintiffs should receive from the account the amount of $25,276.33, together with interest at the rate of eight percent, compounded annually, from December 1, 1979, the date of the note, through April 1986, when the property was sold. This, when added to the amount allocated to plaintiffs' one-half interest in hogs, will exceed the amount received from the sale of the livestock. Consequently, all money from the sale of livestock should be allocated to plaintiffs. We modify the trial court's order accordingly.

One item remains to be decided, and that is how interest is allocated from the time the funds were deposited in escrow until the judgment is final and the parties receive their respective shares of the escrow account. The allocation made by the trial court has given the defendant bank interest from the account from the date of sale to the beginning of the trial, at the interest in the defendant

bank's notes, namely fourteen percent. This allocation was challenged by plaintiffs, and while our decision as to priorities would change the amount going to the bank, we agree with plaintiffs such an allocation was incorrect.

We find the relevant date is the date on which the secured property was sold. Absent any disagreement between the parties, that is the date on which the funds would have been distributed. Since the parties did not agree, however, the courts were called upon to decide how the proceeds should be allocated. Once the court determines the rights of the parties, that determination relates back to the date when the property was sold. See First Constr. Co. v. Tri-South Mortgage Investors, 308 N.W.2d 298, 302 (Minn. 1981). To compensate the parties for lost use of their money during the proceedings, each party is allowed the interest actually earned on its share of the funds during that period. See id. Interest generally is not recoverable on funds subject to litigation, except to the extent actually earned. 47 C.J.S. Interest & Usury § 65 (1982). We direct that each party shall have that portion of the escrow account to which they were entitled on the date the livestock was sold, plus interest earned on that portion while in the account.

Costs on appeal are taxed to the defendant-appellee bank.

AFFIRMED IN PART AND MODIFIED IN PART.