

IN THE COURT OF APPEALS OF IOWA

FEB 24 1982

CLERK SUPREME COURT

LLOYD G. ERBOE and
DOROTHY L. ERBOE,

Plaintiffs-Appellees,

vs

HERBERT E. SCHWARTZ and
LYNN SCHWARTZ,

Defendants-Appellants)

Filed February 24, 1982

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1-357
2-65355

Appeal from Cedar District Court - L D Carstensen, Judge.

Defendants appeal from trial court decree in an action involving title to real estate. REVERSED AND REMANDED

John C Stevens of Lewis & Stevens, P C , Muscatine, Iowa, for defendants-appellants

William B Norton and Donald B Clark of Norton, Freese, Zearley & Bates, Lowden, Iowa, for plaintiffs-appellees

Submitted to Oxberger, C J , and Donnelson, Snell, Carter and Johnson, JJ.

Defendants appeal from decree in action involving title to real estate. The action is in two counts. The first count seeks a declaratory judgment as to the respective rights and interests of the parties with respect to 40 acres of land which plaintiffs occupy as their homestead. The second count asks the court to quiet title to this 40 acres in the plaintiffs, free and clear of any claims of defendants. The action also requested a temporary injunction preventing defendants from foreclosing or forfeiting the plaintiffs' interest in this property while the action was pending. The trial court granted the temporary injunction pendente lite and following trial entered a decree quieting title to the 40 acres in the plaintiffs free and clear of any claim or interest of defendants. Defendants have appealed from this decree. The action having been tried by equitable proceedings in the court below, our review is *de novo*. Iowa R. App. P. 4.

The principal facts are not in dispute. The 40-acre interest which plaintiffs seek to protect is a portion of an 80-acre tract which plaintiffs purchased on an installment contract from William and Virginia Kysely in November of 1971. In January of 1977, plaintiffs filed a voluntary petition in bankruptcy in the federal court at which time a substantial unpaid balance remained owing on the Kysely contract. At this time, plaintiffs set off and declared the 40 acres to which the present action relates as their homestead. The record reflects that they had occupied this property as their homestead since March 1, 1972.

The 40-acre portion of the 80 acres which plaintiffs did not claim as their homestead was sold by plaintiffs' trustee in bankruptcy in May of 1977 to the First National Bank of Elgin, Illinois, as administrator of the estate of Elsa Schwartz. At the time the administrator of the Elsa Schwartz estate purchased this interest in the 40 acres, it held a judgment lien against plaintiffs' interest in the entire 80 acres. This lien resulted from a judgment entered in favor of the Elsa Schwartz estate against the plaintiffs on December 19, 1974, in the United States District Court for the Southern District of Iowa, and subsequently transcribed to Cedar County, Iowa. The amount of the judgment is \$19,176.66 plus accrued interest and

costs. It is stipulated in the present record that the debt on which this judgment was based was contracted for prior to plaintiffs' acquisition of any interest in the 80 acres purchased from the Kyselys or their occupation of any portion thereof as their homestead.

The sale of plaintiffs' interest in the 40 acres not claimed as their homestead was not free and clear of existing liens. The interest in that 40 acres was therefore sold by the bankruptcy trustee subject to the vendor's interest under the Kysely contract and the Schwartz estate's judgment lien. At the time of the trustee's sale, the vendor's interest in the entire 80 acres had been purchased from the Kyselys by the defendants Herbert E. and Lynn Schwartz. This transaction occurred on March 28, 1977, at which time the unpaid principal balance owing to the holder of the vendors' interest was \$17,500.

The next installment payment under the contract was due on March 1, 1978, and was made at or about that time by plaintiffs to defendants Herbert E. and Lynn Schwartz (this was nearly a year after the underlying obligation had been discharged in bankruptcy). By this time, defendant Herbert E. Schwartz had succeeded to the interest of the Elsa Schwartz estate to both the 40 acres purchased from the trustee and the judgment lien on plaintiffs' interest in the entire 80 acres. The March 1, 1979, payment on the Kysely contract was not made by plaintiffs and, as a result, they were notified by defendants that the entire unpaid principal balance was declared to be accelerated. Shortly thereafter, plaintiffs commenced the present action. Other facts necessary to our resolution of the issues presented are stated in the discussion which follows.

The trial court's conclusion that defendants were precluded from enforcing either their judgment lien or their rights as assignees of the Kysely contract against plaintiffs' homestead property was based upon its interpretation and application of the decision in Moore v. Olive, 114 Iowa 650, 87 N.W. 720 (1901). Defendants, on appeal, urge that that case has no applicability to the facts of the

present case and that plaintiffs' interest in the 40 acres is subject to both the unpaid balance of the Kysely contract (now held by defendants) and the judgment lien which defendant Herbert E. Schwartz inherited from the Elsa Schwartz estate.

Moore v. Olive and the later case of Weir & Russell Lumber Co. v. Kempf, 234 Iowa 450, 12 N.W.2d 857 (1944), establish two principles which must be considered in determining whether the trial court ruled correctly in the present case. The first principle, sometimes called the primary fund theory, is that:

It is . . . well settled, where it is not stipulated to the contrary, that a purchaser under foreclosure of a junior lien acquires only the interest of the debtor and the land is charged with primary liability for payment of the prior lien. The purchase by him of such prior lien will not ordinarily avoid the primary liability of the land therefor.

Kempf, 234 Iowa at 453, 12 N.W.2d at 859.

The second principle, sometimes called the secondary liability theory, is that ordinarily, a homestead is only secondarily liable where it and other property secure the same obligation. Id.; Moore v. Olive, 114 Iowa at 656, 87 N.W. at 722. See also §§ 561.21(1), (2), The Code. We must consider these two principles as they affect defendants' rights to enforce (a) the unpaid balance of the Kysely contract, and (b) their judgment lien against the 40 acres which plaintiffs occupy as their homestead. In this regard we agree with defendants' contention that the doctrine of merger is not involved in the present case because the extent of their liens are not coextensive or commensurate with the interest they hold in the 40 acres which is not homestead property. See 55 Am. Jur. 2d Mortgages § 1267.

The primary fund theory is based on the principle that where it has been contracted that the land is responsible for payment of prior liens, the right of the debtor to have payments thus made may not be defeated by subrogation or assignment of the prior lien to a junior lienholder who acquires the land. Our

analysis of the primary fund theory leads to the conclusion that standing alone it is not dispositive of the issues involved in the present case. The defendants in the present case are not seeking to enforce their claims other than against the property which is encumbered by their vendors' interest or judgment lien. The trial court's decision as to defendants' rights must therefore be upheld, if at all, on the basis of the secondary liability theory. The latter theory, however, depends for its application upon the character of plaintiffs' 40 acres as homestead property as against the interests which defendants seek to enforce. While we have no doubt that the said 40 acres enjoy homestead status as to the lien of the judgment which defendant Herbert E. Schwartz inherited from the Elsa Schartz estate, we do not agree with the trial court's view that this is the case as to defendants' interest as assignees of the Kysely contract. The law seems settled that plaintiffs held no homestead rights as against the holders of the contract under which they purchased the land. Utle v. Boone, 230 Iowa 979, 985-86, 299 N.W. 437, 440 (1941); Westerman v. Raid, 203 Iowa 1270, 1276, 212 N.W. 134, 136-37 (1927). This is equally true when the contract is held by an assignee of the original vendors. Johnson County Savings Bank v. Carroll, 109 Iowa 564, 575, 80 N.W. 683, 684 (1899).

Because plaintiffs cannot claim homestead rights as against the holders of the Kysely contract, the trial court erred in concluding that the decision in Moore v. Olive precludes enforcement of this interest against the 40 acres owned by plaintiffs. In so holding, we necessarily reject the trial court's conclusion that when Elsa Schwartz's administrator bid \$100 at the bankruptcy trustee's sale for the nonexempt 40 acres subject to the Kysely contract and the judgment lien, that this was an implicit recognition that the value of the property was sufficient to satisfy the liens against it. The evidence in the record as to the value of this property when compared to the amount of the outstanding judgment lien and

unsatisfied vendors' interest renders this conclusion untenable.¹

While we are not in agreement with the trial court's conclusion that the principles stated in Moore v. Olive serve to completely relieve plaintiffs' 40 acres from the obligations of the Kysely contract, we do not believe plaintiffs can be held responsible for the entire unpaid balance owing for the sale of the 80 acres at the time of the assignment of the contract to defendants. Under recognized principles of equitable contribution, plaintiffs are entitled to subject defendants' 40 acres to payment of a proportionate share of this obligation. Hansen v. Cerro Gordo State Bank, 209 Iowa 1352, 1357, 230 N.W. 415, 417-18 (1930). To accomplish this result, we direct that the extent to which the contract indebtedness may be asserted against plaintiffs' 40 acres be limited to 50% of the unpaid balance of the contract indebtedness as it now exists. Any interest owing under the contract shall be computed on that reduced sum. The basis for this proportionate reduction is our finding from the evidence that the 40-acre tracts are of approximately equal value. Because of their discharge in bankruptcy, plaintiffs have no personal liability on the Kysely contract, but it may be enforced against their 40 acres to the extent of the proportionately reduced sum herein established. The remedies available to defendant for subjecting this land to the contract obligation shall be as specified in the contract.

¹ Actually, this determination by the trial court was made as a conclusion of law rather than a finding of fact. It is apparently based on the circumstances discussed in Moore v. Olive wherein a conclusive presumption was applied that the junior lienor in that case had taken the amount of prior liens into consideration in fixing the amount of his bid and that as a result of that circumstance, the value of the property purchased should be applied so as to completely extinguish the prior liens. The court in Moore v. Olive states, as a basis for invoking such presumption, that the bidder was bound to take note of the secondary liability rule. Because we have determined in the present case that the secondary liability rule does not apply with respect to part of defendant's claims against the property, there is no reason to follow Moore v. Olive on this issue.

We next consider the rights and obligations of the parties with respect to the judgment lien which defendant Herbert E. Schwartz inherited from the Elsa Schwartz estate. As in the case of the Kysely contract, plaintiffs, as a result of their discharge, have no personal liability with respect to this judgment. We therefore consider only the extent to which the judgment may be enforced against the 40 acres which plaintiffs still own. Initially, we note that it appears without dispute that the debt in question was contracted for prior to the acquisition of this property as plaintiffs' homestead. Plaintiffs' 40 acres is therefore not exempt from levy of execution under this judgment. § 561.21(1), The Code. But, unlike the situation presented as to the Kysely contract, the judgment lien is subject to the principle of secondary liability set forth in Moore v. Olive. This means that the value of the 40 acres which were not included in the homestead must be first resorted to before resort may be had to the homestead 40 acres. From the evidence, we find the value of defendants' 40 acres to be \$20,000. In practical application, because defendant will not employ this judgment so as to levy on his own property, a credit must be applied against the amount levied on plaintiffs' 40 acres equal to the value of defendants' 40 acres. For this purpose, however, the value of defendants' 40 acres must first be reduced by the proportionate share of the Kysely contract attributable to that 40 acres.² The sum thus arrived at shall be credited against the total amount owing on the judgment (including interest and costs) and thus reduce the extent to which plaintiffs' 40 acres may be subjected to execution under the judgment.

² For purposes of computing this credit, the same amount should be used as is arrived at following the proportionate reduction of defendants' claim against plaintiffs' property under the Kysely contract. That reduction should be based upon 50% of the unpaid principal balance of the contract following the March 1978 payment on the contract plus accrued interest on the proportionately reduced sum since the date of that payment. If on remand the parties cannot agree on this sum, the trial court shall establish it and may take additional evidence for this purpose if necessary. •

The decree of the trial court quieting title in plaintiffs is reversed and the cause is remanded for entry of a declaratory judgment in accordance with this decision.

REVERSED AND REMANDED.