IN THE COURT OF APPEALS OF IOWA

No. 2-331 / 11-0831
Filed June 27, 2012

LIBERTYVILLE SAVINGS BANK,
Plaintiff-Appellee,

vs.

DANIEL M. MCKEE and JILL L. MCKEE,
Defendants-Appellants.

Appeal from the Iowa District Court for Davis County, Annette J. Scieszinski, Judge.

The defendants appeal the district court's declaratory ruling and issuance of a decree of foreclosure. **AFFIRMED ON APPEAL AND REMANDED.**

David Morse of Rosenberg & Morse, Des Moines, for appellants.

Paul Zingg of Kiple, Denefe, Beaver, Gardner & Zingg, L.L.P., Ottumwa, for appellee.

Heard by Vogel, P.J., and Tabor and Bower, JJ.

BOWER, J.

Defendants Daniel and Jill McKee appeal the district court's declaratory ruling and issuance of a decree of foreclosure.[1] The McKees make several arguments in regard to Libertyville Savings Bank's ability to foreclose on their farm mortgages. They further argue the district court erred in applying an auction proceeds check toward the debt of the McKees' corporation. Upon our review, we affirm the district court's ruling and decree.

I. Background Facts and Proceedings.

Danny's Diggin' N Dozin', Inc. ("corporation"), was an excavation business operated by Daniel "Danny" McKee and his wife, Jill. Danny and Jill owned the corporation 51 percent and 49 percent, respectively, and served as president and vice-president. The McKees began doing business with Libertyville Savings Bank in 1997, when the corporation was about six years old. Over the years, three different loan officers at the bank assisted the McKees in borrowing money for the corporation's operating costs and equipment purchases. Ultimately, the security for the lending arrangement included security agreements, four open-ended mortgages on a 258-acre farm,[2] and the personal guaranty of Danny and Jill McKee.

In particular, the McKees' personal guaranty, dated April 2, 2003, stated: "[T]he undersigned guarantees to Lender the payment and performance of each

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[1] Daniel and Jill McKee are the only defendants that appeal the district court's ruling.

[2] The farm straddles the county line between Davis and Wapello counties. Two mortgages, each for $48,000, were taken in 1997: one for the portion in Davis county and one for the portion in Wapello county. Two more mortgages, each for $168,992, were taken in 2001.

and every debt, liability and obligation of every type and description which [the corporation] may now or at any time hereafter owe to [the bank]." The McKees' liability under the guaranty was listed as "$ UNLIMITED." A box was checked noting the guaranty was "unsecured." The guaranty provided the McKees' agreement to be responsible, indefinitely, for the corporation's obligations. According to Paragraph 7 of the guaranty:

> The Undersigned waives any and all defenses, claims and discharges of [the corporation] pertaining to Indebtedness, except the defense of discharge by payment in full. Without limiting the generality of the foregoing, the Undersigned will not assert, plead or enforce against [the bank] any defense of waiver, release, statute of limitations, . . . illegality or unenforceability, which may be available to [the corporation] or any other person liable in respect of any Indebtedness . . . . The Undersigned expressly agrees that the Undersigned shall be and remain liable, to the fullest extent permitted by applicable law, for any deficiency remaining after foreclosure of any mortgage or security interest securing indebtedness, whether or not the liability of [the corporation] for such deficiency is discharged pursuant to statute or judicial decision.

And Paragraph 13 of the guaranty set forth: "[T]his guaranty may not be waived, modified, amended, terminated, released or otherwise changed except by a writing signed by the Undersigned and [the bank]."

The McKees had also given the bank four open-ended mortgages as security for the corporation's debt. These mortgages encumbered 258 acres of farm real estate they owned personally. Notably, the mortgages did not encumber their homestead, which was on a separate forty-acre tract, or a separate farm owned by the parties that Jill McKee later had transferred to a limited liability company.

In early 2005, the financial condition of the corporation deteriorated and it could not meet its obligations. The corporation filed for chapter 11 bankruptcy reorganization in federal bankruptcy court. The corporation emerged from the reorganization with a plan, a $1,400,000 consolidated debt to the bank, and the security agreements and the McKees' 2003 guaranty still in place. Under a new promissory note, the corporation was to make monthly payments of $15,000 during the months of the construction season. In consideration for the note, the bank wrote off more than $500,000 of the corporation's debt.

By the April 2008 maturity date of the note, the McKees had been able to keep up with the monthly payments and had paid the corporation's debt down to $1,200,000. In May 2008, they entered into an extension agreement on the note, extending its maturity date to April 2009, which the McKees signed in their capacities as corporate officers and individually. The parties understood the McKees' 2003 guaranty and the security they had contributed over the years were still in place. Indeed, the extension agreement stated the collateral of the original note remained "unchanged and in full force and effect" and included:

> COLLATERAL: Two $168,992 Open-End Mortgages dated 05-16-2001; Two $48,000 Open-End Mortgages dated 09-04-1997; One $100,000 Open-End Mortgage dated 04-01-2005; and Commercial Security Agreements dated 08-15-1997, 06-08-1998, 04-17-1999, 06-16-1999, 04-02-2003, 09-23-2003, and 04-01-2005.

Within months, it became clear the corporation could not meet its monthly debt obligations. The parties, again, attempted to establish a pay-off plan. The

parties entered a settlement agreement on October 29, 2008,[3] which the McKees signed as corporate officers and individually. The bank agreed to write off over $250,000 in debt, hoping to entice a debtor refinancing through another lender. The debt subject to the settlement agreement was that remaining under the promissory note. The settlement agreement confirmed what collateral was in place:

> The loan is secured by first mortgages on 258 acres of real estate in Davis and Wapello Counties, commercial security agreements on equipment and other business chattels, and an assignment of a life insurance policy on Daniel M. McKee. Borrowers have proposed selling real estate and equipment currently serving as collateral for the loan and using the sale proceeds to pay off the loan. Bank agrees to this proposal subject to [fair sale prices].

In January 2009, the bank formally declared the corporation's note in default, and resolved it would have to pursue liquidation of pledged equipment and mortgaged farmland. Communications between the bank and the McKees' attorney ensued in a final attempt at a voluntary pay-off. The bank stated it would accept "$925,000 cash" in satisfaction of the corporation's debt.[4] The McKees were willing to sell the equipment (appraised at "roughly $900,000") and apply the proceeds to pay off the corporation's debt, but they were "fighting to keep the land." The bank remained adamant the farm mortgages would remain as security until $925,000 was paid.[5]

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[3] This was also the day of the McKees' last voluntary payment on the corporation's account.

[4] At that time, the corporation's debt exceeded $1.2 million.

[5] The McKees had asked over the years for the land to be released, but the bank had refused.

The parties signed another settlement agreement, dated June 30, 2009, drafted by the McKees' attorney. The agreement set forth the parties' latest payment plan, which included a sale of the corporation's equipment and application of the proceeds toward the corporation's debt. It stated in part:

> 1. The terms of this Agreement modify, novate and supercede the terms of the original Promissory Note dated April 1, 2005; the extension and modification of Promissory Note dated May 20, 2008; and the Settlement Agreement signed on October 29, 2008. To the extent the terms herein are different, any prior Agreements are novated by the terms of this Agreement.
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> 2. The payment of $925,000 on or before September 15, 2009 shall constitute full and complete satisfaction of the obligations that the Borrower and McKees owe to the bank.
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> 3. Borrower pledge that they will sell all equipment owned by the Borrower which is the subject of any collateral pursuant to a Security Agreement in favor of the Bank. . . . [T]he proceeds from said sale shall be sufficiently available in time for payment on or before said September 19, 2009 date.
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> 4. . . . [I]f Borrower does sell all of the equipment collateral as above described and the proceeds of said sale bring less than $925,000, the obligation of the Borrower shall be further reduced to the greater of the proceeds from the sale or $875,000, whichever is greater.
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> 5. The balance set forth as remaining due shall remain an obligation of the Borrower going forward.

On October 8, 2009, the corporation's equipment and personal property were auctioned. The proceeds were grouped in two checks. One check, for $249,211.13, represented the proceeds from the majority of the items and was immediately credited against principal the corporation owed to the bank. The other check, for $16,670.24, was generated from the sale of items the McKees contended were not pledged as loan security, so it was held pending resolution of the dispute over collateral status.

On February 11, 2010, the bank initiated this action by filing a petition in equity against the corporation and the McKees, seeking to foreclose on property encumbered by the four mortgages in order to satisfy the corporation's remaining debt. On March 25, 2010, the McKees filed an answer, claiming the mortgages to be unenforceable by the bank. Specifically, the McKees contended the parties' final agreement, entered on June 30, 2009, "novated the terms of all prior loan documents and agreements" and "the intention of [the bank] to foreclose mortgages which were novated by agreement is contrary to the agreement of the parties."

On June 2, 2010, Danny McKee filed for personal bankruptcy protection in federal court, and the state court litigation was stayed. As part of the federal bankruptcy proceedings, the bank filed a motion for adequate protection on the $16,670.24 auction proceeds check. The bank also filed a motion for relief from stay, so the state action could continue. A hearing on the motions was held before the bankruptcy court on July 22, 2010. At the hearing, the McKees' attorney agreed the motion for adequate protection had been resolved and the check relinquished to the Trustee, who forwarded it to the bank, in exchange for the bank's agreement to not seek a personal judgment against Danny McKee in state court. The court observed the bank could, however, seek a personal judgment against Jill McKee, as she was not part of the bankruptcy proceeding. The bankruptcy court entered a written order granting both motions. The bank

subsequently amended its state court petition to state it was seeking *in rem* relief as to Danny McKee's interest in the farm mortgages.[6]

Trial on the bank's petition took place on December 16, 2010. On March 18, 2011, the district court entered its ruling and foreclosure decree in favor of the bank against the corporation, in personam; Danny McKee, in rem; and Jill McKee, *in personam* and *in rem*. The court concluded the bank was entitled to retain both auction checks ($249,211.13 and $16,670.24) from the sale of the corporation's equipment. The court concluded the bank was further entitled to payment in the amount of $804,442.32.[7]

Accordingly, the court determined the bank was entitled to foreclose on the mortgage security, which included the farm mortgages the McKees submitted as collateral at the outset of their borrowing relationship with the bank. In reaching this conclusion, the court found the farm collateral had not been novated, or "written out of the lender-borrower relationship," by the September 2009 settlement agreement between the parties. The McKees now appeal.[8]

II. Scope and Standard of Review.

The foreclosure of a real estate mortgage is an action in equity and therefore our review is de novo. Iowa R. App. P. 6.907; *see Beal Bank v. Siems*,

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[6] The amended petition further acknowledged the bank was no longer seeking a personal judgment against Danny McKee.

[7] This total amount included: $650,062.54 (principal loaned); $127,671.46 (accrued interest to 12/16/10, at $129.12 per diem); $23,114.24 (attorney fees); $3,594.08 (advanced costs).

[8] The McKees are the only defendants that have appealed the district court's ruling; judgment was also entered against the corporation. Even assuming, arguendo, any of the McKees' arguments on appeal prevailed, the bank could still reach the security at issue (i.e., mortgages and auction proceeds check) through the judgment entered against the corporation.

670 N.W.2d 119, 123 (Iowa 2003). "In equity cases, especially when considering the credibility of witnesses, the court gives weight to the fact findings of the district court, but is not bound by them." Iowa R. App. P. 6.904(3)(g); *see also Iowa State Bank & Trust Co. v. Michel*, 683 N.W.2d 95, 98 (Iowa 2004).

III. Farm Mortgages.

The McKees raise various arguments on appeal in regard to the mortgages for a 258-acre farm, in which they contend the status of the mortgages as collateral was abandoned, waived, or otherwise compromised by the bank. In its ruling, the district court reiterated the significance of the mortgages to these parties:

> The evidence is overwhelming that the McKees put their farmland on the line at the outset of their borrowing relationship with the Bank. The financing plan that implicated the pledge of real estate was taken to maintain viability of Danny's business venture, the Corporation—and the chief source of household support. The risk of losing the farmland was a compelling factor in the McKees' dedicated efforts to pay off the debt; clearly, it has been their consistent priority to hang onto the land. The strength of that collateral also played a pivotal role in the Bank's patience, and its resilient efforts to obtain a loan payoff without foreclosure. . . . [T]he ongoing mortgage security was the stabilizing factor in much of the parties' 13-year lending relationship.

A. Personal Guaranty. First, the McKees argue the mortgages are "not enforceable because there is no debt" owed by Danny or Jill McKee. They contend their 2003 personal guaranty was cancelled pursuant to the 2005 promissory note, which provided the "personal guaranties of Daniel and Jill McKee . . . shall be forgivable and cancelled provided the Debtor makes all of its payments of Note #1 through December 2005." They allege that because the

corporation made payments through 2005, the personal guaranties were cancelled.

Upon our review, we find the McKees' claim misconstrues the promissory note. The promissory note was actually comprised of two separate notes: "Note #1" and "Note #2." The McKees' claim is applicable to Note #2 only. And in fact, Note #2, with indebtedness in the amount of $514,110.50, was "forgiven effective December 31, 2005," when the corporation made its payments through calendar year 2005.

However, the validity of the main component of the promissory note, Note #1, with indebtedness in the amount of $1,400,000, was not tied in any way to the corporation's payments through 2005.[9] Note #1 remained "secured by all Assets of the Debtor, including the personal guaranties of Daniel McKee and Jill McKee." Indeed, Note #1 was later extended by the 2008 extension agreement on the note, which stated the collateral of the original note remained "unchanged and in full force and effect."[10] Accordingly, this argument fails.

B. Novation. The McKees next contend the mortgages are not enforceable because the bank agreed to "walk away from the remaining obligation" and has "no basis for a personal claim" against them. Specifically, they argue the "terms of the promissory note and all later extension and settlement agreements were novated" by the June 2009 settlement agreement.

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[9] Aside from the fact the payments on Note #1 reduced its principal.

[10] Although the personal guaranty was not specifically listed on the extension agreement, the guaranty, by its terms, was "continuing" and guaranteed payment of every debt the McKees "may now or at any time hereafter" owe to the bank. Further, there could be no release or termination of the guaranty "except by a writing signed by [the McKees] and [the bank]."

They claim the settlement agreement constituted a novation or relinquishment by the bank of all collateral except the corporation's equipment. According to the McKees, the settlement agreement set forth the bank's request "to sell all of the remaining equipment which was presumed to have satisfied the loan in full."

As a preliminary matter, we find the terms of the settlement agreement *do not* novate existing security or the personal guaranty of the McKees. The paragraph of the settlement agreement at issue states:

> 1. The terms of this Agreement modify, novate and supercede the terms of the original Promissory Note dated April 1, 2005; the extension and modification of Promissory Note dated May 20, 2008; and the Settlement Agreement signed on October 29, 2008. *To the extent the terms herein are different, any prior Agreements are novated by the terms of this Agreement.*

(Emphasis added.) We have reviewed the settlement agreement in its entirety, and find the only terms "different" than the prior agreements include those relating to: the amount the bank would accept in satisfaction of the corporation's debt; the sale of the corporation's equipment; the application of the proceeds from the sale to the debt; and instructions for any remaining balance going forward. Accordingly, these were the only terms that were possibly "novated" by the settlement agreement. The security remained in place and was not affected by the settlement agreement.

Further, we do not find the parties agreed the settlement agreement would extinguish all prior security held by the bank. "The elements of a novation are (1) a previous valid obligation; (2) agreement of all parties to the new contract; (3) extinguishment of the old contract; and (4) validity of the new contract." *Emmet Cnty. Bd. of Supervisors v. Ridout*, 692 N.W.2d 821, 830 (Iowa 2005). To prove

a novation, the McKees must establish its elements by clear and satisfactory evidence. *Id.* The district court addressed this issue and concluded:

> The facts in this case do not support the McKees' proposition that their debtor-creditor and mortgagor-mortgagee relationship with the bank was novated. . . . There is no credible proof that the parties—even the McKees, themselves—ever believed that the mortgages had been written out of the lender-borrower relationship through the incentives that were the centerpiece of the June 30, 2009 Settlement Agreement. The use of the word "novate" in that document is inconsistent with significant and credible evidence that the pre-existing debt and security remained in place.
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> We affirm as to this issue.

C. Future Advance Clause and Maximum Obligation Limitations. The McKees contend this court "should refuse to enforce the dragnet clause" of the mortgages. The McKees rely on *Farmers Trust & Savings Bank v. Manning*, 311 N.W.2d 285, 289 (Iowa 1981) to support their contention that "Iowa views with disfavor the inclusion of future advances clauses within mortgages drafted by the lender." However, our supreme court has concluded these types of mortgages are valid. ("Mortgages of the type here considered dragnet mortgages are valid but are not favored by the law."). They are to be "strictly construed" against the lender. *Id*.

Each of the four mortgages at issue in this case contains the following notice: "NOTICE: This mortgage secures credit in the amount of [$48,000; $48,000; $168,992; $168,992; respectively]. Loans and advances up to this amount, together with interest, are senior to indebtedness to other creditors under subsequently recorded or filed mortgages and liens." Each mortgage also contains the following paragraph defining "secured debt":

> SECURED DEBT DEFINED. The term "Secured Debt" includes, but is not limited to, the following:
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> A. . . . all extensions, renewals, modifications or substitutions [of the originally borrowed amount under the] Note Dated 9-4-97 #102434.
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> B. All future advances from the Lender to Mortgagor or other future obligations of Mortgagor to Lender under any promissory note, contract, guaranty, or other evidence of debt existing now or executed after this Mortgage whether or not this Mortgage is specifically referred to in the evidence of debt and whether or not such future advances or obligations are incurred for any purpose that was related or unrelated to the purpose of the Evidence of Debt.
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> . . . .
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> D. All additional sums advanced and expenses incurred by Lender . . . under the terms of this Mortgage.
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> E. Mortgagor's performance under the terms of any instrument evidencing a debt by Mortgagor to Lender and any Mortgage securing, guarantying, or otherwise relating to the debt.

The McKees contend the mortgages should be limited to their "maximum obligation" limitations (i.e., $48,000; $48,000; $168,992; $168,992). They argue it was the "clear intention" of the parties that the mortgages would serve "as additional collateral . . . subject to their respective dollar limitations." The bank claims the amount disclosures "were never intended by the Bank, nor the McKees, to cap the exposure of the collateral for collection of the Corporation's debt." Rather, the bank argues, the amount "has to do with the position of security as it relates to subsequent mortgages," and because there were no subsequent mortgage holders here, "there is no limit on the rights of the bank to recoup its debt." The district court addressed this issue and concluded:

> Each mortgage contained a notice to other, potential creditors who might subsequently take security in the same land, that the Bank's priority security was capped at a certain amount. However, those disclosures were never intended by the Bank, nor the McKees, to cap the exposure of the collateral for collection of the Corporation's debt. Iowa Code section 654.12A, which the court judicially

> notices, sums up the purpose and context of the paragraph 2 "NOTICE" in each mortgage instrument.

We agree. Under Iowa Code section 654.12A, a mortgage containing this type of "priority" notice "generally provides loans and advances made under a prior recorded mortgage will have priority over subsequently recorded or filed liens." *First State Bank v. Kalkwarf*, 495 N.W.2d 708, 713 (Iowa 1993). In this case, there were no subsequent mortgage holders; accordingly, the bank's collection on the mortgages is not limited to the credit listed in the priority notice.

Further, contrary to the McKees' contention, the evidence is clear the parties intended the mortgages as security to guarantee full payment of their debts to the bank. Indeed, the McKees undertook subsequent loans during their lending relationship with the bank, ultimately resulting in nearly $2,000,000 in debt. Following agreements between the parties referenced the mortgages. Upon our review, we conclude the loans made to the McKees are secured by the mortgages. We affirm on this issue.

IV. Auction Proceeds.

The McKees contend the district court erred in failing to find Danny McKee entitled to receive the $16,670.24 auction proceeds check. Specifically, they argue the court erred in finding their attorney "waived" any right to the auction proceeds, and allege the proceeds are "personal property" of Danny McKee in which the bank has "no lien or interest."

We disagree. We, like the district court, find the auction proceeds check dispute was resolved as part of the bankruptcy proceedings and at the request of the McKees' attorney. Indeed, the record includes a portion of the transcript from

a hearing before the bankruptcy court, which sets forth that the McKees' attorney agreed the motion for adequate protection had been resolved and the check relinquished to the Trustee, who forwarded it to the bank, in exchange for the bank's agreement to not seek a personal judgment against Danny McKee in state court. We affirm on this issue.

V. Attorney Fees.

The bank requests we remand this case to the district court for consideration of reasonable appellate attorney fees and costs.[11] *See* Iowa Code § 625.22 ("When judgment is recovered upon a written contract containing an agreement to pay an attorney fee, the court shall allow and tax as a part of the costs a reasonable attorney fee to be determined by the court."). Here, the bank is entitled to reasonable attorney fees for legal services necessary in defending against the McKees' appeal. *See, e.g*., *Van Sloun v. Agans Bros., Inc.*, 778 N.W.2d 174, 184 (Iowa 2010); *GreatAmerica Leasing Corp. v. Cool Comfort Air Conditioning & Refrigeration, Inc.*, 691 N.W.2d 730, 733 (Iowa 2005).

Because the bank has not filed the affidavit required under Iowa Code section 625.24, we are without authority to tax the attorney's fees as costs. *See Van* Sloun, 778 N.W.2d at 184. We remand this case to the district court to determine and fix reasonable appellate attorney fees.

AFFIRMED ON APPEAL AND REMANDED.

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[11] The McKees did not appeal the district court's award of trial attorney fees to the bank.