

IN THE COURT OF APPEALS OF IOWA

No. 2-909 / 12-0489
Filed January 9, 2013

ROLLING HILLS BANK & TRUST,
An Iowa Banking Corporation,
Plaintiff-Appellant,

vs.

**MOSSY CREEK FARMS LIMITED
PARTNERSHIP and ERNEST M.
REEVES,**
Defendants-Appellees.

Appeal from the Iowa District Court for Pottawattamie County, James M. Richardson, Judge.

Rolling Hills Bank & Trust appeals from the district court's decision finding Mossy Creek Farms, L.P. discharged its obligations under five promissory notes prior to receiving notice of assignment to the bank, and finding its general partner not liable for the alleged debt. **AFFIRMED.**

Nathan R. Watson, James P. "Sam" King, and Steven J. Woolley of McGill, Gotsdiner, Workman & Lepp, P.C., L.L.O., Omaha, Nebraska, for appellant.

Gene Summerlin and Andrew Weeks of Husch & Blackwell, L.L.P., Lincoln, Nebraska, and Lyle Ditmars of Peters Law Firm, P.C., Council Bluffs, for appellees.

Heard by Doyle, P.J., and Mullins and Bower, JJ.

MULLINS, J.

Rolling Hills Bank & Trust (the Bank) brought a breach of contract action against Mossy Creek Farms, L.P. (Mossy Creek) for failure to repay five promissory notes. Mossy Creek executed five promissory notes in favor of Southwest Iowa Cattle Feeders, L.L.C. (Southwest), and Southwest then assigned the promissory notes to the Bank. It is undisputed that the Bank never received payment on the five promissory notes. However, Mossy Creek asserts it paid Southwest prior to receiving notice of assignment to the Bank, thus discharging its obligation. We affirm.

I. Background Facts

Southwest is a custom cattle feeding operation. Southwest was in the business of financing the purchase of cattle for its customers. Southwest fed and cared for its customers' cattle until the cattle reached market weight. After the cattle reached market weight, Southwest sold the cattle to meat packing operations, and Southwest sent the profit, if any, back to its customers.

To finance its operation, Southwest reached an agreement with the Bank. Pursuant to the agreement, the Bank financed Southwest's feedyard operation and provided capital for Southwest to lend to its customers. To accomplish this end, the Bank created blank promissory notes, security agreements, and endorsement and assignment agreements for Southwest. The Bank structured its transactions with Southwest to ensure it dealt only with Southwest, rather than Southwest's customers.

Mossy Creek, a Virginia-based limited partnership, executed a series of twenty-seven promissory notes in favor of Southwest for the purchase, care, and feed of its cattle at Southwest's facilities in Iowa. Southwest calculated the estimated cost of these services and filled in the blanks on the promissory notes accordingly. Southwest then mailed the promissory notes to Mossy Creek in Virginia. After Mossy Creek executed the notes, Southwest endorsed and assigned the notes to the Bank. The Bank then advanced money to Southwest as it incurred costs, up to the value of the note.

Southwest cared for and fed Mossy Creek's cattle, with the Bank advancing funds as previously described. After the cattle reached market weight, Southwest sold the cattle to various packers, who in turn issued checks to Southwest. Southwest then deposited the proceeds into its general demand checking account at the Bank. Other customers engaged in business with Southwest in a similar manner. The proceeds from the sale of Mossy Creek's cattle were commingled with the proceeds from the sale of other customers' cattle in the same account. It was not uncommon for Southwest to combine and sell cattle from different customers' lots to facilitate full shipments to market.

After the sale of a particular cattle lot, the Bank relied on Southwest to direct it to pay down the associated note. To determine Mossy Creek's profit or loss on a particular cattle lot, Southwest issued closeout statements to Mossy Creek and the Bank, detailing the purchase, care, feed, and marketing costs of each lot. After deducting the principal and interest due on the promissory note, Southwest sent the profit to Mossy Creek along with the closeout statement.

In the summer of 2009, Southwest's manager, Richard Cody, fell behind in issuing closeout statements to customers. As a result, more than a million dollars accumulated in Southwest's general demand account at the Bank. At that time, several notes were outstanding.

John Foley, the Bank's loan officer, was responsible for conducting regular inspections at Southwest and monitoring payments on the notes. Foley contacted Cody and informed him that Southwest needed to pay down the outstanding notes. Cody had not yet calculated closeout statements for these notes. Without preparing closeout statements, Foley and Cody agreed to use the funds in Southwest's general demand account to pay off the outstanding notes.

Five notes are at issue in this case. Each note is associated with a particular cattle lot number. The parties referred to the lots at issue as MC 25, MC 26, MC 27, MC 28, and MC 29. For the twenty-two notes Mossy Creek executed in favor of Southwest prior to the notes at issue, Southwest sold Mossy Creek's cattle, deposited the proceeds into its account at the Bank, issued closeout statements to Mossy Creek and the Bank, and directed the Bank to pay off the note associated with the respective lot.

For the notes at issue (the Notes), Southwest sold the cattle in lots MC 25 through MC 29 to various packers. The packers issued checks to Southwest. Southwest deposited the proceeds into its general demand account at the Bank. In late May or early June of 2009, Southwest prepared closeout statements for lots MC 25 through MC 29. Cody deducted the principal and interest due on each note from the proceeds identified in the closeout statements. On June 12,

2009, Cody issued closeout statements to Mossy Creek and the Bank for lots MC 25 through MC 29. Along with the closeout statement, Cody sent Mossy Creek profits for the respective lot based on his calculations. Neither Cody nor anyone else at Southwest directed the Bank to pay down the Notes associated with these lots.

In late June 2009, Foley noticed Southwest's inventory listed more cattle than were actually on the lot. Upon discovering the discrepancy, the Bank froze Southwest's bank accounts. Southwest effectively ceased doing business at that time.

On or near June 30, 2009, Southwest contacted Matthew Mullenix—a local accountant with whom Southwest had previous dealings—to reconstruct their financial records and determine why Southwest's bank account was insufficient to cover outstanding notes. Mullenix attempted to reconstruct Southwest's general ledger. However, the financial records were “filed throughout the entire [Southwest] building in different parts and in piles just on the ground.”

During 2009, the Bank sent three letters to Mossy Creek. On March 6, 2009, the Bank sent Mossy Creek a letter stating, “We are in the process of verifying our loans held with Southwest Iowa Cattle Feeders.” Representatives of Mossy Creek testified they thought this was an internal bank audit verifying Southwest's accounts receivable, not indicating the Notes had been assigned to the Bank. On July 21, 2009, the Bank sent Mossy Creek a letter indicating that it had identified a discrepancy in the number of cattle under Southwest's care. The

letter stated, "You are receiving this letter because of loans you currently have with the Bank which are secured by cattle at [Southwest]." Mossy Creek immediately responded to the letter asserting it had paid off all of its notes with Southwest. On August 7, 2009, the Bank sent Mossy Creek a demand letter "concerning [Mossy Creek's] cattle feeder notes with Southwest Iowa Cattle Feeders, LLC which have been assigned to Rolling Hills Bank and Trust."

II. Prior Proceedings

On February 4, 2010, the Bank filed a breach of contract action against Mossy Creek. The Bank alleged Mossy Creek executed the Notes in favor of Southwest. The Bank asserted it was the owner and holder of the Notes as the assignee from Southwest. The Bank sent a demand letter to Mossy Creek on August 7, 2009. Mossy Creek raised the affirmative defense of payment, maintaining, in part, that it paid Southwest prior to the demand letter as evidenced by the June 12, 2009 closeout statements.

From October 12 through 14, 2011, the district court held a bench trial on the matter. On October 28, 2011, the court issued a ruling in favor of Mossy Creek. The court found that the June 12, 2009 closeout statements served as the final settlement between Southwest and Mossy Creek for the Notes. Although Southwest had assigned the Notes to the Bank, "notification of the assignment was not given [to Mossy Creek] until August 7, 2009." The court stated:

It is undisputed that [Southwest] owes the Bank for the amount of its loan secured by the assignment of the promissory notes. However, the facts have established that Mossy [Creek] has previously satisfied its obligation pursuant to the promissory notes

with [Southwest]. The Bank as assignee cannot rise above the rights of [Southwest] as assignor.

The Bank filed a motion to amend and enlarge the findings. The court heard argument on the motion and found Mossy Creek was not liable to the Bank because Mossy Creek discharged its obligation to Southwest prior to receiving notice of assignment.

III. Standard of Review

We review actions at law for corrections of errors of law. Iowa R. App. P. 6.907; *Harrington v. Univ. of N. Iowa*, 726 N.W.2d 363, 365 (Iowa 2007). If substantial evidence supports the district court's factual findings, those findings are binding upon us. *Harrington*, 726 N.W.2d at 365. "Evidence is substantial if reasonable minds could accept it as adequate to reach the same findings." *Tim O'Neill Chevrolet, Inc. v. Forristall*, 551 N.W.2d 611, 614 (Iowa 1996).

IV. Analysis

A. Agency

The Bank argues it was Southwest's obligation, as Mossy Creek's agent, to direct the Bank when and in which amounts any promissory note should be repaid with any of the proceeds of financed cattle sales deposited in Southwest's account at the Bank. The Bank contends neither Mossy Creek nor Southwest directed it to pay off the Notes, and the Notes remain unpaid.

The determination of an agency relationship is generally a fact question. *C & J Vantage Leasing Co. v. Outlook Farm Golf Club, L.L.C.*, 784 N.W.2d 753, 760 (Iowa 2010). An agency relationship may be express, implied, or apparent. *Id.* at 759. Neither express nor implied agency exists under the facts of this

case. See *id.* “For apparent authority to exist, the principal must have acted in such a manner as to lead persons dealing with the agent to believe the agent has authority.” *Vischering v. Kading*, 368 N.W.2d 702, 711 (Iowa 1985).

In an arm’s length transaction, the Bank arranged to finance Southwest’s custom cattle feeding operation. The Bank drafted the promissory notes, the security agreements, and the endorsement and assignment agreements at issue. The district court found, “The Bank specifically wanted [Southwest] as its customer and not the cattle owners.” Southwest and Mossy Creek entered into a separate arm’s length transaction for the purchase, care, and feed of Mossy Creek’s cattle at Southwest’s facilities. Mossy Creek did not act in a way to lead the Bank to believe an agency relationship existed in such a way that Mossy Creek would be liable for Southwest’s failure to direct the Bank to pay down the Notes. See *id.* We find the Bank’s assertion of an agency relationship between Mossy Creek and Southwest is without support in the record.

B. Payment

Article 9 of the Iowa Uniform Commercial Code governs this dispute. See Iowa Code chap. 554 (2011). Absent authenticated notice of assignment from the assignor or the assignee, “an account debtor on . . . chattel paper . . . may discharge its obligation by paying the assignor or the assignee.” Iowa Code § 554.9406(1); see also *id.* § 554.9102(1)(k) (defining chattel paper). “After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.” *Id.*

Mossy Creek, the account debtor, executed the Notes in favor of Southwest. See *id.* § 554.9102(1)(c) (defining account debtor). Southwest, the assignor, then assigned the Notes to the Bank, the assignee. We find substantial evidence supports the district court's finding that neither Southwest nor the Bank notified Mossy Creek of the assignment until the August 7, 2009 demand letter. At issue is whether Mossy Creek discharged its obligation under the Notes to Southwest prior to receiving notification of assignment.

The Bank contends the district court erred in finding Mossy Creek discharged its obligations under the Notes because substantial evidence does not support the finding that Mossy Creek paid Southwest. To determine whether Mossy Creek satisfied the amount due under the Notes, the Notes require the parties to refer to the "Feedyard's liability record." The Notes define the "Feedyard" as Southwest, but do not define the phrase "liability record."

We apply the principles of contract interpretation to determine the meaning of the words used in a contract. *Fashion Fabrics of Iowa, Inc. v. Retail Investors Corp.*, 266 N.W.2d 22, 25 (Iowa 1978). It is well established that "the cardinal rule of contract interpretation is to determine what the intent of the parties was at the time they entered into the contract." *Pillsbury Co., Inc. v. Wells Dairy, Inc.*, 752 N.W.2d 430, 436 (Iowa 2008). "Wherever reasonable, the manifestations of intention of the parties to a promise or agreement are interpreted as consistent with each other and with any relevant course of performance, course of dealing, or usage of trade." *Id.* (internal citations omitted).

Southwest and Mossy Creek were the original parties to the Notes. Foley, Cody, and a Mossy Creek representative each testified that they considered the closeout statements to be the “Feedyard’s liability record.” As it had done with the cattle associated with the twenty-two previous promissory notes, Southwest sold Mossy Creek’s cattle in lots MC 25 through MC 29. Southwest deposited the proceeds from the sale into its general demand checking account at the Bank. On June 12, 2009, Cody sent both the Bank and Mossy Creek closeout statements for lots MC 25 through MC 29. Along with the closeout statements, Southwest sent Mossy Creek a check in the amount it believed represented the profit on lots MC 25 through MC 29 after accounting for the principle and interest due on the Notes.

The assignee is subject to any defenses the account debtor may have as against the assignor, including payment, prior to notice of assignment. See Iowa Code § 554.9404(1). Southwest deposited money from the sale of Mossy Creek’s cattle, and issued settlement checks to Mossy Creek prior to the Bank notifying Mossy Creek of the assignment. We find, as a course of dealing, substantial evidence supports the district court’s finding that Southwest’s closeout statements were the Feedyard’s liability record, and the settlement checks to Mossy Creek were the final account settlements as between Mossy Creek and Southwest. Thus, Mossy Creek is not liable to the Bank, the assignee, because Mossy Creek discharged its obligation under the Notes to Southwest, the assignor, prior to receiving notice of assignment from either Southwest or the Bank. See *id.* § 554.9406(1).

C. Equitable Estoppel

The Bank contends the doctrine of equitable estoppel prevents Mossy Creek from asserting the affirmative defense of payment. Equitable estoppel is

a rule of justice which, in its proper field, prevails over all other rules. It is a rule of last resort, but when it is aroused into activity, it stays the operation of other rules which have not run their course, when to allow them to proceed further would be a greater wrong than to enjoin them permanently.

Keokuk State Bank v. Eckley, 354 N.W.2d 785, 792 (Iowa Ct. App. 1984).

In support of its equitable estoppel claim, the Bank alleges Southwest overpaid Mossy Creek in the amount of \$320,840.04. As previously indicated, the transactions at issue were the result of two separate arms-length business relationships. First, the Bank reached an agreement with Southwest about how the Bank would finance Southwest's custom cattle feeding operation. To this end, the Bank drafted promissory notes, security agreements, and endorsement and assignment agreements for Southwest to use with its customers. The Bank structured its transactions with Southwest to ensure it dealt only with Southwest, rather than Southwest's customers. Second, Mossy Creek reached an independent agreement with Southwest to finance the purchase, care, and feed of its cattle.

The Bank did not adequately protect its business relationship with Southwest by failing to notify Mossy Creek of the assignment of the promissory notes in a timely manner. As a result, the Bank is subject to any defenses Mossy Creek has against Southwest, including discharge of the underlying obligation by payment. See Iowa Code § 554.9404(1). Under the facts of this case, we do not

find equitable estoppel prevents Mossy Creek from asserting the affirmative defense of payment.

As we find Mossy Creek discharged its obligations under the Notes, we do not reach the question of whether Ernest M. Reeves, a general partner of Mossy Creek, is liable for the debts of the limited partnership.

V. Conclusion

We find substantial evidence supports the district court's finding that Mossy Creek discharged its obligation under the Notes to Southwest prior to receiving notice of assignment to the Bank. As a result, we do not reach the question of whether Mossy Creek's general partner is liable for the debts of the limited partnership. Accordingly, we affirm.

AFFIRMED.