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APR - 2 1991
CLERK SUPREME COURT

IN THE COURT OF APPEALS OF IOWA

No. 0-714 / 90-483

FARMERS SAVINGS BANK, MITCHELLVILLE, IOWA,

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Appellee,

vs.

JAMES P. KENNEDY and MARY M. KENNEDY,

Defendants-Appellees/Cross-Appellants,

and

D.M. PIAGENTINI d/b/a ASSOCIATED ENGINEERING OF IOWA, and CITY OF DES MOINES, IOWA,

Defendants.

Appeal from the Iowa District Court for Polk County, Luther T. Glanton, Senior Judge.

Farmers Bank appeals a district court order dismissing its petition seeking an in rem foreclosure of a mortgage on real estate owned by the Kennedys. **AFFIRMED.**

W. Don Brittin, Jr. and John E. Landess of Nyemaster, Goode, McLaughlin, Voigts, West, Hansell & O'Brien, P.C., Des Moines, for appellant.

Ed Skinner and Larry G. Wilson of Skinner, Beattie & Wilson, P.C., Altoona, for appellees.

Heard by Oxberger, C.J., and Schlegel and Sackett, JJ.

SACKETT, J.

This case concerns the issue of whether certain indebtedness is secured by a real estate mortgage on a homestead. We agree with the trial court all indebtedness secured by the real estate mortgage has been paid in full. We affirm the trial court's dismissal of the action.

Defendants-appellees/cross-appellants James and Mary Kennedy, husband and wife, were indebted to plaintiff-appellant Farmers Savings Bank, Mitchellville, Iowa, on a number of promissory notes. Defendants have taken bankruptcy, and any personal indebtedness they had to plaintiff has been discharged. A discharge in bankruptcy relieves the debtor from personal liability but it does not affect the lien of the mortgage. See First State Bank v. Zoss, 312 N.W.2d 127, 127-28 (S.D. 1981). The question is, what promissory notes, if any, were secured by a mortgage defendants gave plaintiff on their homestead. Mortgage foreclosures are equitable, and our review is de novo. Decorah State Bank v. Zidlicky, 426 N.W.2d 388, 390 (Iowa 1988).

The real estate mortgage on defendants' homestead was given by defendants to plaintiffs on July 28, 1977. Defendants have given plaintiffs a series of promissory notes. The mortgage is security for a debt. Johnson v. Board of Supervisors, 237 Iowa 1103, 1107, 24 N.W.2d 449, 452 (1946). A promissory note is the instrument evidencing the debt. Id.

On July 28, 1977, when the real estate mortgage was given, defendants borrowed $100,000 from plaintiff to enable James to purchase a business, Midwest Visual Educational Service, Inc. The $100,000 went to the corporation. James owned all the stock in the corporation and was its sole officer. Mary was a director.

At that time, defendants gave plaintiff three separate promissory notes totaling $100,000. The first promissory note was for $35,000. It stated it was secured by the real estate mortgage. The second, a $6,500 note, has now been paid. The third, a $58,500 note, has been renewed but has not been paid. Both defendants signed all three notes. The same day defendants also gave the bank an agreement that either of them could borrow money.

The real estate mortgage showed it was given in consideration of $35,000. It then provided it would become void on payment of:

> $443.37 Sept. 10, 1977 and $443.37 each month thereafter until the full principal sum is paid. Said payments to include interest with final payment due August 10, 1987.
>
> Various other notes.
>
> Payments to be applied first to interest balance to principal.

The $35,000 note showed it was secured by a mortgage on defendants' homestead. The plaintiff received the monthly payments on the $35,000 note and recorded them separately on a ledger. On February 16, 1988, plaintiff recorded the $35,000 note as being paid in full.

Plaintiff seeks to establish a lien on defendants' homestead by virtue of the $58,500 note given it by defendants on July 28, 1977, a guarantee, and a future advance clause in the mortgage.

The $35,000 note paralleled the consideration shown on the mortgage as to amount and schedule of payment. The $35,000 note on its face showed it was secured by the real estate mortgage. The plaintiff accepted payments on the $35,000 note and recorded them separately on a ledger. The other two notes made no reference to being secured by the real estate mortgage. The $6,500 note showed on its face it was secured by furniture and fixtures, and the $58,500 note showed on its face it was secured by inventory and accounts receivable. Plaintiff contends the three notes given were all secured by the real estate mortgage because of the words "various other notes" on the real estate mortgage.

Because the other two notes do not list the real estate as security, we must look to the mortgage to see if it shows evidence that it is security for these notes. The only consideration shown on the mortgage is $35,000. Plaintiff first contends the $58,500 note and the $6,500 note were secured by the real estate mortgage because the words "various other notes" were inserted in the mortgage. The words "various other notes" are not part of the consideration portion of the mortgage. The words were inserted in a space left for payment provision in the

preprinted mortgage form. If any assumption could be made from the insertion of the words "various other notes" in the mortgage, the assumption would be that the $35,000 obligation could be paid with various other notes.

We agree with the trial court that the insertion of the words "various other notes" in the mortgage did not cause the $58,500 note given July 28, 1977, to be secured by the real estate mortgage. In reaching this decision, we consider (1) the instruments were prepared by plaintiff, (2) all three notes clearly specify the items by which they are secured, (3) the consideration shown on the real estate mortgage is shown as $35,000, (4) the words "various other notes" were inserted as a part of the method of the payment provision of the mortgage, (5) the bank received and credited payments to the $35,000 note separately, and (6) there is no language on the $58,500 note indicating it was secured by the real estate mortgage.

We recognize the bank officer handling the July 28, transaction testified it was the bank's intent to have the real estate mortgage secure all three notes, while the defendants contend it was their understanding only the $35,000 note was secured by the mortgage. The trial court believed defendants' version. While our review is de novo, we give weight to the finding of fact of the trial court, especially when considering the credibility of witnesses but are not bound by them. Iowa R. App. P. 14(f)(7).

Plaintiff's next contention is the $58,500 note given was secured by the real estate mortgage because on the back of the mortgage there was the following dragnet clause:

> This instrument shall be construed as covering and securing the indebtedness herein mentioned and any and all additional indebtedness, whether as future advances or otherwise, now owing or which may hereafter be owed by the parties of the first part [Kennedys], or either of them, during the time that this mortgage is in force, together with any renewals or extensions of said indebtedness herein secured, or any advancements, and any and all costs of collecting the same.

We do not interpret the dragnet clause to include the $58,500 note given contemporaneously with the mortgage where it was not identified on either the note or mortgage as being secured by the real estate mortgage. The $58,500 note was executed on the same day as the real estate mortgage and could easily have been specifically shown as being secured by the real estate mortgage if that had been the parties' intent. Good faith would appear to require this so defendants could easily and clearly understand the obligation on the mortgage. See First v. Byrne, 238 Iowa 712, 718, 28 N.W.2d 509, 512 (1947).

Plaintiff next contends by virtue of the dragnet clause, additional future advances to James alone were secured by the mortgage. They point also to the July 28, 1977, guarantee. Typically, the fine print future advances clause buried in a security agreement will not convey the broad scope of its coverage to the borrower. Decorah State Bank v. Zidlicky, 426 N.W.2d 388, 390 (Iowa 1988); In re Simpson, 403 N.W.2d 791, 793 (Iowa 1987).

Mortgages pledging real estate as security for future, as well as present, loans are valid but not favored by the law. See Freese Leasing, Inc. v. Union Trust & Sav. Bank, 253 N.W.2d 921, 925 (Iowa 1977). Such clauses are strictly construed against the mortgagee. Farmers Trust & Sav. Bank v. Manning, 311 N.W.2d 285, 289 (Iowa 1981). The use of a dragnet clause is not highly regarded in equity. First v. Byrne, 238 Iowa 712, 715-16, 28 N.W.2d 509, 511 (1947). The use of such a clause is not to be commended, and it naturally arouses suspicion as to the good faith of the mortgagee in the transaction. Byrne, 238 Iowa at 716, 28 N.W.2d at 511. It might in many cases not require much evidence of concealment, haste, or artifice to overturn it. Id.

On July 28, 1977, James and Mary gave a guarantee and assumption agreement agreeing to guarantee and pay the notes and obligations of each other. There is no language in this agreement referring to the homestead or waiving any homestead rights. Therefore, the only document we can look to is the mortgage where Mary's homestead rights were waived. Homestead interests of a husband and wife cannot be split. Decorah State Bank, 426 N.W.2d at 391; Merchants Mut. Bonding Co. v. Underberg, 291 N.W.2d 19, 21 (Iowa 1980). Neither guarantee signed by Mary refers to the mortgage as providing security therefor. See Decorah State Bank, 426 N.W.2d at 390.

For the subsequent notes to be secured by defendants' homestead, it is therefore necessary the future advances be secured by the dragnet clause. In the absence of clear, supportive evidence of a contrary intention, a mortgage containing a dragnet-type clause will not be extended to cover future advances unless the advances are of the same kind and quality or relate to the same transaction or series of transactions as the principal obligation secured or unless the document evidencing the subsequent advance refers to the mortgage as providing security therefor. Freese Leasing, 253 N.W.2d at 927 (quoting Emporia Bank and Trust Co. v. Mounkes, 214 Kan. 178, 184, 519 P.2d 618, 623 (1974)). Hawkeye Bank & Trust Co. v. Michel, 373 N.W.2d 127, 130 (Iowa 1985).

In In re Simpson, 403 N.W.2d 791, 793 (Iowa 1987), the court stated:

> Parties can either clearly state their intent when drafting a future advances clause or refer back to the clause when making new loans in order to clarify the series of transactions. However, the [relatedness] rule may regularly limit the scope of such clauses in contracts of adhesion. Future advances clauses are suspect under Iowa law, and adhesion contracts are construed against the writer. Typically, the fine print future advances clause buried in a security agreement will not convey the broad scope of its coverage to the borrower. Under such a situation, the lender should be held to a reasonable limit unless further evidence shows that the borrower understood and agreed to the broader scope. In this way, application of the relatedness rule protects borrowers from lender overreaching and surprise.

Id.

The language of the dragnet clause is not conclusive of the intent of the parties. Rather, the issue is what they meant by what they said. See Freese Leasing, 253 N.W.2d at 921. There is no evidence Mary consented to the homestead standing as security for future advances. The trial judge found Mary's intent through all the transactions was to only mortgage her homestead for $35,000. We agree.

The bank contends we should find the dragnet clause covers because the money from all the loans went into the business. A dragnet-type clause will generally be extended to cover future advances where the advances are of the same kind and quality or relate to the same transaction or series of transactions as the principal transaction secured. See Freese Leasing, 253 N.W.2d at 927. Plaintiff argues because the $35,000 loan secured by the mortgage on the house went into the business, as did the other loans, they were secured by the dragnet clause. However, as far as security, the home was only used for the one debt which was set up to be paid back as a single transaction with monthly payments that remain constant despite the fluctuation in business indebtedness. The future loans had no relationship to the home.

AFFIRMED.

Schlegel, J., concurs; Oxberger, C.J., dissents.

OXBERGER, C.J. (dissenting)

I respectfully dissent.

A mortgage is subject to the principles which govern contracts generally and are designed to assist the trier of fact in identifying the intention of the parties. Freese Leasing v. Union Trust & Sav. Bank, 253 N.W.2d 921, 924 (Iowa 1977). In ascertaining whether a future advance clause includes a particular debt, our courts have adopted the following standard:

> [I]n the absence of clear supportive evidence of a contrary intention a mortgage containing a dragnet type clause will not be extended to cover future advances unless the advances are of the same kind and quality or relate to the same transaction or series of transactions as the principle obligation secured or unless the document evidencing the subsequent advance refers to the mortgage as providing security therefor.

Freese Leasing, 253 N.W.2d at 927 (quoting Emporia Bank and Trust Co. v. Mounkes, 214 Kan. 178, 184 519 P.2d 618, 623 (1974)).

The key to the rule adopted in Freese Leasing is seeking the parties' intent by comparing the original security agreement with later debt. In re Simpson, 403 N.W.2d 791, 793 (Iowa 1987).

During the nine years after the Kennedys purchased Midwest Visual, the bank extended them additional funds for

operation of the business. These notes were signed by James Kennedy as an officer of the corporation. On October 10, 1985, several notes were renewed, and James, as president of Midwest Visual and personally, gave the bank a business security agreement. A typed portion of the security agreement includes the Kennedy homestead as collateral. On October 10, 1986, the Kennedys signed a guaranty agreement stating that each agreed to be jointly and severally liable for all indebtedness incurred at that time. On October 20, 1986, various notes were consolidated in the amount of $81,300, the consolidation agreement was signed by James as president of Midwest visual.

The Kennedys ultimately closed Midwest Visual in February 1988. The collateral of Midwest Visual was voluntarily surrendered to the bank, which applied the proceeds to reduce the balance of the notes to $72,744.94. The Kennedys subsequently filed for Chapter 7 bankruptcy on October 12, 1988, and were eventually discharged of personal liability for the debts evidenced by the notes at issue in the present case. The $35,000 note was ultimately paid by the Kennedys.

Upon consideration of all the evidence in the present case, I am convinced the mortgage dated July 28, 1977, was intended by the parties to be security for the $35,000 loan and all other future loans. Applying the standards set forth in Freese Leasing, I also find the consolidation note

dated October 20, 1986, which specifically refers to "RE Mortgage dated 7-28-77 Book 4720, Page 073" a significant guide to the parties' intent. The consolidation note refers to the business security agreement, which refers to the mortgage as security. The consolidation states that the note is a renewal of various loans taken out by James in 1985. The notes taken in 1985 were accompanied by a business security agreement signed by James which refers to the 1977 homestead mortgage as security.

Additionally, the subsequent loans were of the same transaction, or of the same kind and quality as related to the original mortgage and secured loans dated July 28, 1977. The objects of the the 1977 loans and the subsequent loans were the same. The initial loans and all subsequent loans were taken out by the Kennedys to enable them to carry on the business of Midwest Visual. The future advances were clearly of the same kind and quality as the original indebtedness secured by the mortgage, and related to the same transactions or series of transactions covered by the original indebtedness.

Further, the parties intended that the future advances be covered by the language of the original mortgage. The bank clearly intended future advances to be covered by the security of the mortgage because the language of the 1977 mortgage states the parties contemplated future loans would be extended to enable the Kennedys to operate Midwest

Visual. The personal guaranty signed by the Kennedys unequivocally states that both parties agreed to guarantee the payment of all notes then in existence and all future notes. The guaranty acknowledges that loans may be extended without the necessity of the other being present, for which both of them would be obligated. The Kennedys therefore had reason to know the bank intended the mortgage to cover future notes as well as the notes signed in 1977. Though Mary testified she had no intention of securing future notes through the 1977 mortgage, Mary clearly knew James had taken out numerous other loans during the nine year period Midwest Visual was in business. There is no evidence in the record Mary objected to these loans. Construing the contracts in light of all the circumstances as a whole, I conclude the future loans taken out by the Kennedys were secured by the 1977 mortgage on the Kennedy homestead.