IN THE COURT OF APPEALS OF IOWA

No. 0-436 / 89-1352

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IOWA FUEL & MINERALS, INC.,

Appellant/Cross-Appellee,

vs.

IOWA STATE BOARD OF REGENTS, and **IOWA STATE UNIVERSITY OF SCIENCE AND TECHNOLOGY** and **STATE OF IOWA,**

Appellees/Cross-Appellants.

Appeal from the Iowa District Court for Polk County, Gene L. Needles, Judge.

Iowa Fuel appeals a district court judgment awarding it $218,048.28 for improper price adjustments, but dismissing its remaining claims for breach of contract, negligence, and bad faith. Defendants cross-appeal the amount awarded. **AFFIRMED IN PART; REVERSED IN PART.**

John R. Sandre and Pamela D. Griebel of Scalise, Scism, Sandre & Uhl, Des Moines, and Vincent S. Klyn of Gaass, Klyn & Boehlje, Pella, for appellant.

Thomas J. Miller, Attorney General, and Gordon E. Allen, Deputy Attorney General, for appellees.

Heard by Schlegel, P.J., and Sackett and Habhab, JJ., but decided en banc.

SCHLEGEL, P.J.

Plaintiff, Iowa Fuel and Minerals, Inc., appeals adverse portions of a ruling denying various breach of contract and negligence claims and granting it an award of $218,048.28 against defendants, Iowa State Board of Regents, Iowa State University, and the State of Iowa for breach of contract. Defendants resist all aspects of the appeal and cross-appeal the amount of the award to plaintiff. We reverse in part and affirm in part.

I.

The facts in this case are not overly difficult. The parties' divergent, convoluted, and argumentative statements of the facts, however, make it so. Moreover, rule 14's admonition to include only relevant facts seems to have been lost on both parties.

Iowa Fuel and Minerals (IFM) is a family run coal mining and marketing operation formed in 1978. The Iowa State University of Science and Technology (ISU) is a land grant university under the purview of the Iowa State Board of Regents. ISU is largely dependent upon coal for the production of its heating, air conditioning, and electrical needs. From its formation in 1978 until 1986, IFM supplied coal to ISU. The parties' original five-year contract for unwashed coal was terminated by mutual agreement in 1980 because of new environmental regulations requiring ISU to burn only "washed" coal.

In 1980 ISU invited bids on a ten-year contract to supply the university with low-sulfer, washed coal. Bidders responded on university-drafted proposal forms which contained the terms of the contract ultimately forged. In contemplation of the contract and the change in environmental regulations, IFM expended approximately $1 million to construct a coal washing facility. ISU was aware of this expenditure.

ISU granted the contract to IFM on its bid of 100,000 tons per year of washed industrial stoker coal for $32.28 per ton delivered free on board ($1.68 per million Btu's). The ISU contract comprised approximately ninety-five to ninety-seven percent of IFM's business, totaling approximately $4 million per year. ISU officials were aware of this fact.

The coal price under the terms of the contract was not intended by either party to remain static over the ten-year period. At least two price increases were agreed upon. By June 1983 ISU was paying IFM $39.54 per ton ($1.88 per million Btu's).

In May 1983 the University of Iowa and the University of Northern Iowa entered into new one-year contracts for their coal needs. Both of those universities paid substantially less for their coal than ISU. In June 1983 the board of regents directed ISU to renegotiate its contract with IFM. Echoing language in the contract, a June 2, 1983, letter from David Hall, ISU's purchasing agent, to IFM stated: "This is to advise you that Iowa State University cannot economically utilize the coal supplied under the [September 19, 1980,] contract and to provide the required thirty (30) days written notification of our intent to renegotiate this contract." (Emphasis added.) Plaintiff suggests, and there is considerable evidence to the effect, that the sole motivation for ISU's renegotiation demand was the low bids received on coal contracts for the other two major regents institutions. The parties stipulated that the requested price reduction was not prompted by an inability of ISU to pay for the coal.

Despite IFM's requests to delay renegotiation to determine whether the other suppliers could fulfill their contracts to the other universities (which they did not), ISU pressed forward with their renegotiation demand. ISU was also unsympathetic to IFM's claims that the coal provided the other universities was not of comparable quality or for similar time periods.

Discussions between the parties in mid-June 1983 resulted in a couple of IFM alternative offers. Relying on representations made by Richard L. Monson, associate director for the ISU physical plant, as to what the board of regents and the ISU bureaucracy would accept, IFM offered to freeze the current price of $39.54 per ton ($1.88 per million Btu's) for three years or to reduce the price to $35.91 per ton ($1.71 per million Btu's), provided there could be regular increases as provided by the original contract. At that time, IFM had substantial fixed costs (e.g., the coal washing plant) and insufficient time to replace the ISU contract, and ISU was aware of these facts.

In a July 1983 letter, Monson notified IFM of ISU's belief that a price of $35.07 per ton ($1.67 per million Btu's) was a fair price. He wrote:

> We have reviewed the coal bids received at both the University of Northern Iowa and the University of Iowa and have discussed these bids with the Board [of Regents] Office. . . . It is our feeling that if our present producers are not agreeable to the above-named price that contracts will be canceled and rebid as soon as possible.

Defendants' brief explains, "It became obvious to the Board [of Regents] office that the [ISU-IFM] Coal Contracts were economically 'out of line.'" Claiming it had no choice, IFM accepted the readjusted delivered coal price. While defendants now disingenuously assert, "No counter-proposal was made," it was clear to everyone involved that this was a "take-it-or-leave-it" price.

The trial court found that the parties had negotiated a price reduction. It further stated, "Although IFM was not happy, the parties did reach an agreement." The trial court explained: "While the advantage was with ISU in the negotiations, because it could buy coal cheaper from other suppliers, the Corut [sic] finds that the claims of IFM that the price reduction was arbitrary and capricious is [sic] without merit." The court ultimately held that ISU had not negotiated in bad faith.

Unfortunately, the foregoing was only the opening salvo for what became a protracted dispute. The next significant cause of consternation occurred at about the time ISU sought a price reduction. In the words of the trial court, "ISU began to notice (apparently) that the coal supplied by IFM did not meet the BTU's specifications in the contract." IFM's bid called for delivery of coal with a heating value 10,500 Btu's per pound. At approximately the same time, it appears that plaintiff had made adjustments to its washing process which generally resulted in cost savings, less efficient washing, and lower Btu content.

ISU satisfied itself with its own testing methods that the Btu specifications were not being met, and they demanded price adjustments as allowed in the contract. The trial court, however, found ISU's "method of testing did not follow the requirements of the contract" and held the price adjustments were unjustified. It stated:

> The contract called for testing to comply with [American Society for Testing Materials (ASTM)] requirements, and the evidence showed [ISU] did not. As an example, ASTM requirements provided that every truck delivered must be separately sampled. However, ISU was sampling only about two trucks out of the total of 15 or 20 that made deliveries in one day. Further, ASTM provided in sampling the coal a full-stream cut must be taken from the conveyer belt. ISU was only taking a partial stream cut. Moreover, stream cuts according to ASTM standards should be taken in alternating directions. ISU was taking the cuts in the same direction. Moreover, the ASTM standard required that the stream cuts should be of the entire depth of the coal. The sampling container used by ISU was insufficient to do this. . . .

The amount ISU actually deducted between July 1983 and August 1986 is the subject of the cross-appeal. IFM's expert accountant determined, and the trial court held, that ISU deducted $218,048.28 from the price paid to IFM for delivered coal based on its Btu adjustments. ISU claims it deducted only $127,259.11.

The relationship finally collapsed in 1986. A July 21, 1986, letter by Ronald J. Santi, director of business affairs at ISU, to IFM stated: "[Y]ou have failed to meet the quantity levels specified in your coal contract again this year. . . . [T]hirty (30) days after your receipt of this letter, your contract for the purchase of coal will be canceled." The Santi letter went on to detail the alleged shortfalls as 21,595 in fiscal year 1983-1984; 19,428 in fiscal year 1984-1985; and 7,816 in fiscal year 1985-1986. These would be shortfalls of 21.60%, 19.43%, and 9.77% of the expected amount, respectively.

Between 1983 and 1986, ISU had two coal suppliers, the other being Iowa Coal Mining Company. In the summer of 1985 the parties agreed to reduce the annual tonnage requirement from 100,000 to 80,000. Iowa Coal Mining was actively seeking a greater share of ISU's business and in an informal parallel agreement increased its annual shipments by 20,000 to 80,000. There had been numerous occasions when one supplier made up for a shortfall by the other supplier. Indeed, plaintiff seems to contend that a ten percent variation, though not specified in the contract, was built into the system either by separate agreement or by custom and usage and that ISU received 160,000 tons of coal regardless of plaintiff's shipments. Plaintiff further points to the fact that the contract specifies 100,000 tons as an estimate to be adjusted according to climatic and other conditions affecting coal usage. The trial court stated, "While [the delivery] shortcoming by IFM may have been excused, and indeed it was for several years, it appears to be . . . the straw that broke the camel's back."

Plaintiff steadfastly maintains that no problems with the quantity or the quality of its coal would have been encountered had ISU not demanded the price reduction in 1983. Each problem, it contends, resulted from its being backed into an economic corner by ISU. Defendants are equally steadfast in arguing that the corner IFM was in was of their own construction and that they should not be held accountable for IFM's "gossamer" financial condition and myopic business decisions.

At trial, plaintiff sought and recovered $218,048.28 for adjustments in price made by defendants for plaintiff's alleged failure to provide coal with proper Btu content. Separately, plaintiff seeks to recover additional damages for a price reduction defendants imposed because of an alleged inability to "economically utilize" coal supplied. Alternatively, if defendants properly sought the price reduction, plaintiff argues it was damaged by defendants' failure to bargain in good faith. Plaintiff further contends defendants were not entitled to terminate the contract.

II.

We determine first our scope of review. The trial court describes this as a "contested case," a phrase suggestive of an administrative appeal. Iowa Code § 17A.2(2) (1989). In at least a couple of parts of its opinion, the trial court indicates that it applied a burden to show an action was either "wrongful" or "unreasonable, arbitrary, or capricious." This too is suggestive of a judicial review of an administrative action. See id. § 17A.19(8)(g). If this is the case, we think the trial court was mistaken.

The trial court's various statements notwithstanding, it seems clear in all other aspects that neither the parties nor the court conducted themselves as though this was judicial review of a contested case. See id. § 17A.19. Rather, all involved seemed to consider this an ordinary action for breach of contract and negligence. Consequently, our review is for errors of law. Iowa R. App. P. 4. We are bound by the trial court's findings of fact if supported by substantial evidence, Iowa R. App. P. 14(f)(1), but we are not bound by its interpretations of law.

III.

Though the parties can find little else on which to agree, it appears they do recognize the fighting issue in this case to be whether defendants were justified in seeking price renegotiation in June 1983. Both would acknowledge that this rests on an interpretation of the contract language giving ISU the right to demand renegotiation in either of two scenarios. In a division of the contract entitled "termination," the parties agreed in relevant part as follows:

> If the University cannot economically utilize the coal supplied under this contract or in the event the Bidder's proven escalation [price] results in a total price that is unreasonable in view of the price of other comparable coals being offered under contract for periods of time equal to the period remaining under this contract, then this agreement may be renegotiated on thirty (30) days written notice from either party and, failing mutual agreement within a reasonable period of time, the contract shall be terminated upon thirty (30) days written notice following the end of negotiation. Every effort will be made by the University and Bidder to negotiate in good faith a mutually acceptable price for the coal supplied under this contract before giving notice of termination.

IFM contends neither of the triggering events that would have allowed ISU to require renegotiation occurred. In other words, ISU did not show that it could not "economically utilize" the coal, and it did not show the price to be "unreasonable in view of other comparable coals." As discussed below, IFM also contends ISU failed to comply with the final sentence in the quoted provision requiring negotiation in good faith.

A. Taking the second condition first, the trial court made no specific findings as to whether IFM's "proven escalation [price] result[ed] in a total price that [was] unreasonable in view of the price of other comparable coals being offered under contract for periods of time equal to the period remaining under [the] contract." Although the trial court remarked that ISU "could buy coal cheaper from other suppliers," neither this fact nor the record support a conclusion that the price was "unreasonable in view of the price of other comparable coals" for comparable periods. Plaintiff suggests emphatically that there is no evidence to support a trial court finding that ISU could have bought coal from other suppliers at a cheaper price, and we agree.

B. We turn next to the ground indicated in ISU's June 1983 letter requesting renegotiation: "the University cannot economically utilize the coal supplied under the contract." Construction of a contract is the process of determining its legal effect and is a matter of law to be resolved by the court. Interpreting a contract is the process of determining the meaning of the words used and, likewise, is a matter of law to be resolved by the court, unless it depends on extrinsic evidence or a choice among reasonable inferences to be drawn. Farm Bureau Mut. Ins. Co. v. Sandulte, 302 N.W.2d 104, 107-08 (Iowa 1981); Hamilton v. Wosepka, 261 Iowa 299, 305, 154 N.W.2d 164, 168-72 (1967). When contract terms are not ambiguous, the court must enforce them as written, Spilman v. Board of Directors, 253 N.W.2d 593, 596 (Iowa 1977), but when there are ambiguities in the contract, they are strictly construed against the drafter, Village Supply Co. v. Iowa Fund, Inc., 312 N.W.2d 551, 555 (Iowa 1981); Fashion Fabrics of Iowa, Inc. v. Retail Investors Corp., 266 N.W.2d 22, 27 (Iowa 1978); Rector v. Alcorn, 21 N.W.2d 196, 202 (Iowa 1976). We will not interpret a contract giving discretion to one party in a manner which would put one party at the mercy of another unless the contract clearly requires such an interpretation. Midwest Management Corp. v. Stevens, 291 N.W.2d 896, 913 (Iowa 1980); Harvey Const. Co. v. Parmele, 253 Iowa 731, 742, 113 N.W.2d 760, 766 (1962).

The parties introduced no extrinsic evidence bearing on the interpretation of the phrase "economically utilize." Essentially, plaintiff argues the phrase is susceptible to at least two meanings, and defendants argue the phrase is clear on its face. "Because this was an issue of law, of course, the trial court's interpretation is not binding on appeal, Connie's Construction Co. v Firemans Fund Insurance Co., [227 N.W.2d 207, 209 (Iowa 1975)], and we address that issue anew." Sandulte, 302 N.W.2d at 108. Unfortunately, the trial court did not define the phrase, but because it found for defendants on this issue, we presume it adopted defendants' version or found the phrase unambiguous.

Before going further, we must determine whether the phrase "economically utilize" is ambiguous. Defendants properly point out that the fact the parties disagree on the meaning of the phrase does not necessarily establish ambiguity. Id. at 108. "The test is an objective one: Is the language fairly susceptible to two interpretations?" Id. (citing Central Bearings Co. v. Wolverine Insurance Co., 179 N.W.2d 443, 445 (Iowa 1970)). We think it is.

ISU seems to argue it could demand renegotiation anytime it felt it would be "thrifty" to do so. The shocking reality of such an interpretation is that ISU would not be bound by a price if it unilaterally believed it was not getting the best possible price. Thus, if the market price of coal took a downward turn for a couple of months, ISU could demand renegotiation, turning the contract into one for market price, albeit delayed. Such an interpretation is absurd. As plaintiff points out, this would be a contract of a completely different type than the ten-year supply contract it had with ISU. It is also abundantly clear that this is not what either the parties or an objective observer would expect.

If there is a "plain, ordinary meaning" for the phrase "economically utilize," an objective person would read it as requiring ISU to show it could not put the coal to use in an "economical" way, not that it could obtain coal that would be "economical" to it. In fact, defendants' argument places such inordinate emphasis on the adverb "economically" (and a dictionary definition of that word as "given to thrift") that they completely lose the verb "utilize" and the object "coal." Defendants' interpretation, moreover, would subsume the second condition--requiring an unreasonable price as determined from contracts of similar duration for comparable coal--when that condition unambiguously is an alternative.

Thus, we find the trial court's interpretation of the phrase "economically utilize" was in error. We conclude there was insubstantial evidence to show defendants were justified in seeking price renegotiation in June 1983. We reverse the trial court on this issue. If the price had not been reduced in July 1983 and if actual cost factors had been used to both increase and decrease the price every six months within the limits allowed by the contract, IFM would have received an additional $807,830 for coal actually delivered. Plaintiff is entitled to damages in the amount of $807,830 suffered in consequence of defendants' breach of contract.

IV.

Plaintiff's next assignment of error is that the trial court erred in finding that ISU bargained in good faith for a price reduction. This assignment presumes ISU established grounds for renegotiation, but we have held in the previous division that this was not the case. Therefore, we need not reach the question of whether defendants bargained in good faith.

Likewise, plaintiff's third assignment of error is that the trial court erred in failing to conclude that the alleged agreement to service the contract at a lower price was ineffective as a contract modification because it was secured through coercive means and economic duress. This again presumes ISU established grounds for renegotiation. Because we have already held that it was inappropriate for ISU even to demand renegotiation, we need not address these contentions either.

V.

We consider plaintiff's last two assignments of error together. Plaintiff argues that the trial court erred in failing to find that the coal delivered in fiscal year 1985-1986 satisfied its contractual obligation. Plaintiff also asserts that cancellation of the contract was not warranted even if it was in breach of contract for delivering insufficient quantity.

The record is quite clear in showing that IFM consistently failed to provide the amount of coal required under the contract. IFM had shortfalls of 21,595 tons, 19,428 tons, and 7,816 tons in the three fiscal years between 1983 and 1986. These were shortfalls of 21.60%, 19.43%, and 9.77% of the expected amount, respectively.

Plaintiff placed in the record much evidence to excuse its shortfalls and show compliance with the contract. IFM attempted to show that the parties had agreed to allow the supply to vary by ten percent of the expected amount. The trial court heard this testimony and concluded that no such agreement existed because it found no reason not to enforce defendants' right to terminate for a failure to supply stipulated quantities. Plaintiff also relies on the fact that the quantity specified in the contract is an estimate and may vary based on climatic conditions and other variables; however, no such data is before us.

Plaintiff also suggests that the shortfalls were excused. Although the trial court alludes to the possibility that the "shortcoming by IFM may have been excused, and indeed it was for several years," it obviously found that strict performance had not been excused. The record is filled with evidence to show that ISU remained concerned about the quantity IFM was supplying throughout the 1983-1986 period. We find no evidence to show that strict performance in this respect was not warranted.

Although it would be clearly inaccurate to say that the termination was not a result of an accumulation of problems, of which quantity was the last, it would be equally inaccurate to say that ISU did not have an unambiguous right under the contract to terminate because of IFM's failure to deliver "in the quantities stipulated." We hold there is substantial evidence to support the trial court's finding that defendants properly terminated the contract.

VI.

Separate from its claim that defendants breached the contract in obtaining a price reduction, plaintiff also sought and recovered damages of $218,048.28 for numerous price adjustments made by defendants allegedly for supplying coal with inadequate Btu content. Defendants cross-appeal the amount of the award. The trial court rejected defendants' rule 179(b) motion challenging the accuracy of the court's arithmetic.

The contract specified that IFM would supply coal with a minimum value of 10,500 Btu's per pound. The contract did not require either party to test the coal, but it permitted ISU to do so. The contract required sampling and testing "be done according to the specifications set up by the American Society for Testing Materials." The same provision allowed ISU to adjust the price "on a cents per million Btu basis" if six analyses showed the supplied coal was "more than 300 Btu's below the guaranteed analysis" of 10,500 Btu's per pound. There is substantial evidence in support of the trial court's finding that ISU failed to test as required by the contract.

Defendants' challenge to the amount of the damage award for improper price adjustments is not supported by the record. As noted above, ISU eventually agreed to a price increase after the reduction. ISU undercalculates the amount of the Btu price adjustment because it fails to take into account the fact that its adjustments took two forms:

failure to apply the agreed price increase and the Btu adjustment itself. We affirm the judgment awarding plaintiff $218,048.28.

VII.

Because we found the trial court's interpretation of the phrase "economically utilize" was in error and that there was insubstantial evidence to show defendants were justified in seeking price renegotiation in June 1983, we reverse and award IFM $807,830 for breach of contract. We found, however, that there was substantial evidence to support and affirm the trial court's finding that defendants properly terminated the contract on the grounds that IFM had failed to provide the quantity of coal stipulated in the contract. Because of our holdings we did not have to address the balance of plaintiff's assignments of error. Finally, we determined there was substantial evidence in support of the trial court's finding that ISU made improper price adjustments based upon alleged Btu shortfalls and affirmed the trial court judgment awarding IFM $218,048.28.

The costs of this appeal shall be taxed to defendants.

AFFIRMED IN PART; REVERSED IN PART.

All judges concur, except Sackett and Habhab, JJ., who concur in part and dissent in part.

SACKETT, J. (concurring in part and dissenting in part)

I concur in part and dissent in part. I would affirm the trial court in all respects.

Habhab, J., joins this partial dissent.