IN THE COURT OF APPEALS OF IOWA

No. 0-199 / 89-661

FILED
JUN 26 1990
CLERK SUPREME COURT

FIRST SECURITY STATE BANK, f/k/a THE EVANSDALE STATE BANK,
Plaintiff-Appellee,

vs.

106

JAMES T. SKARLIS,
Defendant-Appellant,

JAMES T. SKARLIS,
Third-Party Plaintiff-Appellant,

vs.

CEDAR FALLS TRUST & SAVINGS BANK,
Third-Party Defendant-Appellee.

Appeal from the Iowa District Court for Black Hawk County, George L. Stigler, Judge.

Skarlis appeals a district court judgment finding him liable to First Security under a loan guaranty agreement. **AFFIRMED IN PART AND REVERSED IN PART.**

Max E. Kirk of Ball, Kirk, Holm & Nardini, P.C., Waterloo, for appellant.

George D. Scully, Jr. and Joe Nutting of Martin, Nutting, Miller, Keith, Pedersen & Scully, Waterloo, for appellee First Security State Bank.

John L. Lorentzen of Nyemaster, Goode, McLaughlin, Voigts, West, Hansell & O'Brien, P.C., Des Moines, and R. James Sheerer of Correll & Sheerer, Cedar Falls, for appellee Cedar Falls Trust & Savings Bank.

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

SACKETT, J.

This case involves a series of issues arising from a guaranty agreement given by defendant-appellant James Skarlis to plaintiff-appellee First Security State Bank. The guaranty agreement in the amount of $100,000 was given by defendant to plaintiff when defendant's stock in Forest Hill Motor, Inc., a car dealership, was purchased by Richard Meewes. Meewes and defendant had operated the dealership together prior to the stock purchase. Forest Hill Motors subsequently was liquidated, resulting in losses to plaintiff who then sued on the guaranty. The trial court entered judgment for plaintiff and against defendant for $100,000, with interest from the date the petition was filed and attorney fees of $24,203.75.

Defendant appeals. He contends he was released from any obligation due to fraud on the part of plaintiff and to a substantial change in the business operation of the debtor. Further, he contends he should be partially relieved of liability to the extent of losses caused by the plaintiff's improper banking practices and to the extent of recoveries by plaintiff of property repossessed by the bank. Also at issue is whether the trial court properly awarded prejudgment interest. Our review is for the correction of errors at law. We affirm in part and reverse in part.

I.

Defendant's first contention is the trial court erred in failing to relieve him under the agreement because of changes in the Forest Hill management and business operations. The parties agree that under certain circumstances some jurisdictions have discharged guarantors where grantees have agreed to substantial changes in contractual relations between a debtor and a creditor. See Marshall V. Wells Co. v. Tenney, 118 Or. 373, 244 P. 84 (1926).

Defendant contends Iowa should adopt such a position. We find it unnecessary to determine whether the grantor should be discharged under some circumstances. There are no circumstances here that would support a discharge. When it became obvious Forest Hill would have problems discharging the debt, Forest Hill filed bankruptcy. Plaintiff and Cedar Falls Trust & Savings agreed, and it was ordered the business be moved and liquidated. The change in business was intended to establish a commercially acceptable manner of collecting the debt. We agree with the trial court and reject defendant's contention that this change in business operation should serve to relieve defendant of liability under the guaranty agreement.

II.

Defendant next contends he should have no liability under the agreement because plaintiff made fraudulent statements in order to induce him to sign the guaranty agreement. Defendant claims plaintiff caused him to believe the guaranty would expire as soon as a Small Business Administration loan was in place. Defendant contends plaintiff had Meewes tell him the agreement was temporary. Defendant does not contend he was given this information by a bank officer or employee. The trial court found the plaintiff did not authorize or ask Meewes to make any representations or inducements to defendant in order to obtain his guaranty.

The trial court's decision on this issue is supported by substantial evidence.

III.

Defendant next argues his liability should be reduced and he should not be liable for those losses caused by plaintiff's affirmative acts and improper banking practices. A guarantor is discharged from his or her obligation by any act on the part of the guaranty which increases the guarantor's risk or in any manner injures his or her rights or remedies. Fidelity Sav. Bank v. Wormhoudt Lumber Co., 251 Iowa 1121, 1126, 104 N.W.2d 462, 466 (1960). Affirmative acts of the guaranty which diminish security that might have been available to pay the debt

will discharge the guarantor pro tanto, or to the extent of the loss incurred. Id. at 1127, 104 N.W.2d at 466; see also D.W. Jaquays & Co. v. First Sec. Bank, 101 Ariz. 301, 305, 419 P.2d 85, 89 (1966) (guarantor relieved of liability to extent of injury caused by guaranty's failure to record security interest in collateral); Custom Leasing, Inc. v. Carlson Stapler & Shippers Supply, Inc., 195 Neb. 292, 237 N.W.2d 645, 649 (1976) (guarantor released from liability to extent of loss caused by guaranty's willful or negligent acts); First Nat'l Bank in Grand Forks v. Haugen Ford, Inc., 219 N.W.2d 847, 852-53 (N.D. 1974) (even though unconditional guarantor consented to any extension or modification of the loan, it did not waive creditor's obligation to preserve security by filing financing statement). But see A & T Motors, Inc. v. Roemelmeyer, 158 So. 2d 567, 570 (Fla. Dist. Ct. App. 1963) (guarantor not released when creditor released car titles, which debtor paid for with worthless checks); American Bank of Commerce v. Covolo, 88 N.M. 405, 409, 540 P.2d 1294, 1297 (1975) (guarantor not excused when bank mistakenly believed interest in collateral was properly perfected; standard is whether bank acted in good faith in exercising reasonable means to protect guarantor's rights); National Bank v. Equity Investors, 81 Wash. 2d 886, 898-99, 506 P.2d 20, 38-39 (1973) (guarantor not excused merely because other banks may have followed different practices in advancing additional funds).

Defendant contends plaintiff took a deliberate risk in failing to investigate Forest Hill's financial troubles at Cedar Falls Trust & Savings and its handling of a series of insufficient funds checks written by Forest Hill and the Cedar Falls Trust & Savings. Defendant also contends plaintiff failed to secure its interest in several of the used cars financed under the floor plan.

When Meewes bought defendant's shares of stock, Meewes obtained a Small Business Administration loan with plaintiff. Additionally, Meewes arranged to finance the dealership's used car inventory with plaintiff. The trial court found, and we agree, that these loans were covered under defendant's guaranty. Defendant's complaints about plaintiff's procedure involve the used car financing arrangement. The used car inventory was financed in the amount of $100,000. Under the arrangement, plaintiff generally kept the certificates of title to the cars in the used car inventory. When Forest Hill sold a car, it would give plaintiff a check drawn on its checking account at Cedar Falls Trust & Savings to pay for the car. Plaintiff did not always keep possession of the titles. In some cases it would maintain a list of serial numbers of the cars financed, and Forest Hill would keep the title.

Forest Hill operated its used car floor plan at the limit of its loan authorization. Thus, when Forest Hill made payment to plaintiff and received a car title,

plaintiff would immediately issue to Forest Hill a cashier's check for the exact amount of the payment made to plaintiff. Forest Hill initially obtained financing from plaintiff two to three times a week. By December 1985, it was financing with plaintiff on almost a daily basis.

Plaintiff became suspicious of the arrangement in December 1985 when cars that had been removed from the floor plan began reappearing as collateral for additional borrowing. Meewes told plaintiff that Forest Hill sometimes paid it for a car so it could attempt to sell the car at a dealer auction. If the car did not sell, however, Forest Hill would then refinance it. Plaintiff was not satisfied with Meewes' explanation. It was concerned with the volume and frequency of the loan transactions. Plaintiff decided to stop its financing with Forest Hill for a time during December, figuring that any financial problems of the dealership would then surface. When none did, plaintiff resumed its financial arrangements with Forest Hill. During this time, however, Forest Hill was also financing with MidAmerica Savings Bank. Records later showed that Forest Hill met its financial needs during that month through arrangements with MidAmerica.

Lowell Husome, plaintiff's loan officer for the Forest Hill account, was aware of the financing at MidAmerica. He was alerted by a loan officer at Cedar Falls Trust & Savings. Husome testified that he did not recall when he

first became aware of the MidAmerica financing. He stated that he was concerned about it and probably would have mentioned it to the president of plaintiff bank. The president did not recall being told of the financing by Husome. Husome did not investigate the financing at MidAmerica.

Also during December 1985, Husome became aware that Forest Hill's checking account at Cedar Falls Trust & Savings was occasionally overdrawn. He found this out through phone calls from a representative of Cedar Falls Trust & Savings Bank, who called Husome on various occasions to ask whether Forest Hill would be doing any financing with plaintiff that day. The representative was concerned because Forest Hill did not have sufficient funds to pay checks and needed to make a deposit to avoid additional overdrafts. Husome never inquired as to the extent of the overdraft problem.

Husome was also aware Forest Hill was using the cashier's checks given to it by plaintiff to prevent overdrafts in its account with Cedar Falls Trust & Savings. No attempt was made at any juncture by plaintiff to communicate with defendant about the problems Forest Hills was experiencing.

This potentially explosive situation finally blew up in March 1986. Plaintiff accepted one check each day from Forest Hill on March 12, 13, and 14. Each day, plaintiff

issued Forest Hill a cashier's check for the amount of the check it gave plaintiff. Each of the three checks plaintiff received was drawn on Forest Hill's account at Cedar Falls Trust & Savings. The total amount of the checks given to plaintiff, and of the cashier's checks given to Forest Hill, was $112,125.00. On March 14, 17, and 18, Cedar Falls Trust & Savings called plaintiff to notify them that the three checks written by Forest Hill would not be paid due to insufficient funds.

Plaintiff suffered a loss on the checks and the trial court charged the loss to defendant under the guaranty agreement. We agree with defendant that he should not be charged with the insufficient fund checks. Meewes' lending limit at the bank was $100,000. The checks were above the lending limit. The trial court found the loss on the insufficient funds checks was the result of plaintiff's negligence. We agree with this finding. We find plaintiff's acceptance of the insufficient funds checks was an affirmative act and one for which defendant should not be responsible. We modify the judgment to exclude the insufficient fund check as an obligation under the guaranty.

Defendant contends he should have credit for the value of used cars in which plaintiff failed to properly secure its interest. While plaintiff was probably negligent in failing to properly protect its interest in all of the used

cars financed under the floor plan, plaintiff's negligence alone does not serve to discharge defendant as a guarantor. Fidelity, 104 N.W.2d at 466.

Defendant also contends the loss for which he is liable should be reduced by the amount realized by plaintiff from the sale of the used car collateral. He contends plaintiff applied some of these funds to the loss from the returned checks. As a general rule, a creditor may apply a voluntary payment to whichever of the debtor's obligations the creditor wishes. Sorge Ice Cream & Dairy Co. v. Wahlgren, 28 Wis. 2d 220, 224, 137 N.W.2d 118, 120 (1965). However, under the "identical property" exception to this general rule, a creditor must apply the proceeds from the sale of collateral to the debt secured by that collateral. See Sorge, 137 N.W.2d at 120-22. Since we have found that defendant should not be liable for plaintiff's loss due to the bad checks received, we agree that plaintiff should apply the proceeds from the sale of the used cars to the debt secured by that collateral and guaranteed by defendant.

Accordingly, we find defendant should be held liable for a total loss to plaintiff of $59,338.40. This represents the balance of the floor plan note of $114,500.00 plus the Small Business Administration loan of $1,052.76, less sale of used car collateral in the amount of $56,214.36.

IV.

Defendant contends the trial court erred in awarding prejudgment interest because the record reflects the amounts claimed by plaintiff for which judgment was entered included interest to date of trial which was February 22, 1989. Plaintiff's response is only that the interest calculation is not erroneous because the debt was in excess of the guaranty. With our modifications, the debt is less than the guaranty. We agree with the defendant on this issue. We modify the judgment to provide interest shall run from February 22, 1989.

V.

The final issue involves attorney's fees. The guaranty agreement states that the guarantor will be liable for any "reasonable attorney's fees at any time paid or incurred in endeavoring to collect" the guaranteed debt. The trial court, having found defendant liable for the full $100,000 amount of the guaranty agreement, awarded plaintiff attorney's fees of $24,203.75. In light of our decision as to defendant's liability, we reduce this amount to $10,000. Costs on appeal shall be assigned one-half to each party. We award no attorney fees on appeal.

AFFIRMED IN PART AND REVERSED IN PART.