IN THE COURT OF APPEALS OF IOWA

FILED
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CLERK SUPREME COURT

204

THE RIDGE CORPORATION,

Plaintiff-Appellant/ Cross-Appellee,

vs.

ROBERT J. MARCHANT, SR. and IRENE F. MARCHANT, Husband and Wife,

Defendants-Appellees/ Cross-Appellants,

FIRST FEDERAL SAVINGS & LOAN,

Defendant.

Filed February 26, 1986

MARCHANT & SON, INC.,

Plaintiff-Appellee,

vs.

THE RIDGE CORPORATION, DONALD H. HAMANN, ALLEN A. HAMANN, and ROBERT J. BEERT,

Defendants-Appellants.

5-640
85-282

Appeal from the Iowa District Court for Scott County (No. 67728) - J. L. Burns, Judge.

Vendor of real estate appeals the trial court's dismissal of its foreclosure petition against buyers. Vendees cross-appeal claiming a right to rescind the real estate contract due to the vendor's fraud or misrepresentation. **AFFIRMED.**

Jack D. Darland of Wells, Brubaker, de Silva, Flynn & Darland, P.C., Davenport, for The Ridge Corporation.

Dennis D. Jasper of Stafne, Lewis, Jasper & Payson, Bettendorf, for the Marchants.

Considered by Oxberger, C.J., and Donielson and Snell, JJ.

This case involves a dispute between the buyers and the seller of real estate in Eldridge, Iowa. The defendant, First Federal Savings & Loan, is not a party to this appeal.

In 1977, Donald Hamann, Allen Hamann, Robert Beert, and their spouses formed a corporation entitled Tri-Sports, Inc. to purchase the Rustic Ridge Golf Course in Eldridge. At that time the real estate included a nine-hole course, located on approximately 76 acres. The real estate also included two A-frame buildings and an open-sided shelter. The A-frames served as a starter shack and a clubhouse. In 1980, Tri-Sports, Inc. built a new two-story clubhouse facility. The A-frames remained on the property but were not used. The Hamanns and Beerts formed a corporation entitled The Ridge Corporation to operate the clubhouse. The clubhouse is locally known as the Ridge House. The bottom floor served as a bar and restaurant. Primarily soup and sandwiches comprised the menu. Golf merchandise was also sold there and greens fees received. The second floor served as a banquet room where food would be catered or fixed on the premises as the parties desired. The Ridge Corporation operated the Ridge House during the 1980 and 1981 golf seasons. The business was closed during the winter months.

After months of negotiation, on March 1, 1982, The Ridge Corporation entered into an agreement with Marchant and Son, Inc., for the sale of the Ridge House and one acre of real estate. Marchant and Son, Inc. was formed for purposes of this purchase by parents, Robert and Irene Marchant, their son, Daniel, and his wife, Barbara. Daniel and Barbara were to actually operate the business. None of the Marchants had prior experience in restaurant management. The real estate contract itself was executed on March 31, 1982 and provided for a principal sum of $170,000. The contract provided for a $35,000 down payment,

with the unpaid balance payable in monthly installments of $2,096.10, with the first payment to be on May 1, 1982. The down payment of $35,000 was in the form of a promissory note, security for such being a mortgage on separate real estate owned by Robert and Irene Marchant. The promissory note provided for monthly payments of $1,000 commencing on April 1, 1982, at the rate of 18 percent per annum. The real estate contract provided concerning this note as follows:

> In the event of a default, it is expressly understood by and between the parties that the remedies of the Seller shall be cumulative. In the event of a default, the Seller shall have all rights and remedies as provided by law. In addition thereto and irrespective of how Seller may proceed under those available remedies, the Seller shall also have the right to institute a foreclosure action on the note and second mortgage referred to hereinabove. Said note securing the down payment as provided herein.

The contract also required that the underlying mortgaged real estate be listed for sale and the note paid in full when the real estate sold.

In April of 1982, the Marchants expanded the clubhouse business to a full-service sit-down dinner operation. During the first several months, the business went well, in fact, better than the Marchants had anticipated. However, throughout the summer the Marchants began to experience various problems with the clubhouse equipment and septic system. They presented The Ridge Corporation with a detailed list of problems in September of 1982. These problems were not resolved to the Marchants' satisfaction. Because the Marchants were forced to spend more for maintenance than they had anticipated, they were unable to operate the business profitably. The Marchants ceased operating the business at the end of October, 1982.

They did not make the September 1, 1982 and October 1, 1982 payments due under the real estate contract. Neither did they make the August through

October payments due on the promissory note. As a result, notice of forfeiture of real estate contract was served on Marchant & Son, Inc. on October 26, 1982.

On May 13, 1983, The Ridge Corporation sought to collect the unpaid balance under the promissory note (approximately $33,000) by foreclosing the mortgage on the underlying property and forcing its sale.

On May 25, 1983, the Marchants filed an action to rescind the real estate contract on the ground of fraud and misrepresentation by The Ridge Corporation. By joint motion the two actions were consolidated for trial.

The trial court dismissed the foreclosure petition on the ground that once the real estate contract was forfeited, the corporation was barred from any attempt to recover any part of the purchase price involved in the contract. The trial court also found that the representations made by The Ridge Corporation were not fraudulent and, therefore, the Marchants were not entitled to rescind.

The court found, however, that the Marchants were entitled to recover $8,500, which constituted the value of the perishables and other supplies left at the clubhouse when they vacated.

On appeal, The Ridge Corporation contends that the trial court erred in dismissing its petition for foreclosure. The Marchants cross-appeal, claiming a right to rescind the real estate contract due to The Ridge Corporation's fraud or misrepresentation in making the sale.

An action to foreclose a mortgage is tried in equity. Golden Sun Feeds, Inc. v. Clark, 258 Iowa 678, 682, 140 N.W.2d 158, 161 (1966). Therefore, our scope of review is de novo. Iowa R. App. P. 4. Especially when considering the credibility of witnesses, we give weight to the fact findings of the trial court but are not bound by them. Iowa R. App. P. 14(f)(7).

Foreclosure Remedy. The Ridge Corporation contends that the trial court erred in finding that it is barred from recovering the part of the purchase price

represented by the promissory note. The Ridge Corporation argues that the Marchants agreed in writing that in the event of default, The Ridge Corporation could forfeit the main contract as well as foreclose on the note and mortgage, and the Marchants should be bound by such agreement. To support its argument, The Ridge Corporation relies on the fact that a cash down payment is not remitted to the vendee upon contract forfeiture and, therefore, the form of the down payment should not alter this result. In other words, The Ridge Corporation desires that we hold that the note and mortgage were not part of the purchase price under the installment contract.

The facts in this case are similar to the facts in Gray v. Bowers, 332 N.W.2d 323 (Iowa 1983). Gray involved the sale of real estate under two separate installment contracts. On the date that the second contract was executed, the buyers also executed a promissory note in the amount of $30,000 secured by a mortgage on real estate other than the real estate covered by the two contracts. Payments on the note were not required unless the buyers defaulted on the two contracts. The agreement provided that in the event of such a default, payments on the note would continue even if the seller exercised his right to forfeit or foreclose on the real estate contract. Approximately one year later, the buyers defaulted and the seller forfeited the buyers' interest in both contracts. The seller then attempted to collect on the $30,000 note. The Iowa Supreme Court concluded that the seller's action in forfeiting the real estate contracts precluded his recovery on the separate note and mortgage. The court reasoned:

> The court of appeals held that the common law doctrine of election of remedies does not preclude plaintiff's recovery because the contract documents contemplate that his remedies with respect to forfeiture of the two installment contracts and enforcement of the separate note and mortgage shall be cumulative and consecutive. We agree that the doctrine of election of remedies does not preclude distinct and independent grounds of action arising from the same transaction and which may be

> concurrently or consecutively pursued to satisfaction. Bolinger v. Kiburz, 270 N.W.2d 603, 605 (Iowa 1978); 25 Am. Jur. 2d Election of Remedies § 13 (1966). But this abstract legal proposition is not dispositive of the present dispute. We conclude that under our holdings, plaintiff's recovery is precluded by a substantive legal doctrine which is separate and distinct from the common law doctrine of election of remedies.
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> This conclusion has reference to our holding in Abodeely v. Cavras, 221 N.W.2d 494, 497-98 (Iowa 1974) that when a vendor exercises a right of forfeiture against a defaulting vendee, the liability of the latter for the unpaid purchase money is extinguished. While it is true that this result is triggered by the election of a remedy, i.e., the forfeiture of the contract, the end result is not dependent on the doctrine of election of remedies. Such result instead flows from the fact that the contract between the parties has been terminated, thereby extinguishing any right to recover the unpaid purchase price. The same result has been reached in cases involving abandonment or rescission of the contract. See First National Bank v. LaBarron, 201 Iowa 853, 855-56, 208 N.W. 364, 366 (1926); Stephenson v. Neppel, 192 Iowa 246, 252-53, 182 N.W. 369, 371-72 (1921). We are reluctant to permit circumvention of this result by means of contract clauses which reserve to the vendor a right to receive additional payment after forfeiture.

Id. at 324-25.

LeBarron also involved facts similar to those before us. There, two promissory notes had been delivered as the down payment for an installment sale of real estate. One of the notes was paid, the other renewed. Subsequently, the vendee defaulted under the installment contract and the vendor elected to rescind the contract. He sold the land to a third party who sought to enforce the unpaid note against a surety of the vendee. The Iowa Supreme Court held that the note was part of the purchase price under the installment contract and, therefore, when the vendor elected to terminate the contract, he waived any right to separately enforce the note. LeBarron, 201 Iowa at 856, 208 N.W. at 366.

In the present case, the record reflects that the note and mortgage given by the Marchants were additional consideration for the March 1982 installment

contract. In this respect, the note was clearly part of the purchase price under the contract. Therefore, we can only conclude that The Ridge Corporation's action in forfeiting the real estate contract precludes its enforcement of the separate note and mortgage. The trial court properly dismissed The Ridge Corporation's petition for foreclosure.

Fraud. The Marchants contend that the trial court erred in finding that they were not entitled to rescind the real estate contract because of misrepresentations by The Ridge Corporation. They argue that the primary reason that they purchased the Ridge House was because it was a new facility. Because they had little operating capital, they anticipated that there would not be extensive repair bills. The Marchants argue that The Ridge Corporation knew of their limited financial condition and knew or should have known that problems existed with the clubhouse, yet failed to disclose such pertinent information during the negotiation of the real estate contract.

It is a well settled principle of equity that misrepresentations amounting to fraud in the inducement of a contract, whether innocent or not, give rise to a right of avoidance on the part of the defrauded party. First National Bank in Lenox v. Brown, 181 N.W.2d 178, 182 (Iowa 1970). While to establish fraud in law actions, it is necessary to prove 1) representation, 2) falsity, 3) materiality, 4) scienter, 5) intent to deceive, 6) reliance, and 7) resulting injury or damage, equity may grant relief absent a showing of scienter or pecuniary damages. Smith v. Peterson, 282 N.W.2d 761, 766 (Iowa Ct. App. 1979). In equity, fraud may be shown from surrounding circumstances. Id. Plaintiff carries the burden of establishing fraud by a preponderance of evidence which is clear, satisfactory, and convincing. Id.

> [I]n Iowa a seller is required to reveal to the buyer material facts known to him but not readily observable upon reason-

able inspection by the buyer concerning the property which is the subject of the sale. . . .

To recover in equity on the ground of fraudulent misrepresentation, the alleged fraud must be material. Rosenberg v. Mississippi Valley Construction Co., 252 Iowa 483, 486, 106 N.W.2d 78, 80 (1961). A fact is material if it substantially affects the interest of the party alleged to have been defrauded. Wilden Clinic, Inc. v. City of Des Moines, 229 N.W.2d 286, 292 (Iowa 1975). Materiality has been found where a fact influences a person to enter into a transaction, where it deceives him or induces him to act, or where the transaction would not have occurred without it. Wilden Clinic, 229 N.W.2d at 286; First National Bank in Lenox v. Brown, 181 N.W.2d 178, 182 (Iowa 1970); Rosenberg, 252 Iowa at 486, 106 N.W.2d at 80.

Id. at 765.

The Marchants took advantage of several opportunities to view and inspect the clubhouse facility before signing the purchase agreement. They were given the option to either lease or purchase the clubhouse. They were aware of the fact that the clubhouse had only a limited food service operation prior to the sale. The Marchants also inspected The Ridge Corporation's profit and loss statements, actual utility bills, and other financial information concerning the expenses of the clubhouse operation. Prior to signing the purchase agreement, Barbara Marchant spoke with people who had attended large parties at the Ridge House and called the Scott County Board of Health. At that time the only problems with the clubhouse that the Board of Health reported were the need for a fire extinguisher and a bigger vent fan above the grill.

The Marchants were informed that the building itself, the furnaces, air conditioning, and a dishwasher were new at the time of construction, and that the other equipment was used but operational as of the close of the 1981 golf season. The problems with equipment related to the Marchants during sale negotiations included that the dishwasher operated awfully slowly, the air conditioner would not cool the second floor very well for large receptions in the

summer, the barroom air conditioner leaked, the deep fat fryer leaked, and the kitchen air conditioner required periodic maintenance. The Marchants were instructed regarding the operation and maintenance of all of the mechanical components of the building. The Marchants were informed that The Ridge Corporation had a problem the first winter with water leakage around the foundation of the clubhouse. However, the grade was raised and eaves spouts installed which corrected the problem. Furthermore, The Ridge Corporation allowed the Marchants to operate the clubhouse facility under its licenses and with its assistance during the month of March before the sale was completed. Initially, the Marchants operated with a limited menu, but after a couple months expanded to every night sit down dinners.

During the first several months of the Marchants' ownership, the only problems were with two doors which opened inward, allowing sand and water to be blown into the dining room and kitchen of the clubhouse during rainstorms. *When informed about this problem, The Ridge Corporation rerouted eavespouts* around the areas, which reduced the problem but apparently did not solve it.

Late in the spring of 1982, the septic system backed up around the sump pump hole in the kitchen of the clubhouse. This occurred eight to ten times over the next few months according to the Marchants. Once the toilets overflowed in the ladies restroom. Don Hamann testified that he frequently visited the clubhouse and was not aware of any septic problems. However, he did state that when the new clubhouse was constructed with increased toilet facilities, he had signed an agreement with the Scott County Board of Health to take immediate corrective action if any sanitary problems arose with the system in existence. At that time the Board of Health issued The Ridge Corporation a permit to operate the clubhouse with the existing septic system. Mr. Hamann

did not disclose the existence of the written agreement with the Board of Health to the Marchants.

Don Hamann further testified that the Ridge Corporation served some large banquets and receptions of 100 to 150 people in the 1980 golf season and remained open through the holidays for private parties. From May to September of 1981, The Ridge Corporation entertained twenty-eight wedding receptions with up to 300 people coming and going and about twenty sit-down banquets serving anywhere from 30 to 120 people in the clubhouse facility. They had encountered no problem with overuse of the septic system on these occasions. The only problem The Ridge Corporation experienced was in late 1979 when the gas company severed a minor line of the septic system. In the fall of 1981, some surface water appeared in this area and the line was capped. The Marchants were not told about this capped line during negotiations for the sale of the clubhouse. Don Hamann testified that he knew he had explained to the Marchants how the sump pump worked and what maintenance for the septic system was required. They also were provided with a backup pump in case the main pump failed. He did not recall discussing with the Marchants whether the septic system would handle an expanded restaurant business. The Marchants, however, testified that Mr. Hamann told them that, in his opinion, the septic system would handle the large numbers of people they anticipated.

On October 28, 1982, Barbara Marchant registered a complaint with the Board of Health regarding the septic system. She and her husband testified that they were under the impression that the Scott County Board of Health gave them no alternative but to upgrade the septic system or curtail their business. However, a public health sanitarian testified that the Scott County Board of Health records did not indicate that the clubhouse septic system was defective, failing, or insufficient. Nor was there indication that the clubhouse business

had to be curtailed for public health reasons. No other complaints or violations were on file for the clubhouse system.

Another one of the major problems which the Marchants encountered was the existence of an A-frame within 25 feet of the front entrance to the clubhouse. It is not disputed that this structure was unsightly and that Don Hamann promised the Marchants during their negotiations that it would be removed in the spring of 1982. The two A-frames had been purchased by the Eldridge Park Board in 1981. One A-frame was removed in late 1981; however, the second one remained through November of 1982. It is undisputed that all three directors of The Ridge Corporation made numerous requests to the Park Board for removal of the second A-frame. However, the Park Board was not able to coordinate the requisite volunteer labor for the project.

The Marchants list numerous other problems which arose during their period of ownership. The Scott County Board of Health required the Marchants to install a hard surface under the outside refuse dumpster and lids on the inside refuse containers. Electricity expense was greater than the Marchants expected and they testified that the air conditioning units would not cool the restaurant. On at least one occasion water leaked in a storage room and down a kitchen wall during a rainstorm. Another incident involved the walk-in cooler which quit operating and over $600 of foodstuffs spoiled. The Marchants encountered several other problems with the clubhouse equipment—including the central vacuum system, the showers, the dumbwaiter, the bar's glass washer, and the kitchen air conditioner.

It is unfortunate that none of these problems with equipment were anticipated by the Marchants. However, it is clear that The Ridge Corporation did not expressly guarantee that such problems would not occur. Neither is there evidence in the record that The Ridge Corporation knew or should have known

of any defects in the Ridge House equipment which would likely result in such problems. Both Barbara and Daniel Marchant testified that no one problem caused the demise of their business, but rather it was all the problems combined. Barbara stated that they anticipated that going to a full service operation would place greater strain on the building's mechanical components, but they did not expect such extensive problems. We conclude that the Marchants have not established that The Ridge Corporation intentionally deceived them or misrepresented the condition of the clubhouse facility. Therefore, the trial court properly denied the Marchants' request for rescission of the real estate contract.

AFFIRMED.