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CLERK SUPREME COURT

IN THE COURT OF APPEALS OF IOWA

EDWARD TUBBS, State)
Superintendent of Banking,)
State of Iowa, Receiver,)

Plaintiff-Appellant,)

vs.)

UNITED CENTRAL BANK, N.A.,)
Des Moines, Iowa, n/k/a)
First Interstate Bank of)
Des Moines, N.A.,)

Defendant-Appellee.

9-92
87-1691

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Appeal from the Iowa District Court for Davis County
(CL 258-1283-53-34), Phillip R. Collett, Judge.

Plaintiff appeals the decision of the district court
which dismissed with prejudice all of its claims.

AFFIRMED IN PART AND REVERSED IN PART.

Mark E. Schantz and Richard A. Malm of Dickinson,
Throckmorton, Parker, Mannheimer & Raife, Des Moines, for
plaintiff-appellant.

Patrick J. McNulty and Ross H. Sidney of Grefe &
Sidney, Des Moines, for defendant-appellee.

Heard by Donielson, P.J., and Hayden and Habhab, JJ.,
but decided by Hayden, P.J., and Sackett and Habhab, JJ.

HAYDEN, J.

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Plaintiff receiver appeals the decision of the district court which dismissed with prejudice all of its claims. Plaintiff brought several claims in law and equity against defendant bank alleging certain assets of a failed private bank should be available to the depositors and not to the defendant. We reverse in part and affirm in part.

I.

The Exchange Bank of Bloomfield was founded in 1871 by Amos Steckel. His son, W.J. Steckel, continued operation of the bank until his death in January 1940. In 1919, the Iowa legislature required all new banks to be chartered and subject to regulation. However, existing private banks were permitted to continue under a "grandfather clause," which meant the Exchange Bank, throughout its existence, remained a private, unincorporated, unregulated bank. W.J.'s holdings later passed to his daughter, Josephine, who married Edward Burchette in 1935. Edward became president of the bank. The final probate report in W.J. Steckel's estate contained a statement to the effect Josephine assumed full personal liability for the deposits of Exchange Bank.

Josephine died in 1951 with a will leaving the Exchange Bank to Edward Burchette. Again, an order was entered authorizing the continuation of the Bank's business; and it continued to operate without interruption or financial

audit. It was stated in the final probate report of Josephine's estate, Edward agreed to be personally responsible for the claims of the depositors. The probate inventories in each of the estates segregated the Exchange Bank as a separate asset. In addition to the bank, Edward also inherited the Steckel farms which were comprised of approximately 4,500 acres in Davis County, Iowa. This farm land was always considered in the Bloomfield area to be a part of Exchange Bank and has been described as the "backbone of the bank."

From the time W.J. Steckel was involved with the bank, the proprietors withdrew funds at their leisure and never paid any interest. The practice caused the liabilities (basically the sums due depositors) to exceed the assets of the bank. The excess of liabilities over assets is primarily accounted for on the books of the bank during the time it was managed by Edward as a noninterest-bearing overdraft account in his name and in the name of W.J. Steckel. Edward also made a practice of funding various business enterprises with Exchange Bank money, all of which apparently lost money.

The Union Bank & Trust Company of Ottumwa (Union) served as a correspondent bank for Exchange Bank for many years. As correspondent bank, Union cleared Exchange Bank's checks through the Federal Reserve system and provided Exchange Bank with liquidity by direct loans until

early 1974. Exchange Bank's indebtedness to Union generally ranged from \$300,000 in 1966 to \$420,000 in 1974. These loans were secured by notes receivable and other property. In the early 1970's Union was acquired by Banks of Iowa, Inc., an Iowa bank holding company. Edward held a seat on Banks of Iowa's board of directors. As an officer and a member of the board of directors, Edward was subjected to borrowing restrictions of \$5,000, consequently, most of the loans to Exchange Bank by Union were not legally permissible. This problem was resolved by Edward resigning as an officer and director of Banks of Iowa in July of 1974.

The liquidity problem was temporarily resolved when Edward borrowed a total of \$2,000,000 from Continental Bank of Chicago, secured by Banks of Iowa stock which he owned.

Throughout this period, Union and Banks of Iowa urged Edward to obtain a state charter for Exchange Bank. This resulted in an accounting firm compiling financial statements in order to determine Exchange Bank's financial status. Holmes Foster, vice president of Banks of Iowa, inspected the books and records of Exchange Bank around mid-May of 1974. His investigation revealed Exchange Bank had family-related overdrafts in the amount of \$1,300,000 and family-related loans in the amount of \$1,500,000. These overdrafts and loans created the bank's liquidity problems. The financial problems of Exchange Bank were

relayed to the Iowa Department of Banking but no action was taken. On December 31, 1975, Exchange Bank's clearing account at Union was again overdrawn. Banks of Iowa wrote to Edward, forcibly advising him Union could not participate in allowing an unregulated bank to maintain an overdraft in its clearing account. Banks of Iowa further advised that Union would no longer pay cash letters resulting in overdrafts, and Union would not provide additional liquidity. Banks of Iowa further issued an ultimatum that Edward devise a feasible plan for creating a chartered bank by February 13, 1976, or face termination of the Exchange Bank account with Union. No specific plan for chartering was ever devised and Banks of Iowa demanded Exchange Bank transfer its account to another bank. At this point Edward and Exchange Bank turned to United Central Bank (UCB), the defendant in this action. UCB was and is one of Iowa's largest correspondent banks with over 300 active correspondent accounts as of 1976.

Final arrangements for shifting the correspondent account to UCB were made at a meeting in June 1976. The meeting was attended by Edward's attorney, Allen Whitfield, Peter Burchette, and UCB's Eddy Wolfe. Wolfe testified UCB wanted the account if it would be a "profitable relationship" for both banks. As the trial court found during the meeting, Wolfe was told:

That the reason for moving the account was the conflict of interest created by Edward's involvement with Banks of Iowa. During the same

period of time, UCB was aware that Edward was no longer an officer or director at either Valley Bank or Banks of Iowa. At this same meeting, Wolfe was advised that Exchange Bank was illiquid from time to time, and that it would like to use participation agreements to meet that need. UCB gave permission to provide liquidity to Exchange Bank up to \$1,200,000. UCB did not request or obtain any financial statements from Exchange Bank until July or August 1982. Although UCB sometimes contacted a previous correspondent banker concerning the new account, it did not do so in this case.

The second major problem faced by Exchange Bank in 1976 was the securities division of the Iowa Insurance Department. The securities division raised the question whether private bank certificates of deposit were "securities" subject to registration requirements of Iowa's "blue sky" law. Registration would entail complete disclosure of the private bank's financial condition.

An amendment exempting private banks from the blue sky laws was submitted to the legislature in the spring of 1976, but was not acted upon in that year. The superintendent of securities Marshall Hunzelman was asked to, and did stay enforcement action, before the next legislative session. Hunzelman resigned to join the Whitfield firm in January of 1977. Although the proposed legislation was not enacted, his immediate successor did not revisit the issue.

Exchange Bank's next crisis arose in 1980. Edward became critically ill in September and his lawyers were convinced he was going to die. At this time Exchange Bank

had a negative capital of over \$4,000,000. Concerned about the ramification of disclosing Exchange Bank's financial condition, Edward's lawyers developed an elaborate plan for an inter vivos "transfer" of Exchange Bank from Edward to Peter Burchette, and his sister, Nan Burchette Cameron (Edward's children). The plan provided for Peter and Nan to assume the deposit liabilities and accept an unsecured noninterest bearing note from Edward for the deficit (erroneously calculated at that time to be only \$3,578,521). The note was apparently to be paid down over time by the transfer of Davis County real estate.

The assignment transfer agreement was made effective January 7, 1981. In this transaction, Edward executed a "notice of change of ownership" and a "verified statement of business conducted under a trade name." The latter was recorded in the public record of Davis County and it appears on the abstracts for "Exchange Bank Farms." The former was posted briefly on Exchange Bank premises and then immediately removed. Each stated:

That the undersigned, EDWARD BURCHETTE, continues to make available all of his farms, bank stocks, and other assets, both real and personal, for the security of the Exchange Bank.

Attorneys Dean Dutton and Edgar Musgrave testified they felt Edward did not intend by these representations to create a legal charge or lien against his assets. Rather, they were intended as mere "comfort statements" to depositors as confidence rested in their perception that

Edward, unlike Peter and Nan, was a person of substantial means and the holder of unencumbered real estate of great value. Peter and Nan, however, testified it was always their intent that all of Edward's assets remain "behind the bank."

During the period from early June to mid-July 1982, UCB's revolving liquidity loan to Exchange Bank increased from \$2,080,137 to \$3,344,748, approximately UCB's legal lending limit. In addition, Exchange Bank's correspondent account was in continuous overdraft status from July 13 to August 4, 1982. A three-week overdraft of this magnitude had not occurred before in UCB's extensive correspondent experience. UCB insisted Exchange Bank satisfy the overdrafts. Edward, at the request of his attorney, and Peter agreed to provide financial assistance. This assistance took two forms. Edward borrowed \$250,000 from UCB, secured by Banks of Iowa stocks, which was deposited in Exchange Bank's account. He also borrowed from Valley Bank, \$298,000, against certificates of deposit he held at that bank. This money also was deposited into Exchange Bank's account at UCB. UCB sold the \$250,000 loan to Drover's Bank of Chicago without recourse. By December 1982, UCB's concern for its position heightened. To alleviate its concerns, UCB initiated demands for additional collateral in Exchange Bank loans in late December. Edward thought the collateral request was just

"window dressing" for bank examiners, but was told by Peter that if he did not provide mortgages, UCB was prepared to cease doing business. Edward agreed to execute mortgages on Exchange Bank Farms on the express condition UCB agree they not be recorded. UCB was told the reason for this condition was fear depositor knowledge of mortgages on Exchange Bank Farms would prompt a run on deposits and close the bank. Several agreements were reached between the parties. Effective in April of 1983, Exchange Bank agreed to repurchase, on demand by UCB, any participation loans which were in default. The Exchange Bank's owners, Peter and Nan, guaranteed that obligation. Edward agreed to collateralize the Exchange Bank's obligation to repurchase by granting first mortgages on nearly 4,000 acres of his farm land. These mortgages could be filed by UCB upon reasonable notice.

During the 1982 crisis, the possibility of selling Exchange Bank was explored again. Outside accountants were again retained, and they determined as of August 1982, nearly \$7,000,000 cash or cash equivalents would be required to charter and capitalize Exchange Bank.

Peter had unsuccessful discussions with a potential buyer from Omaha who approached UCB himself. Peter also began an involved series of negotiations with Hawkeye Bancorporation which continued in various forms until these negotiations were terminated in September 1983.

When the Hawkeye Bancorporation deal did not materialize, UCB, in early August 1983, advised Edward they might record the mortgages on the farm land. In the latter part of August, UCB was under the impression it would take approximately \$5,000,000 to finalize the sale of Exchange Bank. At a meeting, UCB learned substantial additional capital was required because of the Burchette family overdrafts of approximately \$1,800,000. This was apparently the first time UCB learned of the overdrafts. At the conclusion of this meeting, UCB demanded an opportunity to examine the books and records of Exchange Bank and this request was granted. On August 29, officials of UCB inspected the books and records of Exchange Bank. This inspection revealed an aggregate negative net worth of \$760,000. Full value of the farm land was included in the calculation. In addition, UCB evaluated the loan portfolio and found a deterioration in credits and incomplete documentation. It was revealed Exchange Bank had technically violated the terms of some participation agreements with UCB.

At the request of UCB, a meeting was held with the Iowa Superintendent of Banking on August 31, 1983. UCB disclosed what was learned about the financial condition of Exchange Bank. The superintendent indicated he could not act unless the private bank was tendered to his supervision pursuant to statute.

From August 31 to September 2, 1983, UCB and its counsel met with Peter and his counsel in a series of negotiation sessions. Initially, UCB demanded additional collateral. However, on September 2, UCB advised Peter it would drop its request for additional collateral if it were allowed to record its mortgages on that day. The Burchettes agreed to the execution and filing of the new mortgage on the Burchette farm land securing the guaranty by Edward of the debt of Exchange Bank. There was also an agreement the mortgages would be recorded and UCB would take possession of the notes that were subject to the participation agreements on the same day. Pursuant to their agreement, the earlier mortgages were replaced with a single mortgage which covered all nine tracts of land. This mortgage secured a guaranty by Edward of all the debt of Exchange Bank. On September 2, 1983, officials from UCB recorded the mortgage in Davis County and took possession of the notes in question. Further negotiations between the parties occurred at a later time and culminated in a security agreement being executed in favor of UCB covering all notes, chattel paper, and instruments subject to participation agreements.

On September 5, 1983, Exchange Bank requested supervision from the Iowa Department of Banking which commenced examination on the following day. On September 13, 1983, the superintendent of banking closed

the Exchange Bank after concluding the capital of Exchange Bank was impaired; it was conducting its business in an unsafe and unsound manner; it was in such a condition that it was unsound, unsafe, or inexpedient for it to transact business; and it was insolvent.

Prior to the closing of Exchange Bank, UCB had not declared any of the notes originating in Exchange Bank in default or made demand for the repurchase. However, this was done for the first time on September 23, 1983. This resulted in the superintendent demanding return of the notes and their proceeds. This demand was refused by UCB. As the trial court found, depositor claims were originally \$17,438,000, and after distribution in the receivership, the outstanding deposit claims were \$9,027,103. Between June 1976 and September 1983, Exchange Bank increased its deposit liability from \$9,452,621 to \$17,438,000. The bank deficits increased from \$3,035,235 to \$7,436,940, and losses totaled at least \$2,259,856 during the years between 1976 and 1983. UCB had gross earnings from its relationship with Exchange Bank during this period of time in the approximate amount of \$1,300,000. Depositor claims exceed receivership assets by almost \$7,000,000, excluding consideration of the disputed farm land and notes.

The superintendent, as receiver, brought this suit against UCB, claiming the farm land and notes should be

available for the depositors because the mortgage and security interests were ineffective. The district court determined UCB had a contractual right to the proceeds of the notes or a perfected security interest. The court rejected claims of fraudulent conveyance, equitable lien, equitable subordination, equitable estoppel, and constructive trust. The receiver raised claims in law based on conspiracy or aiding and abetting the Burchettes in fraud, breach of fiduciary duties, and violating the Iowa securities law. The receiver also raised a claim of tortious interference with contractual relations. The court dismissed all of these claims. The trial court concluded UCB has a valid perfected security interest in the notes and its mortgage on the farm land is a first and paramount lien on any claims made by the receiver. Plaintiff now appeals the decision of the district court.

On appeal the superintendent once again raises the issues addressed in the district court because the action below presented both claims for damages at law and distinct claims which were equitable in nature. Where, as here, distinct legal and equitable claims are tried concurrently, the appellate court reviews the law portion for error and the equitable portion de novo. Poulsen v. Russell, 300 N.W.2d 289, 298 (Iowa 1981).

II.

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The dispute between the parties boiled down to its simplest form is whether UCB or the superintendent, acting in his role as receiver, is entitled to the disputed farm land and the notes subject to participation agreements. We initially address the question of which party is entitled to the "Exchange Bank Farms."

We observe Iowa Code section 524.1311 requires the superintendent, as receiver, make a diligent effort to collect the assets of the bank and distribute the proceeds. In the event the bank's assets are insufficient to pay in full all of its liabilities, Iowa Code section 524.1312 then (made applicable here by Iowa Code section 524.1702) provides a statutory scheme of priority.

With these precepts before us, we now address whether the farms should be property of the receivership.

At trial the superintendent argued and the district court rejected, that UCB's claims to the farm land should be subordinated to the equitable liens in favor of the depositors.

Iowa has recognized the equitable lien doctrine. Smith v. Village Enterprises, Inc., 208 N.W.2d 35, 38 (Iowa 1973). The doctrine applies to circumstances falling short of a legally enforceable lien. See Fischer v. Klink, 234 Iowa 884, 14 N.W.2d 695 (1944).

The equitable lien has been defined as a restitution concept applied by courts in equity to avoid injustice and particularly unjust enrichment. Restatement of Restitution § 161. An equitable lien may arise either by express contract or by implication under equitable principles. As the Eighth Circuit Court of Appeals observed in Farmers & Merchants Bank v. Commissioner of Internal Revenue, 175 F.2d 846, 849 (8th Cir. 1949):

A substantial number of cases have approved the following definition:

"An equitable lien arises either from a written contract which shows an intention to charge some particular property with a debt or obligation, or is implied and declared by a court of equity out of general considerations of right and justice as applied to the relations of the parties in the circumstances of their dealings."
[Citations omitted.]

Here the superintendent urges equitable liens arose both from an express contract and from equitable considerations of "right and justice." In regard to the express contract argument, the evidence is clear that Edward Burchette agreed in 1981 with Peter and Nan, and by public declaration, unilaterally with Exchange Bank depositors, that his assets, which included the Exchange Bank Farms, would stand as "security for Exchange Bank." He stated in two instruments, one of which was recorded:

[T]hat the undersigned, EDWARD BURCHETTE, continues to make available all of his farms, bank stocks and other assets, both real and personal, for the security of Exchange Bank.

Similar statements had been previously made in various estate proceedings through which the Exchange Bank and Exchange Bank Farms passed into Edward Burchette's hands. We believe these express statements are enough to create an equitable lien by contract. The district court based its rejection of the equitable lien claim largely upon the testimony of Edward's counsel to the effect language used in the so-called "comfort statement" was not intended to create a legally-enforceable lien. We believe such reliance was misplaced. The receiver did not contend, nor do we hold, the "comfort statement" or the estate declarations were mortgages for security interest enforceable at law. If they were, there would be no occasion for us to consider the equitable lien doctrine here. The equitable lien doctrine is applied by appellate courts to avoid injustice where the basis of the lien is legally insufficient on some ground. Fischer, 234 Iowa at 888-92.

Even if we found the Burchette declarations are insufficient to show an intent to charge their property with a debtor obligation, we believe "considerations of right and justice as applied to relations of the parties and the circumstances of their dealings" would call for this court to imply an equitable lien in this case. See Farmers & Merchants, 175 F.2d at 849. The evidence clearly shows the undertakings of the various estates and in

connection with the transfer of the bank to Peter and Nan, were intended to at least maintain depositor confidence in Exchange Bank. The Exchange Bank Farms were viewed as the "backbone of the bank" and as a substitute for depositor insurance, maintaining the public belief the land was behind the bank was crucial if the bank was to continue in business. Thus, the Burchette declarations were neither casual nor immaterial to the bank depositor relationship. Clearly, the "comfort statement" was intended to create more than the mere appearance of a lien without the substance of one. The inequity of holding the "comfort statement" created only a mere appearance of a lien is obvious. Equity imputes an intent to form declarations such as those of the Burchettes. See Fischer, 234 Iowa at 892.

As the receiver notes, the general rule is a bona fide purchaser for value dealing at arm's length and "without notice" takes free of an equitable lien. Restatement of Restitution § 172. UCB, however, had ample notice and it is thus more than equitable UCB's claims be subordinated to an equitable lien in favor of the depositors. UCB at all times knew about the special relationship with Exchange Bank Farms to the bank and indeed, agreed not to record its mortgage for the very purpose of not upsetting that relationship. UCB noted in its own documents Edward "guaranteed with all his assets" the liabilities of the

bank after its transfer to Peter and Nan. In any event, UCB is clearly charged with constructive notice of the public records which contained all of the relevant estate declarations as well as the "comfort statement."

We find under these circumstances the equitable balance tips in favor of the depositors and against UCB, and hold an equitable lien on the Exchange Bank Farms has been established in favor of the depositors with priority over UCB's later acquired mortgages.

III.

We next address the respective rights of the parties to the future payments of the participation notes.

The trial court held UCB had both a valid security interest in the notes subject to the participations and contractual rights to receive future payments on the notes. These contractual rights are found in the participation agreements between Exchange Bank and UCB. Specifically, the agreements provided Exchange Bank, after receiving payments of principle and interest from the borrower, was to remit those funds to UCB to the extent it was entitled.

UCB anchors its argument for affirming the trial court on a number of federal court decisions involving the Federal Deposit Insurance Corporation. These cases stand for the proposition that participating banks which have established contractual rights to receive payments made of

participation notes are entitled to a pro rata share on any payments made on the notes subsequent to the closing of the bank. Chase Manhattan Bank N.A. v. Federal Deposit Insurance Corp., 554 F.Supp. 351 (W.D. Okla. 1983).

The superintendent argues it is not relevant whether any contractual rights exist. Rather, the issue is one of priorities provided by Iowa Code section 524.1312 (made applicable here by Iowa Code section 524.1702). Section 524.1312 states:

In the distribution of the assets of a state bank which is dissolved under this chapter, or by any other method, the order of payment of the liabilities of the state bank, in the event that its assets are insufficient to pay in full all its liabilities for which claims are made, shall be:

1. The payment of costs and expenses of the administration of the dissolution.
2. The payment of claims for public funds deposited pursuant to chapter 453 and the payment of claims which are given priority by applicable statutes. If the assets are insufficient for payment of the claims in full, then priority shall be determined as specified by the statutes or, in the absence of conflicting provisions, on a pro rata basis.
3. Amounts due to depositors.
4. The payment of all other claims pro rata, exclusive of claims on capital notes and debentures.
5. The payment of capital notes and debentures.

The superintendent contends there is no statute giving UCB's contractual rights a priority.

The trial court determined, and we agree, UCB had a security interest in the notes, which was perfected during the events of September 2, 1983. See Iowa Code § 554.9302(1). This finding, coupled with the FDIC cases, compels us to affirm the district court and hold UCB is entitled to any payments received on the participated loans subsequent to Exchange Bank's closing.

In addition, in making our decision here, we find the receiver's equitable claims regarding the notes to be without merit. Also, we find the trial court did not err in determining UCB did not own the participated notes.

In view of our decisions in divisions II and III, we do not address the other issues presented in this appeal.

AFFIRMED IN PART AND REVERSED IN PART.