IN THE COURT OF APPEALS OF IOWA

No. 8-234 / 97-1766

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, A New Jersey Corporation,
Appellee,

vs.

FREMONT COUNTY SAVINGS BANK, KENNETH L. SCHLANGE d/b/a **S&S ENTERPRISES,** and **SHERWOOD LUMBER & CONCRETE CO.,**
Defendants,

WARDLOU FARMS INC.,
Appellant.

Appeal from the Iowa District Court for Fremont County, J. C. Irvin, Judge.

The mortgagor appeals the decree of foreclosure. **AFFIRMED.**

Ronald L. Comes and Douglas E. Quinn of McGrath, North, Mullin & Kratz, P.C., Omaha, Nebraska, for appellant.

Kim J. Walker and William J. Hunnicutt of Faegre & Benson L.L.P., Des Moines, for appellee.

Heard by Cady, C.J., and Vogel and Mahan, JJ. Sackett, J., takes no part.

VOGEL, J.

The mortgagor, Wardlou Farms, Inc. ("Wardlou"), appeals a decree of foreclosure. It argues the district court erred in finding Prudential Insurance Company of America's ("Prudential") mortgage did not merge in the deed given to Prudential upon default. As we also find Prudential's fee interest and mortgage interest did not merge, we affirm the decision of the district court.

Background facts. Prudential held a promissory note, dated July 17, 1990, for a principal amount of $800,000, executed by Wardlou Farms and Ward and Louella Adams personally. Wardlou gave a mortgage to Prudential on real property located in Fremont County to secure the loan. Subsequently, Wardlou gave a second mortgage on the property to defendant Fremont County Savings Bank. Defendants Kenneth L. Schlange and Sherwood Lumber & Concrete Company later acquired mechanic's liens on the property.

Wardlou failed to make the first payment to Prudential in January 1991. In May 1991, Wardlou filed for relief under Chapter 12 of the United States Bankruptcy Code. Prudential and Wardlou agreed on a new payment plan, which was incorporated in a second amended plan of reorganization. Wardlou was required to place a deed to the real estate in escrow and cure all payments within sixty days of a notice of default. The deed, to Prudential as grantee, contained this language: "the said premises are free from any encumbrance except leases, liens, mortgages, and easements of record . . . ."

Thereafter Wardlou failed to make the first payment under the amended plan, and failed to cure the default within the required sixty days. Prudential recorded the deed. On March 21, 1994, Wardlou's third amended plan of reorganization was denied by the bankruptcy court. The plan intended to set aside the recording of the deed. The bankruptcy court found Prudential held title to the property and "when Prudential filed the warranty deed . . . the estate's interest in the property was extinguished." It also determined the total debt owed to Prudential was $1,096,200, the current value of the property was $1,228,000, and the property was subject to back real estate taxes of $94,439.61. In June 1994, Prudential filed an action to foreclose its mortgage and declare all other liens junior and inferior. Wardlou was not named as a defendant but intervened, arguing against foreclosure as Prudential's mortgage was merged into the deed.

The trial court determined the doctrine of merger did not apply, and Prudential was entitled to foreclose its mortgage. Only Wardlou appeals.

Scope of review. We review equity cases de novo. Iowa R. App. P. 4; *Tom Riley Law Firm, P.C. v. Padzensky*, 430 N.W.2d 416, 417 (Iowa 1988). We give weight to the fact findings of the trial court, but we are not bound by them. Iowa R. App. P. 14(f)(7).

Merger of fee and mortgage interests. Wardlou argues Prudential's mortgage and deed merged into its fee title.

Our supreme court explained in *Tom Riley Law Firm, P.C. v. Padzensky*, a merger has occurred when:

> one person obtains both a greater and a lesser land interest in the same property without any intermediate interest existing in another person. The lesser interest is extinguished. Merger occurs in the case of a mortgage when the mortgagee's interest and the fee title are owned by the same person.

Id., 430 N.W.2d 416, 417 (Iowa 1988) (citation omitted).

However, the United States Supreme Court long ago carved out an exception to the merger doctrine:

> Where an encumbrancer, by mortgage or otherwise, becomes the owner of the legal title or the equity of redemption, the merger will not be held to take place if it be apparent that it was not the *intention* of the owner, or if in the absence of any intention said *merger was against his manifest interest.*

(Emphasis added.) *Factors' & Traders' Ins. Co. v. Murphy*, 111 U.S. 738, 744, 4 S. Ct. 679, 681-82 (1884).

Wardlou contends the language contained in the warranty deed constitutes "compelling evidence" the parties intended merger upon conveyance, citing to the district court's February 1995 order denying summary judgment. It is true the district court held "[t]he Warranty Deed exchanged in this case . . . provided that Prudential took the said property subject to any leases, liens, mortgages or easements of record

. . . [which is] evidence that the parties intended a merger of Prudential's mortgage and lien claims in the title." However, "[*i*]*n summary judgment* matters the trial court's findings are not findings of fact, but are decisions on questions of law." *Arnold v. City of Cedar Rapids*, 443 N.W.2d 332, 333 (Iowa 1989); *Brubaker v. Barlow*, 326 N.W.2d 314, 315 (Iowa 1982). Thus, the decision of the district court regarding matters of summary judgment in this case was not tantamount to a final determination of factual matters; rather, the denial of summary judgment simply allowed the case to properly proceed to trial.

Wardlou also relies on certain language contained in the Second Bankruptcy Plan for evidence merger was intended: "Prudential's claim under the Promissory Note is secured by a valid and property perfected Mortgage and Security Agreement . . . Prudential shall retain all of the liens and security interest provided by the Security Agreement until Prudential's fully secured claim is paid in full." However, we find this plan generally provided for conveyance of the fee interest upon default, and was an inducement for Prudential to accept the plan. This plan nowhere purports to vitiate Prudential's mortgage interest upon conveyance, nor does it indicate Wardlou's debt was considered to be paid in full. Instead, it provided Prudential's interest shall not be altered or amended, "unless expressly modified." Accordingly, as no modification was made, Prudential retained its mortgage rights even after Wardlou defaulted and the deed was conveyed as the deed itself states that the conveyance is subject to *all* liens of record, necessarily including Prudential's first mortgage lien.

Additionally, we adhere to the principle that even if a debt has been discharged as to the mortgagor and the underlying property is taken in "full satisfaction" of the debt, the mortgage can still be enforced against junior lienholders. *See Stimpson,* 5 N.W. at 762 (holding even though conveyance of property accepted by lender as satisfaction of debt which was discharged of record, this discharge of a bankruptcy debtor was distinct from that of the mortgage's discharge as to subsequent lienholders; there was no evidence the holder of mortgage intended to discharge mortgage as against subsequent lienholders; mortgage remained senior to those interests); *accord Riley*, 430 N.W.2d at 418-19.

In arguing for the application of the merger doctrine, Wardlou points out that Prudential had repeatedly, in various pleadings and memoranda, denied Wardlou retained its equity of redemption, which would be consistent with merger. Wardlou therefore contends Prudential should be estopped from asserting an apparent inconsistent position that merger had not occurred.

However, we agree with Prudential that conveyance of a fee interest can be completely absolute as between lender and borrower and still have no effect on the status of the mortgage with regard to and against the junior lienholders. *See Riley*, 430 N.W.2d at 418-19; *Stimpson*, 5 N.W. at 762. It is not inconsistent for a mortgagor to convey its property and lose its equity of redemption without the intent of merger, as the mortgagor is relieved of further obligations. *See Moad v. Neill*, 451 N.W.2d 4, 7 (Iowa App. 1989) ("There is nothing in the law which forbids the disposition of redemption or possession rights.").

Furthermore, there is a presumption in Iowa that a merger does not occur as the mortgagee's interest is to preserve the mortgage. *See Lutz v. Cunningham*, 240 Iowa 1037, 38 N.W.2d 638, 648 (1949). Other Iowa Supreme Court cases similarly held there will not be a merger if it was not intended and where in was not in the mortgagee's interests to merge. *See, e.g., Riley*, 430 N.W.2d at 418; *Guaranty Life Ins. Co. v. Farmers Mut. Ins. Ass'n*, 334 Iowa 1207, 278 N.W. 913, 917 (1938); *Stimpson v. Pease*, 53 Iowa 572, 574, 5 N.W. 760, 762 (1880).

The mortgagee's intent is presumed to correspond with its interest. *See Untied States v. Stowell*, 133 U.S. 1, 19, 10 S. Ct. 244, 248 (1890). We do not believe it was the intent of Prudential to forsake its oversecured position for a position leaving it significantly undersecured; clearly a lender as Prudential would not deem it in its best interests, and thus it would not be its intent, to abrogate its first lien on a property, thereby subjecting itself to junior encumbrances of over $300,000. Courts generally do not support theories that would be illogical and economically damaging or fatal to a party's interest. *See Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 1356, 89 L. Ed. 2d 538, 552 (1986); *Woodward v. Davis*

53 Iowa 694, 698, 6 N.W. 74, 75-76 (1880) (stating it would not be credulous to believe a senior lienholder voluntarily intended to surrender his senior mortgage lien and allow priority to be given to a junior lienholder where the senior lienholder was under no obligation to make such a sacrifice, where "his interest was clearly against it," and "his intention was consistent with his interest.").

We believe Prudential's interests lie with maintaining distinct fee and mortgage interests as it protects its security in the property against the junior lienholders. We thus agree with the district court when it focused on Prudential's intent as consistent with its interest and stated, "If merger applied, Prudential would become junior to three creditors with debts totaling over three hundred thousand dollars. Clearly it is not to Prudential's advantage to have the mortgage merge with the deed." We accordingly find Prudential's mortgage did not merge into the deed given.

Having considered all other issues before us on appeal, and finding the intervenor's other claims to be without merit, we affirm the decision of the district court.

AFFIRMED.