

IN THE COURT OF APPEALS OF IOWA

FILED

MAY 31 1988

CLERK SUPREME COURT

HENRY COUNTY SAVINGS BANK, )

Plaintiff-Appellant, )

vs. )

Filed May 31, 1988

JAMES E. JENNINGS and JANET )

JENNINGS, Husband and Wife; )

ROBERT E. JENNINGS and BONNIE )

JENNINGS, Husband and Wife; and )

JENNINGS PETROLEUM CO., An Iowa )

Corporation, )

Defendants, )

ROY NICHOLS and IOWA NICHOLS, )

Husband and Wife, )

Defendants-Appellees. )

7-603  
87-580

Appeal from the Iowa District Court for Henry County (No. CE810-1284),  
R. David Fahey, Judge.

Plaintiff bank appeals from a district court judgment in favor of defendants  
Nichols on the bank's action for mortgage foreclosure and reformation of a  
real estate contract between the Nichols and defendants Jennings. **AFFIRMED  
IN PART; REVERSED IN PART; AND REMANDED.**

Seleta A. Bainter, Mount Pleasant, for plaintiff-appellant.

Steven R. Hahn of Ruther, Bauer, Schulte, Hahn, Swanson & Crowley,  
Burlington, for defendants-appellees Nichols.

Heard by Hayden, P.J., and Sackett and Habhab, JJ.

**HAYDEN, P.J.**

Plaintiff, Henry County Savings Bank (Bank), appeals the judgment of the district court in the Bank's action for mortgage foreclosure and contract reformation. The court refused to reform a real estate contract between the defendants, the Jennings family and the Nichols family, so as to give the Bank first priority on the business property sold on contract by the Nichols to the Jennings. The court also declined to determine whether subsequent loans made to defendant Jennings Petroleum Company were secured by a future advances clause in the mortgage executed by the Jennings individually. The court then established the order for the sale of the Jennings' assets at the foreclosure sale. The Bank contends the district court erred in all of these rulings.

In 1980 the Jennings offered to purchase real estate on Highway 34 near Mount Pleasant, Iowa, which was owned by the Nichols, residents of California. The Jennings intended to develop the property as a service station. Due to the Jennings' lack of funds, the parties decided a sale on contract was the appropriate vehicle for the purchase. The Jennings first attempted to obtain financing for the down payment and the construction of the service station from the Mt. Pleasant Bank & Trust. This bank declined to provide financing, apparently because of concern regarding its lien priority position on the business property vis-a-vis the Nichols and the potential for a lawsuit which might be brought by James Jennings' former employer pursuant to a non-compete agreement. The Jennings then approached the Bank for financing on the advice of their counsel, who had represented the Bank in the past. The Bank was also concerned about its priority position on the business property. The Nichols apparently remained adamant, however, about retaining their superior right to the property, although they were willing to waive their right to forfeiture. Throughout these

negotiations, the Jennings' attorney served as the intermediary for the parties. The Nichols and their attorney did not negotiate directly with the Bank.

On December 11, 1980, the real estate transaction was closed. The Bank agreed to loan the Jennings partnership \$100,000, \$25,000 of which was to be used to pay off the existing mortgage on farmland owned by the Jennings individually. The Jennings then executed mortgages in favor of the Bank on the farm and business properties, as well as a security interest in certain personal property related to the operation of the service station. On April 27, 1981, the Jennings partnership incorporated as Jennings Petroleum Company. The Bank subsequently made four loans to the Jennings in their corporate capacity. A corporate security agreement allegedly repledged the original collateral by referring to the original business security agreement and mortgages. The Jennings subsequently defaulted on all five loans and the real estate contract. This litigation followed.

#### I.

In December 1984, the Bank filed a foreclosure petition seeking to have its mortgage declared superior to the Nichols' interest in the business property. The Jennings and Jennings Petroleum Co. filed chapter seven bankruptcy shortly thereafter. The district court issued a pretrial order bifurcating the trial. On March 17, 1986, the district court held paragraph 13(b) of the real estate contract between the Jennings and the Nichols did not give the Bank a first lien on the business property. Paragraph 13(b) provided in pertinent part:

In case of the failure of the Buyers to make any of the payments herein provided to be made, or the Buyers' failure to perform any of the covenants and obligations herein contained Sellers have the right to exercise the remedy of foreclosure. Buyers agree in the event of default that said property be sold within 180 days of the receipt of a notice of default from Sellers. Said sale proceeds shall initially be used to pay sale expenses, with the remainder being used to satisfy in order the building note and down payment note of the Henry County Savings Bank and the outstanding balance under

this contract . . . . Sellers are expressly waiving their right to declare a forfeiture but reserve all other remedies available to Sellers either at law or in equity.

The Bank did not appeal the district court's interpretation of this provision. However, on May 1, 1986, the Bank amended its pleadings to seek equitable reformation due to an alleged mistake in the drafting of paragraph 13(b). The Bank contended its first priority position on the business property was not meant to be contingent upon receipt by the Jennings of a notice of default from the Nichols. It is undisputed the Nichols have not sent such a notice. The district court denied reformation due to insufficient proof of mutual mistake.

Reformation of a written instrument may be granted only upon clear, satisfactory, and convincing evidence of fraud, deceit, duress, or mutual mistake. Iowa R. App. P. 14(f)(11). A mutual mistake, as alleged here, is one that is material and common to all the parties to the written instrument. Wilden Clinic, Inc. v. City of Des Moines, 229 N.W.2d 286, 289-90 (Iowa 1975). Reformation is unavailable if the mistake is as to a collateral matter or is unilateral. Id. at 290. The party who seeks the reformation has the burden of establishing by clear and convincing evidence that the written instrument does not reflect the true intent of the parties. See Kendall v. Lowther, 356 N.W.2d 181, 187 (Iowa 1984). As this case was tried in equity, our scope of review is de novo. Iowa R. App. P. 4. We give weight to the fact findings of the district court, especially when considering the credibility of witnesses, but are not bound by them. Iowa R. App. P. 14(f)(7).

Assuming arguendo the Bank was intended to be a third-party beneficiary of the real estate contract between the Jennings and the Nichols, thereby allowing it to raise this claim for reformation, we conclude the district court was correct in finding the Bank introduced insufficient proof of mutual mistake. James Jennings testified in his deposition he had no knowledge of any conversations

regarding a subordination agreement which would give the Bank the first priority on the business property. He stated he was aware the problem had needed to be resolved but he was never informed how it had been resolved. The Nichols, of course, steadfastly maintained they never intended to relinquish their superior right to the property unless they sent the Jennings a notice of default. They contended they merely agreed to relinquish their forfeiture rights, as noted in paragraph 13(b). Thus, none of the parties to the contract assert paragraph 13(b) was mistakenly drafted.

The evidence the Bank relies on most heavily is a letter from the Jennings' attorney to the Nichols' attorney which was sent when the Jennings were attempting to obtain financing from the Mt. Pleasant Bank & Trust. This letter stated:

The bank is raising some concern about lending substantial sums of money when the property is being purchased on a long term contract basis. The bank is suggesting that Mr. Nichols subordinate his interest under the contract to the bank's interest. In order to do that, perhaps the contract could be revised to eliminate the forfeiture provisions and to provide in lieu thereof a foreclosure provision which would require sale of the property upon default. The contract could provide that upon default the property be sold within a certain certified time period. The sale proceeds would be used to pay off the Mt. Pleasant Bank & Trust Company note, the remaining contract balance owed to Mr. Nichols and any excess beyond those two sums be given to Mr. Jennings.

Would you please take this up with your client and inform me as to whether or not this arrangement is acceptable to your clients.

Before the Nichols responded to this proposal, the Jennings' negotiations with the Mt. Pleasant Bank & Trust broke down. Thereafter, the Bank relied on the representations of the Jennings' attorney that its requirements as to priority on the business property had "in essence" been met.

Our review of the record persuades us, as it did the district court, the Bank failed to provide clear and convincing evidence the Jennings and the Nichols made a mutual mistake in agreeing to paragraph 13(b) as drafted. We conclude reformation of that paragraph is not available to the Bank.

## II.

116

The Bank also asserts the district court erred by not ruling the four loans made to the Jennings Petroleum Company were secured by a future advances clause in the mortgage executed by the Jennings individually. The Bank contends the district court, by not so ruling, failed to properly compute the amount of the Bank's in rem judgment against the Jennings' farm property and certain specified personal property. The district court declined to rule on the applicability of the future advances clause to those four loans because, as a practical matter, the value of the Jennings' property is insufficient to satisfy the original note, for \$100,000.

Although we are sympathetic to the position of the district court, resolution of this issue directly affects the proper amount of the Bank's in rem judgment. While this may appear to be an exercise in futility, given the current value of the property involved, there is no guarantee the value of the property will not increase in the future. The district court should have addressed this issue. We remand to give it the opportunity to do so. In so doing, we reverse its computation of the amount of the in rem judgment.

## III.

The Bank's last assertion is the district court erred in its establishment of the order for the sale of the Jennings' assets at the foreclosure sale. The Bank contends foreclosure on the business property is not available to it because of the superior claim of the Nichols. The Bank reasons, therefore, the court erred by concluding it was required to foreclose on the business property before it could foreclose on the Jennings' homestead. See Huttig Mfg. Co. v. Burhans, 148 Iowa 657, 659-60, 127 N.W. 991, 992 (1910) (where portion of the property other than the homestead included in the mortgage is not available to the mort-

gagee for the satisfaction of his debt, his claim on the homestead is not thereby defeated because the other property is deemed "exhausted").

We do not agree the business property is not available to the Bank merely because it currently holds the junior lien. Although there is no guarantee the sale of the property would satisfy even the Nichols' superior claim, the property is not thereby unavailable to the Bank. The Bank may still foreclose its mortgage on the property. See Moore v. Olive, 114 Iowa 650, 87 N.W. 720 (1901) (junior mortgage foreclosed on land covered by two mortgages); Herrick v. Tallman, 75 Iowa 441, 39 N.W. 699 (1888) (discussing sale under mortgage of junior mortgagee). The district court was correct to require the Bank to do so before it could foreclose on the Jennings' homestead. See Iowa Code § 561.21(2) (homestead may be sold to satisfy debt only after "exhausting all other property pledged by the same contract for the payment of the debt"). We affirm on this issue.

#### IV.

To summarize, we affirm the rulings of the district court regarding reformation of paragraph 13(b) of the real estate contract and establishment of the order for the sale of the Jennings' assets at the foreclosure sale. We reverse the court's computation of the amount of the Bank's in rem judgment and remand for the court to determine whether the four loans made to the Jennings Petroleum Company were secured by a future advances clause in the mortgage executed by the Jennings individually.

Costs on appeal are assessed against appellant.

**AFFIRMED IN PART; REVERSED IN PART; AND REMANDED.**