IN THE COURT OF APPEALS OF IOWA

No. 0-178 / 99-1122
Filed September 27, 2000

METRO ENGINEERING, INC.,
an Iowa Corporation,
Plaintiff-Appellant,

vs.

METRO-ERICKSON VENTURES, a Nebraska partnership consisting of Douglas J. Erickson and John P. Chudy as partners, DOUGLAS J. ERICKSON, EB CORPORATION, an Iowa Corporation, TIMOTHY E. RICE, and MARY ANN RICE,
Defendants-Appellees.

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CLERK SUPREME COURT

Appeal from the Iowa District Court for Woodbury County, Richard J. Vipond, Judge.

The plaintiff appeals from the district court's ruling dismissing a mortgage foreclosure action against the defendants. The plaintiff claims that the district court erred in determining that John Chudy paid off the mortgage when the evidence allegedly demonstrated that the mortgage was assigned to the plaintiff. The plaintiff further claims that there were no exceptional circumstances for piercing the corporate veil regarding the plaintiff. **AFFIRMED.**

Edward C. "Ted" Poulsen of Heidman, Redmond, Fredregill, Patterson, Plaza, Dykstra & Prahl, L.L.P., Sioux City, for appellant.

Cletus W. Blakeman, Omaha, Nebraska, for appellees.

Heard by Vogel, P.J., and Mahan and Miller, JJ.

MILLER, J.

Plaintiff Metro Engineering, Inc. appeals the judgment entered against it after trial to the court, dismissing its petition in equity to foreclose a mortgage lien on certain property (Lot 55) against the mortgagor, Metro-Erickson Ventures.[1] We affirm.

I. Background Facts and District Court Ruling

Plaintiff Metro Engineering, Inc. is an Iowa corporation formed in 1992 for the purpose of developing a residential subdivision known as Woodbury Heights. The two shareholders are John Chudy and Paul Sharples. In 1994, Chudy and Douglas Erickson, a general contractor engaged in residential construction, agreed to form a partnership for the purpose of acquiring residential lots and constructing single family residences within Woodbury Heights. To accomplish this goal they formed a Nebraska partnership in the form of a joint venture and named it "Metro-Erickson Venture."[2] The two partners as indicated in the Joint Venture Agreement are "EB Corporation" and "Woodbury MEV, Inc."[3] EB Corporation is an Iowa corporation whose sole shareholder is Erickson. It is the corporation through which Erickson conducts his contracting business.

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[1] Metro-Erickson Ventures did not file an answer in this matter and the record does not reveal entry of default against it. Metro-Erickson Ventures did not file a brief on appeal. Throughout the opinion, all references to the "defendants" will mean only those named defendants who have defended the action: Douglas J. Erickson, Diane Erickson, and EB Corporation.

[2] Although the "Joint Venture Agreement" names the entity that it formed "Metro-Erickson Venture," all concerned appear to have thereafter referred to it as "Metro-Erickson Ventures."

[3] The "Joint Venture Agreement" is the only document in this litigation that refers to the partners of Metro-Erickson Ventures as being Woodbury MEV, Inc. and EB Corporation. It appears because the lending institution required the principals (Chudy and Erickson) of the two corporations be the principal obligors on the promissory note, the parties have treated Metro-Erickson Ventures as a partnership consisting of Chudy and Erickson. In fact, the plaintiff named as a defendant in its petition in equity "Metro-Erickson Ventures, a Nebraska partnership consisting of Douglas J. Erickson and John P. Chudy as partners." We will therefore treat Metro-Erickson Ventures as a partnership of Erickson and Chudy.

Woodbury MEV, Inc. is a Nebraska corporation, formed in 1994 for the purpose of being the investor in the joint venture. Its single shareholder is Chudy.

In October 1994, Pioneer Bank executed a construction loan commitment, subject to certain conditions, to Metro-Erickson Ventures for the construction of a model home on Lots 55 and 56. One condition of primary importance for the purposes of this appeal was that the borrowers be "Douglas J. Erickson and John P. Chudy, personally." Another condition required that the construction loan "be personally guaranteed by principals of Metro-Erickson Ventures."[4] Metro Engineering, Inc., the owner of the Lots 55 and 56, then deeded the lots to Metro-Erickson Ventures. The deed refers to the grantee as "Metro-Erickson Ventures, a Nebraska partnership consisting of Douglas J. Erickson and John P. Chudy as partners."

On October 24, 1994, Erickson and Chudy personally signed a promissory note to Pioneer Bank in the amount of $75,000. The borrower listed on the promissory note was "Douglas J. Erickson, John P. Chudy, dba: Metro-Erickson Ventures." The note was secured by a construction mortgage signed by Erickson and Chudy personally. Like the note, the mortgage was from "Douglas J. Erickson and John P. Chudy, A Joint Venture."

Some problems arose in building a home on Lot 55. The cost of construction was more than anticipated, and the home did not readily sell. A purchase agreement appears in the record, dated July 3, 1997, with Metro Erickson Ventures as the seller and Tim and Mary Ann Rice as buyers. The record does not reveal closing ever took place pursuant to the purchase

[4] As noted in *supra* note 2, we will presume the principals referred to are Erickson and Chudy

agreement, although the amended petition in equity names the Rices as defendants and alleges they are in possession of Lot 55. During opening statements, plaintiff's counsel indicated the attempt to sell the property to the Rices was unsuccessful and they were no longer in possession of the property. Counsel further stated the plaintiff was not seeking a deficiency judgment against the Rices. Another statement by plaintiff's counsel during trial indicates the Rices were just renting the house. Chudy testified that the Rices moved out of the house and no longer desired to buy the property because Erickson had refused to sign the purchase agreement.

The due date of the $75,000 promissory note was extended twice by Pioneer Bank, first in November 1995, and the second time in May 1996. The second extension provided that payments of one thousand dollars were to begin on May 1, 1996.

Subsequent events are the center of this controversy. On October 25, 1996, a payment was apparently made to Pioneer Bank for the amount due under the promissory note. No document in the record shows the means by which the payment was made, or who the payor was. A notation was made on the promissory note that read "This note is being assigned to Metro Engineering Inc. without recourse and with no warranties whatsoever." A written assignment of the construction mortgage to Metro Engineering, Inc. did not occur until some ten months later, on August 19, 1997.

Metro Engineering, Inc. contends it borrowed the money from Metro Engineers,[5] a Nebraska corporation whose sole shareholder is John Chudy, and used that money to buy the assignment of the note and mortgage from the bank. Based upon Metro Engineering, Inc.'s assertion that it obtained an assignment of the note and mortgage, and Metro-Erickson Ventures' failure to thereafter make any payments, Metro Engineering, Inc. filed this suit in equity to foreclose the mortgage and have Lot 55 sold to satisfy the debt.

The defendants asserted as an affirmative defense that the note had been paid in full. It is their position that the note was discharged because the October 1996 payment was "paid . . . by or on behalf of" Chudy, and therefore, there was no note or corresponding mortgage to assign to Metro Engineering, Inc. *See* Iowa Code section 554.3602(1) (1995) ("an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged. . . ."). The defendants also contended, as part of their defense, that the corporate veil of Metro Engineering, Inc. should be pierced if necessary.

The trial court first addressed the defendants' argument the corporate veil of Metro Engineering, Inc. should be pierced. While the trial court acknowledged many of the corporate formalities had been observed and separate books were "maintained with a considerable degree of care," it found that exceptional circumstances existed that would warrant piercing the corporate veil if the

[5] Not to be confused with the similarly named plaintiff in this case, Metro Engineering, Inc. It appears Metro Engineers primarily develops office buildings in Nebraska.

payment had in fact been made by Metro Engineering, Inc. The exceptional circumstance referred to by the trial court was that any such payment to Pioneer Bank by Metro Engineering, Inc. was not made in the ordinary course of the plaintiff's business, as it was not for the purpose of satisfying a corporate liability or "for any other corporate purpose." Instead, the court found that any such payment made by Metro Engineering, Inc. was "for the purpose of satisfying a debt owed by Mr. Chudy in his individual capacity."

The trial court then stated "piercing the corporate veil, however, is not necessary. . . . The evidence shows that the indebtedness was paid by or on behalf of Mr. Chudy and not by the plaintiff." The court had earlier made a finding that Mr. Chudy was not a credible witness and had briefly stated reasons for that finding. It had gone on to explain that some of Chudy's sworn answers to interrogatories were not true and that while his testimony at trial contradicted his answers to interrogatories, that testimony lacked documentary support that should exist if his testimony were true.

Interrogatory No. 15, propounded by the defendants to the plaintiff, asked: "Please describe with specificity the consideration given in exchange for receipt of the purported assignment of the Promissory Note and Construction Mortgage." Chudy, on behalf of the plaintiff, answered: "CH 1806-10/24/96 Pioneer Bank. Cash in the sum of $76,399.70." Check 1806, however, was from Metro Engineering, Inc. to Chudy's corporation, Metro Engineers. During cross-examination, Chudy admitted the interrogatory answer was incorrect. He claimed that check 1806 was a payoff to Metro Engineers for a loan Metro Engineers had made to Metro Engineering, Inc. in order for Metro Engineering,

Inc. to buy the assignment of the note and mortgage. He had earlier testified that he believed Metro Engineers had "made a loan to Metro-Engineering a couple of times," and that Metro Engineers had "made a loan to Metro-Engineering. This check is a repayment of a loan. . . ." However, on neither occasion did he state the loan or loans were to buy the assignment of the note and mortgage. He further testified that he "believe[d] Metro Engineering would have written a check to Pioneer Bank for—for the assignment." However, the plaintiff did not produce such a check at trial.

The trial court found that Mr. Chudy's testimony that "Metro Engineers had made a loan to the plaintiff [Metro Engineering, Inc.] and that Check No. 1806 was given in repayment of the loan" was probably accurate. The trial court found, however, that this fact "shows where Mr. Chudy got the money to pay the balance owed on the note, but it does not show that the plaintiff made any payment to the bank."

The trial court then explained why it believed the promissory note was paid by Chudy:

> It appears that Pioneer Bank threatened to foreclose the mortgage. The plaintiff was in no danger of being named a defendant because it was neither an owner of the property nor a party to the loan. Mr. Chudy, however, was a probable defendant. He did not want to be named a defendant in a foreclosure action, so he decided to repay the loan. The money to repay the loan was available in the plaintiff. To get the money out of the plaintiff, Mr. Chudy had the plaintiff repay its indebtedness to Metro Engineers. That apparently made the money available to Mr. Chudy for use in paying the bank.

The trial court then concluded even though Mr. Chudy insisted the bank assign the note and mortgage to Metro Engineering, Inc., and the bank did so, there was no note or mortgage to assign because the October 1996 payment by

Chudy discharged the obligors' debt and the bank did not have a note or mortgage to assign.

To summarize, the trial court found Chudy paid the note himself, and that he was personally obligated to pay the note. Therefore, pursuant to Iowa Code section 554.3602(1), the note had been discharged and the bank did not have the note or mortgage to assign to Metro Engineering, Inc. The trial court concluded Metro Engineering, Inc. therefore did not own a mortgage to foreclose and its petition in equity must be dismissed. Alternatively, the trial court found that "if necessary" it should pierce the corporate veil of Metro Engineering, Inc. because if Metro-Engineering, Inc. had paid Pioneer Bank it had done so for Mr. Chudy's personal benefit, using the plaintiff's status as a separate entity to obtain an advantage in his conflict with defendant Erickson. Implicit in the court's statements is that if the corporate veil were pierced the court would treat any payment by Metro Engineering, Inc. as if it had been made by Chudy personally.

The plaintiff filed a rule 179(b) motion combined with an alternative motion for new trial. The court overruled the motions. It stated the explanation given by the plaintiff in its motions as to how check No. 1806 was used to buy the note and mortgage was subject to three defects: (1) it completely contradicted Chudy's testimony; (2) it was unsupported by the evidence; and (3) it made no sense. The court also ruled, in response to the second part of the plaintiff's motions, that it would not further comment on the plaintiff's contention the corporate veil should not be pierced because, although it would be appropriate to do so in this case, the decree was not based upon piercing the corporate veil of Metro Engineering, Inc. Metro Engineering, Inc. appeals. It asserts there is no

evidence to support the trial court's determination that Chudy paid off the mortgage. It further asserts no exceptional circumstances exist to warrant piercing the corporate veil, and the trial court erred in ruling it should be pierced if necessary.

II. Scope and Standards of Review

Mortgage foreclosure proceedings are equitable. Iowa Code § 654.1. Because this action was tried in equity, review is de novo. Iowa R. App. P. 4; *First State Bank, Belmond v. Kalkwarf*, 495 N.W.2d 708, 711 (Iowa 1993). Although we give weight to the fact-findings of the district court, especially when considering the credibility of witnesses, we are not bound by them. Iowa R. App. P. 14(f)(7); *Kalkwarf*, 495 N.W.2d at 711.

The question that arises in this case is whether Metro Engineering, Inc. received an assignment of the mortgage it now seeks to foreclose. When the plaintiff in an action to foreclose a mortgage has the note and mortgage in its possession, and introduces them into evidence, an ordinarily sufficient presumption arises that the plaintiff owns the note and mortgage. *Van Gorder v. Lundy*, 66 Iowa 448, 452, 23 N.W. 918, 919-20 (1885).

It is the defendants' burden to prove their affirmative defense, here that the promissory note was paid in full and discharged. *See, e.g., Petty v. Faith Bible Christian Outreach Center, Inc.*, 584 N.W.2d 303, 306 (Iowa 1998). We determine if the defendant has met that burden by considering all the evidence, both in support of and contrary to the proposition, and then weighing each to determine which is more convincing. *Id.*

III. Merits

Pioneer Bank purportedly assigned the promissory note to Metro Engineering, Inc. on October 25, 1996. If, following payment of the note, Pioneer Bank had anything to assign, then Metro Engineering, Inc. acquired both the note and mortgage on October 25, 1996.[6] The defendants claim, however, the note was discharged by payment and thus the bank had nothing to assign to the plaintiff.

Metro Engineering, Inc., through Chudy, apparently possessed the promisorry note and mortgage, and introduced them in evidence. These facts raise a presumption that Metro Engineering, Inc. owned the note and mortgage. *Van Gorder*, 66 Iowa at 452, 23 N.W. at 919. Metro Engineering, Inc.'s claim to ownership is based on its claim that it paid its money to Pioneer Bank in order to receive an assignment of the promissory note. The trial court found that version of the facts was not supported by the evidence. It further found that the indebtedness had been paid by or on behalf of Mr. Chudy, thus implicitly concluding that the defendants had proved their affirmative defense. When we

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[6] We note it makes no difference that the written assignment of the mortgage took place nearly ten months after the note was assigned to Metro Engineering, Inc., because

> The assignment of a debt ordinarily carries with it all liens and every remedy or security that is incidental to the subject matter of the assignment and that could have been used, or made available, by the assignor as a means of indemnity or payment, even though they are not specifically named in the instrument of assignment, and even though the assignee at the time was ignorant of their existence.

Kintzel v. Wheatland Mut. Ins. Ass'n, 203 N.W.2d 799, 805 (Iowa 1973) (quoting 6 Am. Jur. 2d *Assignments* § 121, pp. 302-03). Therefore, the written assignment of the mortgage nearly ten months after the notation of assignment of the promissory note would merely memorialize what had already occurred in law with any October 1996 assignment of the promissory note.

consider all the evidence, both in support of and contrary to the affirmative defense, *See Petty*, 584 N.W.2d at 306, we agree with the trial court.

Metro Engineering, Inc.'s claim that it paid the promissory note is heavily dependent upon the testimony of John Chudy. However, the trial court found that he was not a credible witness, a finding to which we give considerable weight and with which we agree upon our de novo review. Certain of Chudy's sworn answers to interrogatories were untrue. His testimony at trial was contradictory and inconsistent in several respects. In addition, his testimony that Metro Engineering, Inc. paid Pioneer Bank by check is unsupported by documentary evidence that would be in the possession of or available to Metro Engineering, Inc. and Chudy if such a check had been issued, yet no such check was offered or introduced in evidence. When a party whose interest is affected fails to produce relevant evidence within the control of that party a court may infer that the evidence would be unfavorable to that party. *Hamer v. Iowa Civil Rights Comm'n*, 472 N.W.2d 259, 262 (Iowa 1991). An unexplained failure to produce corroborative evidence, or to explain such failure, tends to impeach the testimony of even an uncontradicted witness. *Chader v. Wilkins*, 226 Iowa 417, 420, 284 N.W. 183, 185 (1939). Similarly, the unexplained failure of Chudy, on behalf of Metro Engineering, Inc., to produce a check that would presumably be in the possession of or available to Metro Engineering, Inc. if such a check existed, causes us to infer no such check exists.

At one point in his testimony Chudy testified that Metro Engineering, Inc.'s October 24, 1996, check of $76,399.70 to Metro Engineers was a payoff to Metro Engineers for a loan to buy an assignment of the note and mortgage. His

testimony simply makes no sense. The payoff to Pioneer Bank purportedly occurred on or about October 25, 1996, the date Pioneer Bank purportedly assigned the note to Metro Engineering, Inc. If Metro Engineering, Inc. had borrowed from Metro Engineers to pay Pioneer Bank, it would not repay Metro Engineers for the loaned funds at the same time it was using the loaned funds to pay Pioneer Bank.

The foregoing facts make it very highly improbable that Metro Engineering, Inc. paid the note at Pioneer Bank. On the other hand, numerous factors, when taken together, strongly indicate that Chudy or some individual or entity acting at his direction and on his behalf paid off the note. Metro Engineering, Inc. issued a check (signed by Chudy) in the amount of $76,399.70 to another Chudy corporation, Metro Engineers, on October 24, 1996. This provided a possible source of funds for the payment to Pioneer Bank. The note to Pioneer Bank was paid on or about the next day, October 25, 1996. Chudy had a personal, financial interest in having the note to Pioneer Bank paid off as he was personally obligated on it. Chudy purports to know how the bank was paid, and asserts payment was by check. There is no substantial evidence that anyone other than Chudy who was involved in the real estate development and transactions with the bank has any knowledge as to the source of funds used to pay the bank. Despite Chudy's and Metro Engineering, Inc.'s assertion that Metro Engineering, Inc. paid the bank, and did so by check, they have not produced any documentary evidence to support such assertions.

We find, as the district court did, that the defendants have proved by a preponderance of the evidence that the note to Pioneer Bank was paid by or on

behalf of Chudy. The trial court's dismissal of the plaintiff's petition shall be affirmed. We make no determination as to any claim which Chudy or his corporations may or may not have against others. Having determined the district court's judgment should be affirmed, we need not address the question of whether Metro Engineering, Inc.'s corporate veil should be pierced.

AFFIRMED.