IN THE COURT OF APPEALS OF IOWA

No. 8-143 / 97-0458

WAYNE RALFS,

Plaintiff-Appellant,

vs.

REYNOLD MOWRY and GARY MOWRY, d/b/a MOWRY BROTHERS,

Defendants-Appellees.

FILED
MAY 29 1998

Appeal from the Iowa District Court for Cedar County, David E. Schoenthaler, Judge.

Plaintiff appeals the district court's ruling in this property dispute. **AFFIRMED IN PART; MODIFIED IN PART; AND REVERSED IN PART.**

Brian T. Fairfield of Norton & Norton, P.C., Lowden, for appellant.

Edward M. Blando and Richard Q. Barrett of Elderkin & Pirnie, P.L.C., Cedar Rapids, for appellees.

Heard by Cady, C.J., and Sackett and Streit, JJ.

SACKETT, J.

Plaintiff-appellant Wayne Ralfs appeals (1) challenging the trial court's determination that defendants-appellees Reynold Mowry and Gary Mowry, dba Mowry Brothers, had a lease on 116 acres of Cedar County farm land deeded to plaintiff under a sheriff's deed and that plaintiff was not entitled to immediate possession; (2) contending the trial court should have released a mortgage defendants hold on the same land; and (3) advancing a notice of lis pendens established rights in the real estate. We affirm in part, modify in part, and reverse in part.

The sheriff's deed came as the result of the foreclosure and February 9, 1995 sheriff's sale on a September 13, 1991 judgment in the United States District Court for the Central District of California in favor of Eddy Matsui and against Loan King.[1] At the time of the foreclosure, King owned the fee in the 116 acres subject to any interests defendants obtained through leases and mortgages. Plaintiff purchased the sheriff's certificate from Matsui and obtained his quit claim deed to the premises on March 19, 1996, and the sheriff's deed on April 5, 1996. Defendants were then tenants on the property.

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[1] On September 13, 1991, a default judgment was entered in Matsui's favor in the United States District Court for the Central District of California for $133,935.23 plus $21,206.42 interest and $2500 attorney fees. The judgment was registered in Iowa and a writ of execution issued May 26, 1992. Sale was scheduled for July 30, 1992, but King's chapter 13 bankruptcy petition was intended to stop the sale. The sale was held. Plaintiff, the highest bidder, bid $2000. Subsequently, King asked the sale be set aside and on December 23, 1995, the Iowa Court of Appeals found the sale void as the judgment had not been properly registered. There was no further review of this decision. Neither Matsui nor King are parties to this action.

On August 14, 1990, King gave defendants a mortgage on the land securing a $125,000 promissory note due on March 1, 1993. This mortgage was recorded in the office of the Cedar County recorder. On the same date, King gave defendants a lease on the property until February 28, 1993.

In January 1994, King and defendants executed an extension of the August 14, 1990 mortgage and an extension of the lease through February 28, 1996, with the option to extend the lease under three one-year options. The mortgage extension was never recorded. On August 15, 1995, defendants notified all respective parties they were exercising the option to extend the lease for three years.

On July 11, 1996, plaintiff tendered and defendants accepted $132,000 to be applied to the balance of the debt secured by the mortgage on the property. Plaintiff filed this suit seeking possession of the land and satisfaction of defendants' mortgage. Plaintiff contended the mortgage extension and the lease extension should be set aside as fraudulent conveyances. The trial court disagreed with plaintiff and this appeal follows.

We review de novo. *Graham v. Henry*, 456 N.W.2d 364, 365 (Iowa 1990). There are two basic principals that guide our review in sorting out these interests. Plaintiff has whatever interest Matsui acquired through foreclosure of this judgment lien. His interest is that interest of King's that was purchased at the execution sale. *See In re Estate of Foster*, 483 N.W.2d 327, 330 (Iowa 1992). An execution sale

purchaser ordinarily acquires no better title than the debtor could have conveyed. *Blue v. Oehlert*, 331 N.W.2d 112, 114 (Iowa 1983); *Rippe v. Badger*, 125 Iowa 725, 727, 101 N.W. 640, 642 (1904). Defendants' interests are dependent on the terms and conditions of the lease and mortgage.

Plaintiff basically contends the trial court did not properly determine the interests he acquired as purchaser at the execution sale, and the trial court failed to find certain transfers from King to defendants were invalid as conveyances to defraud creditors.

We first address plaintiff's contention King's extension of the mortgage and extension of the lease in January 1994 [2] should be set aside as fraudulent conveyances.

Defendants advance there is no evidence the lease extension or mortgage extension were given for purposes of avoiding Matsui's claim. Defendants argue King felt Matsui's judgment was not correct and she needed additional time to appeal. Defendants also contend we should consider the fact King was in financial difficulty and needed additional funds, defendants had money to assist her, and defendants wanted the lease extension to plan their farming operations. Defendants contend these factors support a finding the two extensions were legitimate business transactions supported by adequate consideration.

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[2] King's bankruptcy petition was dismissed December 15, 1992.

A fraudulent conveyance is a transaction by which the owner of real or personal property seeks to place the land or goods beyond the reach of his creditors, or which operates to the prejudice of their legal or equitable rights. *Graham*, 456 N.W.2d at 366. A debtor's property constitutes a fund from which debts should be paid and the debtor may not hinder a creditor's right to proceed against the fund. *Id.* A debtor who disposes of property with the intent to delay or defraud creditors exceeds legitimate authority and the transaction will be "deemed to be inequitable and subject to being set aside." *Id.*; *see also Beardsley v. Clark*, 229 Iowa 601, 607, 294 N.W. 887, 890 (1940). The doctrine can be subject to leases as well as absolute conveyances of title. *Graham*, 456 N.W.2d at 366; *see also Webber v. King*, 205 Iowa 612, 617-18, 218 N.W. 282, 284 (1928).

Certain facts are considered indications of fraud. These include (1) inadequacy of consideration; (2) insolvency of the person making the transfer; and (3) pending or threatened litigation by a creditor not a party to the transfer. *See First Nat'l Bank v. Frescoln Farms, Ltd.*, 430 N.W.2d 432, 435-37 (Iowa 1988); *Regal Ins. Co. v. Summit Guar. Corp.*, 324 N.W.2d 697, 703 (Iowa 1982); *Rouse v. Rouse*, 174 N.W.2d 660, 667 (Iowa 1970); *Muehlenthaler v. DeBartolo*, 347 N.W.2d 688, 690 (Iowa App. 1984). Other factors considered include (1) secrecy or concealment; (2) departure from the usual method of business; (3) the reservation of benefit to person making the transfer; and (4) the continued possession of the property by the person

making the transfer. *Graham*, 456 N.W.2d at 366. While a single factor may in some instances be sufficient to set aside a transaction, generally a combination of circumstances is necessary to warrant an inference of fraud. *Id.* Proof of fraud must be established by clear and convincing evidence. *Webber*, 205 Iowa at 617, 218 N.W. at 284.

Plaintiff contends he has shown clear and convincing evidence to support a finding of fraud. He advances it was established King engaged in a fraudulent transaction because (1) a few days after the court set aside the two previous sales, she contacted defendants to extend the lease; (2) the lease was extended so the mortgage would be financially stable while she sought to challenge Matsui's judgment; (3) King expected future legal efforts by Matsui to execute on the farm to satisfy the judgment; (4) rent of $130 per acre was below fair rental value, which plaintiff contends is more than $200 per acre; and (5) King was insolvent at the time the lease extension was given.

We find the lease extension was given for less than adequate consideration at a time King had a judgment entered against her owned by a person not a party to the conveyance. *See Textron Fin. Corp. v. Kruger*, 545 N.W.2d 880, 884 (Iowa App. 1996); *Generic Farms v. Stensland*, 518 N.W.2d 800, 803 (Iowa App. 1994). At the time King executed the lease extension, she was insolvent. The lease was for less than fair value. The lease extension placed leasehold rights in defendants' hands and away from King's creditors. Having the land subject to lease delayed King's creditors

possession of the real estate. Defendants intentionally were a part of the scheme. *See Production Credit v. Shirley*, 485 N.W.2d 469, 472 (Iowa 1992). We conclude plaintiff has shown by clear and convincing evidence the lease extension was a fraudulent transaction, and we reverse the trial court's conclusion to the contrary.

The mortgage extension agreement that was never recorded was given at the same time under the same circumstances as the lease extension. It sought to increase the amount of the lien secured by the August 14, 1990 mortgage. It, too, bears the indications of a fraudulent transfer, at least to the extent it secured amounts not actually owed to defendants at the time the mortgage was given. To the extent it secured a debt King owed defendants, the mortgage extension would merely give defendants, as creditors, preference over Matsui as a creditor. Debtors may prefer one creditor over another in securing obligations. *Production Credit*, 485 N.W.2d at 472. However, because the mortgage extension agreement was never recorded, any interest it secured in the 116 acres would be inferior to the interest plaintiff obtained by virtue of Matsui's execution on the land.

Having set aside the lease extension as fraudulent, we need to determine plaintiff's damage. Plaintiff contends he was damaged in the amount of $34,555.10 as a result of defendants' failure to vacate the farm on March 1, 1996. Defendants do not address plaintiff's claim for damages. The land in question is approximately 116 tillable acres. Plaintiff testified fair rental was $150 to $225 an acre. The farm was rented to defendants for about $130 a tillable acre. On our de novo review, we

determine the fair rental value to be $150 an acre. We fix plaintiff's damages at $2320 (116 acres at $20 an acre) for the crop year April 1, 1996 through March 31, 1997. We enter judgment in favor of plaintiff in this amount. We vacate defendants' further lease extensions and order plaintiff in possession.

Plaintiff next contends the trial court should have ordered the August 14, 1990 mortgage King gave defendants released. Plaintiff contends he has paid all amounts legally secured by this mortgage. Plaintiff contends the mortgage has no dragnet clause and it specifically refers only to the one $125,000 note signed by King, which he paid.

Defendants contend and the trial court found there is an additional $29,006.55 due on the August 14, 1990 mortgage before the debt it secures is satisfied. Defendants argue the trial court correctly found the amounts said to be secured by the mortgage in the January 1994 extension were so secured. Plaintiff contends the January 1994 mortgage extension was a fraudulent conveyance and the August 14, 1990 mortgage made no provision that it secure future advances. Defendants contend it did.

We have found the January 1994 mortgage extension to be a fraudulent conveyance to the extent it secured sums not actually owed at the time of execution, and have further determined because it was not recorded any interest it secured was inferior to plaintiff's interest.

The next question is whether any amounts allegedly advanced were secured under the August 14, 1990 mortgage. Future advances clauses, also known as dragnet clauses, are valid but courts look upon them with a definite lack of enthusiasm. *Decorah State Bank v. Zidlicky*, 426 N.W.2d 388, 390 (Iowa 1988). Dragnet clauses are valid but are not favored by the law. *Farmers Trust & Sav. Bank v. Manning*, 311 N.W.2d 285, 289 (Iowa 1981). They are thus strictly construed against the mortgagee. *Id.*

In the absence of clear, supportive evidence of a contrary intention, a mortgage containing a dragnet-type clause will not be extended to cover future advances unless the advances are of the same kind and quality or relate to the same transaction or series of transactions as the principal obligation secured or unless the document evidencing the subsequent advance refers to the mortgage as providing security therefor. *Decorah State Bank*, 426 N.W.2d at 390; *Freese Leasing, Inc. v. Union Trust & Sav. Bank*, 253 N.W.2d 921, 927 (Iowa 1977).

Parties can either clearly state their intent when drafting a future advances clause or refer back to the clause when making new loans in order to clarify the series of transactions. *Decorah State Bank*, 426 N.W.2d at 390. Future advances clauses are suspect under Iowa law. *Id.*

There is no language in the August 14, 1990 mortgage to cover future advances, except for real estate taxes. Defendants obtain no additional lien under the August 14, 1990 mortgage, except as for real estate taxes.

The question is what was due under the August 14, 1990 mortgage. Plaintiff's attorney wrote a letter tendering a cashier's check for $132,000 and indicated (1) it was his understanding the interest was paid through September 1995 by rents owed King by defendants; (2) of the $132,000 tendered, $10,215.73 was to pay interest through July 11, 1996; and (3) the balance of the $132,000 tendered was to pay $121,784.27 of the $125,000 principal, leaving a remaining principal of $3215.73. Additionally, defendants had their claim for approximately $8900 in real estate taxes advanced and secured by the August 14, 1990 mortgage.

We determine the balance owing on September 1, 1995, to be $125,000 which drew interest at the rate of twelve percent per annum.[3] Plaintiff owes twelve percent interest on $125,000 to July 11, 1996, in the amount of $12,905, for a total balance due of $137,905 as of July 11, 1996. Plaintiff paid $132,000, leaving a balance of $5905 with interest accruing at twelve percent. Adding the interest in the amount of $435 which accrued from July 11, 1996 to February 19, 1997 (the date of the trial court judgment), the balance due is $6340.

Plaintiff was also responsible for $8962.13 real estate taxes plus interest at nine and one-half percent from October 21, 1993 to February 19, 1997, in the amount of $284.26, and for $59 real estate taxes plus interest at nine and one-half percent

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[3] The interest rate was reduced to nine and one-half percent in the January 1994 mortgage extension. However, equity would dictate if defendants are not given the advantage of that agreement, they should not suffer from the reduced interest rate.

from May 6, 1994 to February 19, 1997, in the amount of $15.66. The total balance due for real estate taxes plus interest is $9321.05. We modify the trial court's order to provide the balance due on the mortgage on February 19, 1997, was $15,661.05.

Plaintiff also claims a notice of lis pendens filed December 28, 1990 in Cedar County by Matsui contending his suit was against the land establishes certain rights in plaintiff. The trial court decided against plaintiff on this issue. There is no showing the California suit was a suit affecting real estate so as to qualify for indexing under Iowa Code section 617.11. *See Mauer v. Rohde*, 257 N.W.2d 489, 496 (Iowa 1977). No rights accrued to plaintiff as a result of this filing. We affirm the trial court on this issue.

In conclusion, we find the lease extension given by King to defendants on January 26, 1994, is set aside, and judgment should be entered against defendants and in favor of plaintiff for $2320 with interest at the legal rate from March 31, 1997, and without prejudice to plaintiff to seek damages against defendants for wrongful possession after March 31, 1997. We find the balance due to satisfy defendants' August 14, 1990 mortgage as of February 19, 1997, is $15,661.05, and we amend the trial court's judgment accordingly.

Costs on appeal shall be taxed one-half to plaintiff and one-half to defendants.

AFFIRMED IN PART; MODIFIED IN PART; AND REVERSED IN PART.