In the United States Bankruptcy Court

for the Northern District of Iowa

LYNN WORLEY, TERESA WORLEY	Bankruptcy No. 96-10450KC
Debtors.	Chapter 7

ORDER RE MOTION TO AVOID LIEN

The above-captioned matter came on for hearing on October 3, 1996 on a Motion to Avoid Lien on Real Estate pursuant to 522(f). Debtors Lynn A. and Teresa D. Worley were represented by Attorney John Titler. Creditor Mercantile Bank of Cedar Rapids (the "Bank") was represented by Attorney Gregory J. Epping. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(K).

STATEMENT OF THE CASE

Debtors seek to avoid the Bank's lien on their homestead. Prepetition, the Bank received a judgment in a state court action seeking collection on a promissory note which was secured by a mortgage on Debtors' homestead. The Bank did not attempt to foreclose the mortgage itself. Debtors wish to avoid the judgment lien under 522(f). They assert that the Bank's mortgage lien is merged into the judgment on the note. Debtors also argue the mortgage is invalid for lack of consideration and/or negligent misrepresentation.

FINDINGS OF FACT

On December 20, 1991, Debtors executed a promissory note and a mortgage in favor of the Bank. The mortgage grants a security interest in Debtors' real estate, referring to "Note dated 12/20/91" and voluntarily waives Debtors' homestead exemption rights for that property.

The note states that it is secured by "REM dated 12/20/91" as well as two security agreements. REM is an abbreviation for Real Estate Mortgage. The note was a renewal and consolidation of two previous notes between Debtors and the Bank in the amounts of approximately $34,000 and $1,500, respectively. Neither of the notes was previously secured by a mortgage.

The larger of the previous notes was personally guaranteed by Lynn Worley's parents, Robert and Wanda Worley, and was secured by assets of Debtors' business, i.e. restaurant equipment. Debtors state that at the time of the renewal and consolidation in December 1991, the Bank's loan officer led them to believe the mortgage was necessary in order to release Robert and Wanda Worley from their guarantees and because of consequences related to an SBA loan. A notation on an internal Bank memo dated 11/19/90 states that "Robert and Wanda Worley are no longer guarantors for this loan because of the SBA loan application." Thus, Lynn's parents were no longer guarantors of the original note at the time of the December 1991 consolidation.

The consolidation renewed the original notes and lowered the combined monthly payments. The Bank states that it requested the mortgage in order to shore up its collateral position. The collateral restaurant equipment did not have sufficient value in a liquidation context. Debtors' restaurant business closed by the end of 1990, except for catering some special events.

The Bank filed suit on the promissory note and a default judgment was entered on September 23, 1994 in the amount of $35,345.72 plus interest and costs. Levy was made on Debtors' homestead by general execution. Sheriff's sale was scheduled for March 25, 1996. Debtors filed their Chapter 7 petition on March 5, 1996 and received a discharge on June 12, 1996.

CONCLUSIONS OF LAW

Debtors move to avoid the Bank's lien on their homestead property. They assert several bases for lien avoidance: (1) the lien from the judgment on the note is avoidable under 522(f); (2) the mortgage lien is extinguished by the judgment on the note and/or avoidable under 522(f); (3) the mortgage lien is invalid for lack of consideration and negligent misrepresentation in the inducement of the mortgage.

AVOIDANCE OF JUDICIAL LIEN

Federal law determines the availability of lien avoidance under 522(f). In re Thompson, 884 F.2d 1100, 1102 (8th Cir. 1989). The Court looks to federal law to determine whether a lien can be avoided to the extent it impairs a debtor's exemption, even though the debtor has waived the rights granted by the exemption. Id.

As to this question, the language of the Code is clear: "Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien. . . ." 11 U.S.C. 522(f). The plain meaning of 522(f) demands the conclusion that a debtor may avoid a lien on exempted property despite the debtor's waiver of the exemption.

Id. at 1103.

The lien arising from the Bank's judgment on the note is avoidable as impairing Debtors' homestead exemption. Debtors waived their homestead exemption in the real estate mortgage created the same day as the promissory note, securing the note. See Hawkeye Bank & Trust Co. v. Michel, 373 N.W.2d 127, 130 (Iowa 1985) (finding express waiver of homestead in notes relating to the same series of transactions and referring to deed of trust as providing security). Despite this waiver of exemption rights, however, Debtors may avoid the judicial lien on the note under 522(f). The Court concludes that the lien arising from the Bank's judgment on the note is avoidable.

AVOIDANCE OF MORTGAGE LIEN

Debtors argue that the Bank lost its mortgage lien by receiving a judgment on the note either as an election of remedies or under the doctrine of merger. The election of remedies doctrine exists to prevent double recovery for a single wrong. J.C.A. Partnership v. Wenzel Plumbing & Heating, Inc., 978 F.2d 1056, 1061 (8th Cir. 1992). The basic premise of the doctrine is that a claimant is prohibited from choosing between two or more inconsistent, but coexistent modes of procedure and relief allowed by law on the same state of facts. In re Gayle, 189 B.R. 914, 916 (Bankr. S.D. Tex. 1995). An election of remedies defense consists of three elements: (1) the existence of two or more remedies; (2) an inconsistency between them; and (3) a choice of one of the remedies. Reid v. Hansen, 440 N.W.2d 598, 600 (Iowa 1989); In re Hegg, No. 95-62467KW; Adv. 96-6034KW, slip op. at 5 (Bankr. N.D. Iowa Sep. 30, 1996).

A mortgagee who sues on a note is not precluded under the doctrine of election of remedies from pursuing the security

by way of foreclosure. Gayle, 189 B.R. at 918. No double recovery is sought by obtaining a judgment on a note and later proceeding against the collateral when the judgment remains unsatisfied. Id. at 919. A similar analysis is relevant regarding the doctrine of merger. Id. at 920.

The law of the doctrine of merger is well settled in Iowa. United States v. Peckham, 72 F.3d 672, 674 (8th Cir. 1995). "Under this doctrine, a mortgagee who obtains an in rem judgment is limited to the terms of that judgment and cannot subsequently pursue an in personam judgment on the underlying obligation." Id. This is not to say, however, that a mortgagee is prevented from maintaining a personal judgment against the debtor on the note and, following judgment, foreclosing the mortgage. Farm Credit Bank v. Faught, 492 N.W.2d 422, 424 (Iowa 1992).

A mortgage may be foreclosed after a judgment has been entered on the note. Warnecke v. Foley, 11 N.W.2d 457, 459 (Iowa 1943). In this situation, the mortgage remains a lien, subject to foreclosure, until the debt it was given to secure is satisfied. Faught, 492 N.W.2d at 424. The mortgagee retains the right to enforce the lien or gain possession of collateral property. Brenton State Bank v. Tiffany, 440 N.W.2d 583, 585 (Iowa 1989).

Thus, it is the rule in Iowa that the lien of a mortgage is not merged in the judgment. See In re Miller, 8 B.R. 672, 674 (Bankr. N.D. Iowa 1981) (holding mortgage lien survives foreclosure judgment). Obtaining a judgment is not a per se waiver of the mortgage lien. In re Bertram, 8 B.R. 669, 671 (Bankr. N.D. Iowa 1981). A judgment on the mortgage does not convert the consensual mortgage lien into a judgment lien avoidable under 522(f). In re Sinnard, 91 B.R. 850, 854 (Bankr. N.D. Iowa 1988). Because consentuality still exists, the mortgage lien is not subject to avoidance. Bertram, 8 B.R. at 671. Judgment liens are avoidable under 522(f)(1), not mortgage liens voluntarily granted. In re Sweeting, 151 B.R. 322, 323 (Bankr. W.D.N.Y. 1992).

The Court concludes that by obtaining a judgment on the underlying promissory note, the Bank did not elect a remedy which prohibits enforcement of its mortgage. The judgment on the note did not extinguish the Bank's mortgage lien. The mortgage lien, which thereby survives the judgment on the note, is not avoidable under 522(f)(1).

VALIDITY OF MORTGAGE

Debtor also urges that the mortgage should be voided for lack of consideration or negligent misrepresentation in the inducement of the mortgage. The Bank correctly points out that an adversary proceeding is the correct vehicle for determining the validity of a lien. In re Hill, 166 B.R. 444, 445 (Bankr. D.N.M. 1993); Fed. R. Bankr. P. 7001(2). Where a party has proceeded by motion and the record has been adequately developed, however, courts have reached the merits of the dispute despite the procedural irregularity. In re Braniff Int'l Airlines, Inc., 164 B.R. 820, 831 (Bankr. E.D.N.Y. 1994), aff'd 1996 WL 313889 (2d Cir. 1996) (unpublished). The Court concludes the record has been adequately developed in this matter and will address these remaining contentions.

The burden of proof is on Debtor to show a failure of consideration for the Bank's mortgage. Northwestern Nat'l Bank v. Verschoor, 230 N.W.2d 505, 507 (Iowa 1975). A precedent obligation is adequate consideration for a mortgage. Sinnard v. Roach, 414 N.W.2d 100, 107 (Iowa 1987). Retention of a lender as a source of credit in exchange for a mortgage to "shore up" its collateral further benefits a debtor and constitutes additional consideration. Griswold State Bank v. Milne, 416 N.W.2d 109, 112 (Iowa App. 1987). A lender's forbearance in proceeding against collateral can also constitute consideration in granting a mortgage. Sinnard, 414 N.W.2d at 107.

Based on the foregoing, the Court concludes that Debtor has failed to show a lack of consideration for the 1991 mortgage. Precedent obligations obviously existed. The Bank wished to shore up its collateral position and agreed to forebear on collection in exchange for the mortgage. Debtor also benefitted by having lower monthly payments when the two previous loans were consolidated. The consideration given for the mortgage is sufficient.

Debtors assert that the mortgage is invalid because the Bank's negligent misrepresentation concerning the status of the guarantee induced them to sign the mortgage. The tort of negligent misrepresentation applies only to those defendants in the profession or business of supplying information or opinions. Freeman v. Ernst & Young, 516 N.W.2d 835, 838 (Iowa 1994). Such a claim is not actionable against officers of a bank where the alleged misrepresentations are made during arms's-length negotiations between the bank officers and one of the bank's customers. Id.; Haupt v. Miller, 514 N.W.2d 905, 910 (Iowa 1994); Budget Mktg., Inc. v. Centronics Corp., 927 F.2d 421, 428 (8th Cir. 1991) (rejecting claim where parties negotiated a commercial transaction at arm's length).

The Court concludes that the loan consolidation transaction, including the execution of the mortgage on Debtor's homestead constitutes an arm's length transaction. The Bank was not engaged in supplying guidance to Debtors at the time; it was negotiating a business loan. Debtors may not claim that the Bank committed negligent misrepresentation in this situation. Even if the Court were to consider the merits of this argument, the factual record does not support a finding of misrepresentation by the Bank.

If Debtors are asserting the Bank committed fraud in the inducement, they have the burden to prove all seven elements of fraud by clear, satisfactory and convincing evidence. Citizens Savs. Bank v. Wild, 512 N.W.2d 799, 802 (Iowa App. 1993). The elements of fraud are (1) material (2) false (3) representation coupled with (4) scienter and (5) an intent to deceive, which the other party (6) relies upon with (7) resulting damages to the relying party. Sinnard, 414 N.W.2d at 105 n.1; Wild, 512 N.W.2d at 802. The first three elements are referred to as fraudulent misrepresentation: a material representation that is false. Sinnard, 414 N.W.2d at 105.

Debtors argue that the Bank induced them to sign the mortgage on their homestead by misrepresenting the status of the guarantee made by Robert and Wanda Worley. They state that they were under the impression that the mortgage was necessary to protect Robert and Wanda Worley from enforcement of the guarantee and because of other consequences related to an SBA loan application. Debtors argue that the Bank's misrepresentation in the inducement of the mortgage precludes the enforcement of the mortgage lien.

The Court concludes that Debtors have failed to establish the defense of fraud in the inducement by clear, satisfactory and convincing evidence. The Bank required the mortgage to shore up its collateral position, in part because of the cancellation of the guarantee. It is immaterial that the guarantee was canceled in 1990 and the mortgage was executed in 1991. Debtors have not proven that the Bank intended to deceive Debtors regarding the status of the guarantee at the time Debtors signed the mortgage.

SUMMARY

Based on the foregoing, the Court concludes that the judgment lien arising from the Bank's judgment on the note is avoidable under 522(f). The mortgage lien survives the judgment and is not avoidable under 522(f). The mortgage is based on adequate consideration. Debtors may not assert a claim of negligent misrepresentation against the Bank in this situation. They have failed to prove fraud in the inducement of the mortgage. The Bank's mortgage lien is enforceable.

WHEREFORE, the Bank's judgment lien is avoided.

FURTHER, the Bank's mortgage lien survives the judgment and is not avoidable.

SO ORDERED this 10th day of December, 1996.

Paul J. Kilburg

U.S. Bankruptcy Judge