IN THE COURT OF APPEALS OF IOWA

No. 3-1052 / 13-0060
Filed January 9, 2014

LUANA SAVINGS BANK,
Plaintiff-Appellant,

vs.

PRO-BUILD HOLDINGS, INC., Successor in Interest to UNITED BUILDING CENTERS,
Defendant-Appellee.

Appeal from the Iowa District Court for Allamakee County, John J. Bauercamper, Judge.

The plaintiff appeals, and the defendant cross-appeals, from the district court's entry of partial summary judgment in favor of the defendant. **AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.**

Dale L. Putnam, Decorah, for appellant.

Samuel C. Anderson of Swisher & Cohrt, P.L.C., Waterloo, for appellee.

Heard by Danilson, C.J., and Vaitheswaran and Potterfield, JJ.

VAITHESWARAN, J.

This appeal and cross-appeal raise two issues: (A) whether the doctrine of breach of implied warranty of workmanlike construction should be extended to benefit a lender and (B) whether a lender is a third-party beneficiary of a construction contract.

I. Background Facts and Proceedings

Residential developers Ronald and Karen Wahls were the principals of RO-KA Acres, Inc. The company borrowed money from Luana Savings Bank to purchase farmland near Postville. The bank secured the line of credit with an open-ended real estate mortgage.

RO-KA platted the farmland and contracted to sell several lots to a company called Amereeka. Meanwhile, RO-KA defaulted on its payments to Luana Savings Bank and assigned Amereeka's payments under the real estate contract to the bank. The bank, in turn, agreed to forgo collection efforts against RO-KA.

Around the same time, RO-KA agreed to "act as the agent of Amereeka to manage, operate and maintain" certain existing apartments on the land it sold to Amereeka. RO-KA also agreed to manage any additional apartments that might be built.

At issue in this proceeding are Lots 15 and 16, which RO-KA contracted to sell to Amereeka. After the real estate contract was executed but before the deed was issued, Ronald Wahls, the "RO" in "RO-KA," individually contracted

with the predecessor of Pro-Build Holdings, Inc.[1] to construct two apartment buildings on Lots 15 and 16. The construction contract was financed by Amereeka, which obtained a loan from Luana Savings Bank. To secure the loan, the bank obtained a mortgage and assignment of Amereeka's interest in the real estate contract with RO-KA.[2]

Eventually, Amereeka defaulted on its loan with the bank and transferred Lots 15 and 16 to Luana Savings Bank via a deed in lieu of foreclosure. Situated on the lots were the two apartment buildings constructed by Pro-Build. The bank found mold and other problems with the apartments, which it attributed to Pro-Build.

Luana Savings Bank sued Pro-Build, raising claims of negligence, breach of implied warranty of workmanlike construction, and breach of contract. Pro-Build moved for summary judgment. Following a hearing, the district court granted summary judgment in favor of Pro-Build on the negligence and breach of implied warranty counts, but denied summary judgment on the breach of contract claim.

Luana Savings Bank sought interlocutory review of the district court's grant of partial summary judgment, and Pro-Build filed a resistance and conditional application for interlocutory appeal of the court's denial of summary judgment. The Iowa Supreme Court granted both applications and transferred the case to this court for disposition.

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[1] The predecessor was United Building Centers.

[2] The loan proceeds were actually paid to a related company, Nevel Properties Corporation.

We must determine whether there is a genuine issue of material fact that precludes summary judgment on the implied warranty and breach-of-contract claims and whether Pro-Build is entitled to judgment as a matter of law on those claims. *See Bierman v. Weier*, 826 N.W.2d 436, 443 (Iowa 2013).

II. Analysis

A. Breach of Implied Warranty

In *Kirk v. Ridgway*, 373 N.W.2d 491, 493-94 (Iowa 1985), the Iowa Supreme Court recognized that "a purchaser of a new home from a builder-vendor should be protected against latent defects in the home and that our law of real estate should accommodate a rule of implied warranty commensurate with our law of consumer protection in other areas." The court enunciated the following elements of recovery:

> (1) the house was constructed to be occupied by the warrantee as a home;
> (2) the house was purchased from a builder-vendor[3], who had constructed it for the purpose of sale;
> (3) when sold, the house was not reasonably fit for its intended purpose or had not been constructed in a good and workmanlike manner;
> (4) at the time of purchase, the buyer was unaware of the defect and had no reasonable means of discovering it; and

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[3] The court defined "builder-vendor" as:

> [A] person who is in the business of building or assembling homes designed for dwelling purposes upon land owned by him, and who then sells the houses, either after they are completed or during the course of their construction, together with the tracts of land upon which they are situated, to members of the buying public.
>
> The term "builder" denotes a general building contractor who controls and directs the construction of a building, has ultimate responsibility for a completion of the whole contract and for putting the structure into permanent form thus, necessarily excluding merchants, material men, artisans, laborers, subcontractors, and employees of a general contractor.

Kirk, 373 N.W.2d at 496.

> (5) by reason of the defective condition the buyer suffered damages.

Kirk, 373 N.W.2d at 496.

The court later extended the implied warranty of workmanlike construction to subsequent purchasers of a home. *See Speight v. Walters Dev. Co.*, 744 N.W.2d 108, 115-16 (Iowa 2008). The court reasoned, "It is inequitable to allow an original purchaser to recover while, simultaneously, prohibiting a subsequent purchaser from recovering for latent defects in homes that are the same age." *Id.* at 114-15.

Luana Savings Bank is neither a purchaser nor a subsequent purchaser of a home. Accordingly, the bank cannot invoke the implied warranty doctrine recognized and expanded by the Iowa Supreme Court.

Acknowledging this hurdle, the bank invites us to expand the doctrine to include "protection to multi-unit residential dwellings, as well as protection to a consumer lender providing funds to build a multi-unit dwelling for occupancy as a residence." We decline that invitation. *See id.* at 110 (acknowledging our court's express refusal to extend the doctrine in favor of deferring such a decision to our supreme court). We conclude the district court did not err in granting summary judgment in favor of Pro-Build on Luana's breach of implied warranty claim.

B. Breach of Contract

In its petition, Luana Savings Bank alleged that "Plaintiff's predecessor," which all agree was Amereeka, had an oral construction contract with Pro-Build's predecessor. The bank further alleged that Pro-Build "failed to comply with the

oral contract by failing to properly construct" the apartments, and the bank suffered damages as a result.

Pro-Build denied the allegation and moved for summary judgment on the ground that there was "no allegation . . . [Pro-Build] breached any contract with [the bank] and [Pro-Build] breached no duty to [the bank]." The district court determined that the bank "may be considered to be a third-party beneficiary of [Pro-Build]'s contract with Ronald Wahl to construct the apartments," and stated, "The fighting issue is whether the contract shows an intent to benefit [Luana] as a third-party." The court further stated:

> Because [the bank] alleges that [Pro-Build] knew that [the bank] was financing the payments for [Pro-Build's] work on the building, that the [bank] would receive a mortgage on the building in exchange for providing the financing, and that [the bank] was relying on the building to serve as collateral to guarantee repayment of the construction loan and mortgage, factual issues exist on the issue of whether the contract shows an intent to benefit [the bank] as a third party.

Pro-Build contends the court should have granted judgment as a matter of law on the breach-of-contract claim because, in its view, "there is nothing in the contract between Pro-Build and Wahls either directly or indirectly indicating an intent to benefit [the bank]." Pro-Build cites the elements of a third-party beneficiary claim set forth in *Midwest Dredging Co. v. McAninch Corp.*, 424 N.W.2d 216, 224 (Iowa 1988). There, the Iowa Supreme Court adopted section 302 of the Restatement (Second) of Contracts concerning intended and incidental third-party beneficiaries. *Midwest* Dredging, 424 N.W.2d at 224. That section provides:

> (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of

> a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
>
> > (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
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> > (b) the circumstances indicated that the promisee intends to give the beneficiary the benefit of the promised performance.
>
> (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

Restatement (Second) Contracts § 302 (1981).

As the district court noted, "The primary question in a third-party beneficiary case is 'whether the contract manifests an intent to benefit the third party claiming enforceable rights under the contract.'" *RPC Liquidation v. Iowa Dep't of Transp.*, 717 N.W.2d 317, 319 (Iowa 2006) (quoting *Midwest Dredging*, 424 N.W.2d at 224). In determining intent, we look "to the language of the contract and to the circumstances surrounding it." *RPC Liquidation*, 717 N.W.2d at 320.

The construction contract Pro-Build executed with Wahls does not mention the bank. *See Bagelmann v. First Nat'l Bank*, 823 N.W.2d 18, 33 (Iowa 2012) ("A third-party beneficiary claim requires that the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance. This one-page document does not include a promise that IBMC would provide flood hazard determinations, let alone indicate that such determinations would be for the benefit of the Bagelmanns."); *Annett Holdings, Inc. v. Kum & Go, L.C.*, 801 N.W.2d 499, 507 (Iowa 2011) (stating that although a contract imposed "detailed processing requirements on Kum & Go, it did not indicate those requirements were to benefit Annett [as a third-party beneficiary]").

Under the terms of the contract, therefore, Luana Savings Bank is not an intended beneficiary.

This does not end our discussion because Luana Savings Bank argues that surrounding circumstances create genuine issues of material fact on whether the construction contract was intended to benefit it. *See* Restatement (Second) Contracts § 302 (1)(b). The bank points to several documents in support of this assertion, all of which were executed around the time of the Wahls/Pro-Build construction contract.

The first is the management agreement that stated Wahls, as principal of RO-KA, would manage Amereeka's properties. The second is the promissory note between the bank and Amereeka to finance the Wahls/Pro-Build construction contract. The third is the assignment of the real estate contract between RO-KA and Amereeka, which included an assignment of payments due under that contract. The final document is the bank's mortgage securing the Amereeka note.

Based on these documents, the bank argues that Wahls acted as Amereeka's agent when he signed the contract with Pro-Build and "all parties (Wahls, Amereeka, and RO-KA) were providing [the bank] with valuable consideration in the way of assignments and security interests to obtain the financing to build the apartment complexes." The bank asserts that by providing this "valuable consideration" the parties to the construction contract intended the bank to be a beneficiary. Pro-Build counters that the bank was simply a lienholder rather than an intended beneficiary of the construction contract. Pro-Build is correct.

"A third party who is not a promisee and who gave no consideration has an enforceable right by reason of a contract made by two others . . . if the promised performance will be of pecuniary benefit to [the third party] and the contract is so expressed as to give the promisor reason to know that such benefit is contemplated by the promisee as one of the motivating causes of his making the contract." *Vogan v. Hayes Appraisal Assocs., Inc.*, 588 N.W.2d 420, 423-24 (Iowa 1999) (citations omitted).

In this case, the promised performance was the construction of the apartment buildings on Lots 15 and 16. As discussed, those lots served as security for Amereeka's bank loan. The bank tangentially stood to gain from the construction project because its security interest extended to rents collected on the apartments. But, even if the rents could be construed as a "pecuniary benefit" that flowed from the construction contract to the bank, nothing in the construction contract gave Pro-Build (the promisor) "reason to know that such benefit" was contemplated by Wahls (the promisee) "as one of the motivating causes of his making the contract." *See id.*; *see also Tredrea v. Anesthesia & Analgesia, P.C.*, 584 N.W.2d 276, 281 (Iowa 1998) (defining "promisor" as the party sought by a third party to be bound by the agreement" and "promisee" as the party that stood to benefit from contract); *Midwest Dredging*, 424 N.W.2d at 224 ("The focus in Restatement (Second) of Contracts section 302(1)(b) is clearly on the promisee's intent as indicated by the circumstances."). Wahls, through his company RO-KA, sold Lots 15 and 16 to Amereeka and assigned the contract sale proceeds to the bank in satisfaction of the debt it owed the bank. The bank, in turn, released its lien on RO-KA's interest in Lots 15 and 16. Wahls

and the bank, therefore, resolved their creditor/debtor relationship independently of the construction contract. Given that fact, Wahls had no reason to afford the bank an additional benefit through the construction contract with Pro-Build.

Even if Wahls was acting as agent for Amereeka when he executed the construction contract with Pro-Build, there is still nothing to suggest Amereeka entered into the contract to enhance the value of Luana Savings Bank's security interest in the property or to otherwise benefit Luana Savings Bank. Amereeka simply wanted to build apartments with the assistance of bank financing. The bank's loan to Amereeka was protected by virtue of its security interest in the property. Assuming that protection could be construed as a "pecuniary benefit," it did not derive from the Wahls/Pro-Build construction contract, but was a normal incident of the bank's lending business.

Amereeka's assignment made that clear. Amereeka assigned the real estate contract to the bank to "secure" its loan from the bank. Ameereka assigned the bank its payments owing to RO-KA to satisfy RO-KA's obligation under a separate note with the bank, thereby ensuring the bank would obtain a valid security interest in the underlying real estate. There is no indication that the payments were made to elevate the bank to something more than a secured creditor. *Cf. Bridgman v. Curry*, 398 N.W.2d 167, 171 (Iowa 1986) (finding contract sellers of real estate were third-party beneficiaries of assignment contract between contract buyers and joint venturers where assignment contract stated assignees would be bound by terms of real estate contract).

In sum, the bank did nothing more than finance the construction project by providing a loan to Amereeka and Amereeka did nothing more than execute the

necessary paperwork to give the bank a valid security interest in Lots 15 and 16. The bank had a right to enforce its security agreement with Ameereka. It had no right to enforce the construction contract against Wahls or Pro-Build. *See Norwest Fin. Leasing, Inc. v. Morgan Whitney, Inc.*, 787 F. Supp. 895, 899 (D. Minn. 1992) (holding the bank that financed a purchase agreement was "merely a lienholder" and any benefits it obtained were "merely incidental to the purchase agreement"). The bank was not an intended beneficiary of the Wahls/Pro-Build contract and Pro-Build was entitled to judgment as a matter of law on the breach-of-contract claim.

We affirm the district court's grant of summary judgment on the implied warranty claim and reverse the district court's denial of summary judgment on the breach-of-contract claim. We remand for entry of judgment of dismissal against Luana Savings Bank.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

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