

**IN THE COURT OF APPEALS OF IOWA**

No. 7-829 / 06-1541  
Filed December 28, 2007

**JANICE A. MEINCKE,**  
Plaintiff-Appellant,

**vs.**

**NORTHWEST BANK & TRUST COMPANY**  
**and SCRAMM ENTERPRISES, L.C.,**  
Defendants-Appellees.

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**NORTHWEST BANK & TRUST COMPANY,**  
Cross-Claimant,

**vs.**

**SCRAMM ENTERPRISES, L.C.,**  
Cross-Defendant.

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**NORTHWEST BANK & TRUST COMPANY,**  
Third-Party Plaintiff,

**vs.**

**SANDRA R. MARTI and C.A. MEINCKE**  
**PLUMBING, INC.,**  
Third-Party Defendant.

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Appeal from the Iowa District Court for Scott County, Mark D. Cleve,  
Judge.

Plaintiff appeals the trial court's judgment in favor of the defendant.

**REVERSED.**

Timothy L. Baumann, Christopher L. Surls, and William B. Norton of Wm. B. Norton Law Firm, P.C., Lowden, for appellant.

Michael J. McCarthy, McCarthy, Lammers & Hines Law Firm, Davenport, for appellee.

Heard by Sackett, C.J., and Vaitheswaran and Baker, JJ.

**SACKETT, C.J.**

Plaintiff-appellant, Janice Meincke, appeals the trial court's ruling in favor of defendant-appellee, Northwest Bank & Trust Company (Northwest Bank). Plaintiff urges us to reconsider existing precedent concerning whether a party may prevent enforcement of a financing agreement due to a defective acknowledgment. Plaintiff also contends the trial court erred by (1) finding the subordination agreement between the plaintiff and Northwest Bank was supported by consideration, (2) finding that Northwest Bank did not intentionally interfere with plaintiff's contractual relations with the debtor, and (3) denying plaintiff's motion to amend her pleadings to conform to the evidence. We reverse finding no consideration to support the contract.

**I. BACKGROUND.**

This case involves a family's financially troubled businesses and the debt the businesses incurred from an elderly family member and from two banks. C.A. Meincke Plumbing and Scramm Enterprises are owned by Sandra Marti and Craig Meincke. The plaintiff is Sandra's mother and is Craig's aunt. She is eighty-two years old. In July 2002, Sandra and Craig approached the plaintiff for a loan for the businesses. At the time, the plaintiff's husband was in the hospital and in very poor health. Sandra and Craig visited the hospital and made the request. The plaintiff and her husband initially refused to give the loan. After Sandra and Craig told them they would go bankrupt without the money, the plaintiff loaned Scramm Enterprises \$90,000. The plaintiff's husband died two months after the loan was made. To secure the loan, Scramm gave the plaintiff a mortgage on the business's land and buildings. Scramm had already granted

two mortgages on this property to secure loans from Rock Island Bank. Sandra and Craig had also mortgaged their personal homes to secure loans to the businesses.

James Legare was a loan officer at Rock Island Bank who worked with Craig and Sandra to obtain financing for the businesses. At some point, James Legare began working for Northwest Bank and eventually became vice president. He also helped the businesses obtain loans through this bank. In 2003, Scramm obtained loans from Northwest Bank and granted yet another mortgage on the property. The record shows a pattern of financial difficulty for the businesses. The businesses sought, and Northwest Bank approved, continual loan renewals and extensions, loans for paying suppliers, and loans to pay off other lenders. In 2003 and 2004 the businesses' payments on various loans were late over thirty times. In 2004, Sandra and Craig sought another loan from Northwest Bank. The loan was needed primarily to pay the balance owed to Rock Island Bank because these loans were due and Rock Island Bank refused to renew the loans. Northwest Bank agreed to provide these funds on the condition that Northwest Bank acquired the first lien on the mortgaged property.

At this time, Rock Island Bank had first priority to the property, the plaintiff had second priority, and Northwest Bank had third priority. If Northwest Bank expended the funds owed to Rock Island Bank, the plaintiff would have first priority and Northwest Bank would have second priority. To protect its financial interest, Northwest Bank would not provide additional funding unless the plaintiff was willing to subordinate her priority position to Northwest Bank.

At trial, Sandra testified that she knew a subordination agreement was required but never discussed this or any financial matters of the businesses with the plaintiff. The plaintiff testified that Craig called her saying "I had to sign this paper to be second in line." A Northwest Bank employee drafted a subordination agreement and Craig went with the bank's vice president, James Legare, to the plaintiff's house to get her signature. Legare said hello to the plaintiff but no one discussed the agreement. Legare testified that he believed Craig had already explained the agreement to the plaintiff. The plaintiff signed the agreement. A notary was not present at the signing. Legare had the agreement notarized at a later time. The plaintiff was not present when it was notarized.

After the subordination agreement was obtained, Northwest Bank made two loans to the businesses in March of 2004, issuing funds on behalf of the businesses in the amount of approximately \$716,907. Of this amount, approximately \$474,500 was paid for the Rock Island Bank loans. Approximately \$242,000 was applied to refinance other Northwest Bank Loans. Sandra testified that this was a refinancing transaction and none of these funds were actually paid directly to the businesses. Jim Legare testified, and the banking documents show, that the transaction also provided another \$4,000 in a line of credit to the businesses. It appears the businesses drew approximately \$2,209 from this line of credit two days after the loan was made.

Approximately two months later, the plumbing business ceased operations because of financial problems. In 2005, Scramm and Northwest Bank entered into an agreement for non-judicial foreclosure. The mortgaged property was sold. Due to the subordination agreement, the proceeds from the sale were

applied to the Northwest Bank loans first. The proceeds were insufficient to repay the total owed to Northwest Bank and consequently, the plaintiff received nothing toward the debt owed her. The plaintiff filed suit against Northwest Bank claiming, among other things, the subordination agreement was invalid and Northwest Bank intentionally interfered with the plaintiff's contract with Scramm Enterprises. At the close of the evidence at a bench trial, the plaintiff moved to amend her pleadings to conform to the evidence, seeking to add a claim of fraud. The trial court denied this motion and ruled in favor of the defendant on all counts. The plaintiff appeals the trial court's rulings.

## **II. STANDARD OF REVIEW.**

Claims based on a contract tried at law are reviewed for correction of errors at law. Iowa R. App. P. 6.4; *Equity Control Assocs., Ltd. v. Root*, 638 N.W.2d 664, 670 (Iowa 2001). The trial court's fact findings are binding upon us if they are supported by substantial evidence and we view the findings in a light most favorable to upholding the ruling. *Equity Control Assocs.*, 638 N.W.2d at 670. We reverse if there is an erroneous application of the law. *Id.*

## **III. CONSIDERATION.**

The plaintiff contends the trial court erred in finding the subordination agreement was supported by consideration. We must determine whether substantial evidence supports this finding. *Id.* A subordination agreement is generally governed by the rules of contract law. 68A Am. Jur. 2d *Secured Transactions* § 741 (2007). "We presume a written, signed agreement is supported by consideration." *Kristerin Dev. Corp. v. Granson Inv.*, 394 N.W.2d 325, 331 (Iowa 1986); see also Iowa Code § 537A.2. "Either a benefit to a

promisor or a detriment to a promisee constitutes consideration.” *Doggett v. Heritage Concepts, Inc.*, 298 N.W.2d 310, 311 (Iowa 1980). There is consideration even if the benefit flows to a third party. *Clayman v. Bibler*, 210 Iowa 497, 500, 231 N.W. 334, 336 (1930); *Moench v. Hower*, 137 Iowa 621, 624, 115 N.W. 229, 230 (1908). We determine whether there is consideration from what is stated in the instrument or by what was contemplated by the parties at the time of the agreement. *Hubbard Milling Co. v. Citizens State Bank*, 385 N.W.2d 255, 259 (Iowa 1986); *Lane v. Richards*, 119 Iowa 24, 26-27, 91 N.W. 786, 787 (1902). The further extension of credit can serve as consideration in a subordination agreement. One treatise explains,

An agreement subordinating a senior mortgage to a junior one is supported by consideration where the agreement is based on a conviction that further advances from the junior mortgagee would not be possible without the agreement, and that these future advances are necessary to carry on operations on the land to prevent the senior mortgage debt from being lost.

55 Am. Jur. 2d *Mortgages* § 320 (2007) (citing *Stockmeyer v. Tobin*, 139 U.S. 176, 189, 11 S. Ct. 504, 509, 35 L. Ed. 123, 128 (1891)).

However, a party to a subordination agreement can use the failure of consideration or lack of consideration as a defense to invalidate the contract. Iowa Code § 537A.3; *Hubbard Milling Co.*, 385 N.W.2d at 259. In *Hubbard Milling*, the court invalidated a subordination agreement for failure of consideration. *Hubbard Milling Co.*, 385 N.W.2d at 259. The purported consideration stated in the agreement was a bank’s promise to subordinate to another creditor in exchange for that creditor’s promise to loan a farmer funds to purchase pig feed. *Id.* at 257, 259. The creditor never loaned the funds and no pig feed was purchased so the consideration failed. *Id.* at 259. The Eighth

Circuit has also invalidated a subordination agreement on the ground that it lacked consideration. *In re Sepco*, 750 F.2d 51, 53 (8th Cir. 1984). Consideration was lacking when the subordination clause was hidden, the creditor failed to explain the effect of the clause, and no benefit was provided to the subordinating creditor besides assurance it would get paid. *In re Sepco, Inc.*, 36 B.R. 279, 286 (Bkrctcy. S.D. 1984).

The trial court found there was some consideration for the subordination agreement. It ruled that the plaintiff benefited by helping her relatives. The family businesses benefited because the refinancing provided by Northwest Bank allowed the businesses to continue operating at a lower monthly cost by reducing Scramm's monthly loan payments. The court also found Northwest Bank suffered a detriment through the agreement by loaning additional funds. The trial court explained, "[t]he fact that the Plaintiff's secured position on her mortgage was worsened as a result of the subordination agreement and the new loans in no way affects the outcome of the consideration issue."

Although the court properly analyzed the transaction to identify a potential benefit or detriment to serve as consideration, we find the court erred in failing to identify whether, in fact, this consideration was bargained for and contemplated by the parties at the time of the transaction. "Consideration requires the voluntary assumption of an obligation by one party *on the condition* of an act or forbearance by the other." *Summerhays v. Clark*, 509 N.W.2d 748, 751 (Iowa 1994) (emphasis added). If a detriment to a party is serving as the consideration, "it must appear that the disadvantage was suffered *at the request of* the promisor, express or implied." *Heggen v. Clover Leaf Coal & Mining Co.*, 217

Iowa 820, 824, 253 N.W. 140, 142 (1934) (emphasis added). These cases illustrate the requirement of reciprocal inducement or a bargained for exchange for a finding of consideration. Comments to the Restatement (Second) of Contracts explains:

[T]he law is concerned with the external manifestation rather than the undisclosed mental state: it is enough that one party manifests an intention to induce the other's response and to be induced by it *and* that the other responds in accordance with the inducement. But it is not enough that the promise induces the conduct of the promisee *or* that the conduct of the promisee induces the making of the promise; both elements must be present, or there is no bargain. Moreover, a mere pretense of bargain does not suffice, as where there is a false recital of consideration or where the purported consideration is merely nominal.

Restatement (Second) of Contracts § 71, comment b, at 173 (1981) (emphasis added). Parties may have additional motives and other factors may induce a party's performance. Restatement (Second) of Contracts § 81, and comments a and b, at 206 (1981). However, both parties must manifest an intent to induce the other and be induced by the transaction for there to be bargained for consideration. Restatement (Second) of Contracts § 81, comment a, at 206 (1981).

It is the bargained for exchange requirement that is lacking in this transaction. There is no consideration stated in the instrument to identify what exchange was contemplated by the parties. The record shows no indication that the plaintiff subordinated her priority to induce Northwest Bank to make additional loans to the businesses. The plaintiff testified that she signed the agreement to get her money back. She stated that she really did not think of it as helping Craig and Sandra but conceded it may have benefited Craig and Sandra since they asked her to do it. It is clear that the plaintiff did not understand what was

occurring in the transaction and did not contemplate a bargained exchange. In fact, the record shows that the plaintiff was unaware of any other loans or mortgages to the property. According to the plaintiff, she signed the paper to be “second in line.” The testimony suggested that the plaintiff was not aware of her priority before she signed the subordination agreement. She simply believed she needed to sign the paper to obtain the funds owed to her from the sale of the business property. Of particular concern is the plaintiff’s apparent lack of knowledge about the final loan made to the businesses by Northwest Bank. Although this final loan was supposed to be the inducement for the plaintiff’s promise to subordinate, there is no evidence in the record that the plaintiff even knew that her signing the subordination agreement was a condition precedent to the businesses obtaining this funding. Under these circumstances, we find substantial evidence does not support a finding that this contract was supported by consideration. Rather, the subordination agreement is invalid due to a lack of consideration.

Given our resolution on this issue, we need not address the other claims of error. We reverse the trial court’s ruling and hold as a matter of law, the subordination agreement is invalid due to a want of consideration.

**REVERSED.**