IN THE COURT OF APPEALS OF IOWA

No. 2-851 / 12-0577
Filed March 13, 2013

MANUFACTURERS BANK & TRUST COMPANY, Lake Mills, Iowa,
Appellant,

vs.

CLEMENCE WEBER,
Appellee.

Appeal from the Iowa District Court for Winnebago County, Bryan H. McKinley, Judge.

A bank contends that the district court erred in finding in favor of a borrower on his counterclaims for breach of fiduciary duty and fraud after he was sued by the bank to recover an unpaid balance on a loan. **AFFIRMED.**

David J. Siegrist of Siegrist & Jones, P.C., Britt, for appellant.

Ralph Smith of Noah, Smith & Schuknecht, Charles City, for appellee.

Heard by Eisenhauer, C.J., and Vogel and Vaitheswaran, JJ.

VAITHESWARAN, J.

We must decide whether the district court erred in finding in favor of a bank borrower on his counterclaims for breach of fiduciary duty and fraud.

I. Background Facts and Proceedings

Clemence Weber bought, improved, and sold properties for a living. He banked at Manufacturers Bank & Trust in Lake Mills, Iowa. Weber knew the community president of the bank, Randall Finer, and extended a personal loan to him in 2003. Weber also knew and did business with James Wangsness, another customer of the bank.

In 2007, Finer suggested Weber borrow $150,000 from the bank and use the money to assist Wangsness with the improvement of certain properties. Finer made the suggestion because Wangsness was reaching his borrowing capacity with the bank. Weber agreed to the transaction.

Weber's bank loan was reflected by a signed promissory note. The note was secured by "the collateral pledged on Mortgage(s) executed by Borrower and Guarantor(s), if any, including, but not limited to, said Mortgage(s) dated 11/30/05, 4/13/08, 8/1/08, and 7/18/07." The listed mortgages were not on property owned by Weber but on properties owned by Wangsness. Wangsness executed a hypothecation agreement with the bank authorizing these mortgages to be pledged as collateral for the $150,000 note. [1]

According to Wangsness, he and Weber separately agreed that Wangsness would pay a portion of the principal, would keep the interest on

[1] The hypothecation agreement authorized the pledging of the mortgages as security rather than the underlying real estate. Weber had no interest in the mortgages or the underlying properties.

Weber's note current, and would pay Weber $5000 for each property that was improved with loan proceeds provided by Weber. Wangsness testified that this oral agreement was finalized in Finer's presence. Finer stated that he was aware of the agreement but was not involved in consummating it.

Weber defaulted on the note and the bank sued him to recover the unpaid balance. Weber raised several affirmative defenses and counterclaims, among them breach of fiduciary duty and fraud claims. Following trial, the district court found in favor of Weber on these counterclaims. The court dismissed the bank's petition, finding Weber's signature on the note was not voluntary. On appeal, the bank contends the court's ruling was erroneous.

II. Scope of Review

As a preliminary matter, the parties disagree on our scope of review, with the bank contending it is de novo and Weber contending it is at law. As the case was styled a law action and was tried as a law action, with the court ruling on objections, we conclude our review is on error. *In re Matter of Mt*. *Pleasant Bank & Trust Co*., 426 N.W.2d 126, 129 (Iowa 1988). The court's fact-findings bind us if supported by substantial evidence. *Id*.

III. Breach of Fiduciary Duty

"[A fiduciary relationship] exists when there is a reposing of faith, confidence and trust, and the placing of reliance by one upon the judgment and advice of the other." *Kurth v*. *Van Horn*, 380 N.W.2d 693, 695–96 (Iowa 1986) (quoting Black's Law Dictionary 564 (5th ed. 1979)). "As a general rule, . . . a fiduciary duty or confidential relationship does not arise solely from a bank-depositor relationship." *Id.* at 696; *see also Curtis v*. *Armagast*, 138 N.W. 873,

878 (Iowa 1912) (stating terms "fiduciary" and "confidential" relationships are used interchangeably). Because bank services to any particular customer will vary, the facts and circumstances of each case are important in deciding whether a fiduciary or confidential relationship exists. *Kurth*, 380 N.W.2d at 696. "A fiduciary who commits a breach of his duty as a fiduciary is guilty of tortious conduct to the person for whom he should act." Restatement (Second) of Torts § 874(b) (1979).

The district court relied on the following evidence to support its conclusion that the bank had a fiduciary relationship with Weber: (1) Finer's solicitation of a personal loan from Weber, in contravention of bank policy; (2) Finer's utilization of bank documents to reflect that loan; (3) Finer's request that Weber keep the personal transaction secret; (4) Finer's request that Weber not record the mortgage purportedly securing the personal loan; (5) Finer's failure to disclose that the mortgage involved in the personal transaction was a second mortgage; (6) Weber's acquiescence in this conduct, calling into question his "sound business and independent judgment"; (7) the testimony of the bank's expert acknowledging "the significance of this personal transaction in creating a relationship [of] trust, vulnerability and power disparity"; (8) Finer's acquisition of "behavioral insights" into Weber's "submissive tendencies" that aided him in the 2007 loan transaction; and (9) the testimony of Weber's tax accountant, who noticed a change in Weber's mental functioning in the spring of 2007.

We will begin with the ninth piece of evidence concerning Weber's mental status, the only finding that is unrelated to Finer's personal loan from Weber. We believe the question of whether the bank owed Weber a fiduciary duty may be

resolved without that fact-finding. *See First Nat'l Bank in Sioux City v*. *Curran*, 206 N.W.2d 317, 322 (Iowa 1973) (finding confidential relationship despite mental competency of defendant and despite the fact she made "her own decisions on business generally" in action by executor bank to impose constructive trust on assets transferred to third party). The court's discussion of this issue in *Curran*, while not dispositive, is instructive:

> Mrs. Curran contends that since Miss Crosby retained her mental faculties and determination, Mrs. Curran could not be considered to be the dominant one of the two. . . . But Mrs. Curran's contention about dominance misapprehends the import of our decisions. By the very nature of a "confidential relationship," one person has achieved influence over another. The two individuals are not dealing at arm's length. By reason of the trust which has developed, the one who reposes confidence is not on guard; he is exposed; he relies on the other; and the other thus has influence he would not otherwise possess.

Id. The court stated that cases such as *Curran*, "founded on confidential relationships, do not require a showing that the confidant actually stood over the other or in fact bent the will of the other." *Id.* The court distinguished this type of case from cases involving "proof of actual undue influence or fraud." *Id.*; *see also Mendenhall v*. *Judy*, 671 N.W.2d 452, 454 (Iowa 2003) (setting forth the elements of an undue influence claim); *In re Herm's Estate*, 284 N.W.2d 191, 200–01 (Iowa 1979) (setting forth the elements of and stating in conjunction with an undue influence claim, "[o]ne who is infirm and mentally weak is more susceptible to influence than one who is not"). Based on this precedent, we will not address the question of Weber's mental acuity in deciding whether a fiduciary relationship existed between Weber and the bank.

We turn to the court's first eight fact-findings relating to the personal loan Finer obtained from Weber. Those fact-findings are supported by substantial evidence.

Finer testified he was Weber's primary loan officer for several years. While he could not recall whether he functioned in that capacity at the time he borrowed money from Weber, he conceded he was a bank employee. He stated that he already had a first mortgage with the bank and he approached Weber because "a second mortgage rate would be higher than a first mortgage rate at the bank." He acknowledged he used bank documents to reflect the personal loan.

Finer testified he wished to maintain the confidentiality of the loan and keep "a low profile." For that reason, he talked to Weber about not recording the second mortgage securing the note, and he obtained Weber's agreement to turn the mortgage document over to him. As a result, Weber's secured loan became an unsecured transaction. Finer agreed Weber's acquiescence in this unorthodox procedure reflected "a high level of trust in [his] position."

Finer made payments on the loan for several years. The personal loan remained outstanding in 2007, when Finer solicited Weber to lend money to Wangsness.

As the district court found, Finer's personal loan was in clear violation of a bank policy stating, "Bank personnel must refrain from borrowing from bank customers in order to maintain an independent, objective relationship with every customer." A former bank employee testified the purpose of the policy was to "maintain an objective arm's length relationship" so that neither the loan officer

nor the customer felt any pressure or undue trust associated with the relationship.

Finer did not have an objective, arms-length relationship with Weber; by Finer's own admission, Weber reposed undue trust in him. *See First Nat'l Bank in Lenox v*. *Brown*, 181 N.W.2d 178, 182 (Iowa 1970) (in equity action for fraud, concluding bank president "so comported himself that he knew or should have known from [the borrower's] questions and reaction that the latter trusted him implicitly"); *Peoples Bank & Trust Co*. *of Cedar Rapids v*. *Lala*, 392 N.W.2d 179, 186 (Iowa Ct. App. 1986) (finding more than a bank-depositor relationship where customers obtained all their business and personal financing through banker and were "close and trusted personal friends").

Having found substantial evidence to support a confidential relationship between Finer and Weber, we must next decide whether that relationship transformed the bank's association with Weber into a fiduciary relationship. We are not convinced the personal relationship between Finer and Weber automatically created a fiduciary bank-borrower relationship, because Finer was acting on his own behalf rather than the bank's behalf when he sought and obtained the personal loan from Weber. *See Engstrand v*. *West Des Moines State Bank*, 516 N.W.2d 797, 799 (Iowa 1994).[2] But Finer parlayed his personal relationship with Weber into a fiduciary bank-borrower relationship by taking advantage of the trust reposed in him and by convincing Weber to do indirectly

[2] We recognize he used bank documents, but it is undisputed that Weber understood the loan to be personal.

what the bank would not do directly: extend further credit to an un-creditworthy borrower.

In making his case to Weber, Finer omitted and misrepresented material facts associated with the 2007 loan transaction. *See Kurth*, 380 N.W.2d at 697–98 (finding no fiduciary relationship in part based on absence of "misrepresentations of fact" during meetings with the bank); *Manson State Bank v*. *Tripp*, 248 N.W.2d 105, 108 (Iowa 1976) (declining to find relationship of trust between borrower and bank where borrower "had never done business with the [bank vice-president] or plaintiff bank before," and had "received financial statements showing the companies to be 'bailed out' were in serious financial trouble"); *Brown*, 181 N.W.2d at 182 (stating the bank president, "and in turn plaintiff bank, had far more familiarity with the operative facts of the transaction than did defendants and thus, there was imposed upon plaintiff an unfulfilled duty of disclosure"). Specifically, during discussions about the loan, Finer did not "go over the dollar amounts of [Wangsness's] debt" with Weber. He simply told Weber that the bank had reached its limit on the amount it was comfortable lending Wangsness. While this general disclosure may have placed Weber on notice that Wangsness was highly leveraged, it said nothing about Weber's actual exposure on his $150,000 note. To truly understand his exposure, Weber would have needed to know the extent of Wangsness's indebtedness to the bank. Finer omitted that key information.

To add insult to injury, the note Finer prepared was riddled with inaccuracies. It stated the bank was secured by Weber's property, a fact that, if true, would have allowed the bank to pursue Weber's real estate to satisfy the

debt. At the same time, the note also stated the "collateral" consisted of mortgages on real estate owned by Wangsness and his wife. One of those mortgages, dated November 30, 2005, secured a note for $100,000. Another mortgage, dated April 13, 2006, secured a note for $500,000. A third mortgage, dated August 1, 2006, secured a note for $200,000. The bank failed to disclose these details about the "collateral."

An expert retained by Weber succinctly explained the significance of this omission. He testified that, under a compromise agreement Wangsness later executed with the bank, all but one of the properties described in the mortgages purportedly securing Weber's promissory note "were conveyed by Wangsness to Manufacturers Bank . . . in satisfaction or partial satisfaction" of their debt to the bank. He stated that, if the compromise agreement had been fully performed, "[t]here would have been nothing to provide any security for the promissory note" Weber executed.

While the bank responds that Wangsness's properties were not conveyed to the bank until after the transaction with Weber, the fact remains that Weber had no priority interest or, indeed, any interest in those properties that could secure his note to the bank. For that reason, the bank's pledge to secure Weber's loan with the Wangsness properties was a hollow one. *See Lala*, 392 N.W.2d at 191 (concluding bank "had a duty to disclose the full legal effects of" a mortgage executed on the borrower's unencumbered homestead).

Finer's failure to disclose the problems with the collateral was compounded by his affirmative misrepresentation concerning the protection

Weber would receive from that collateral. At trial, he was asked the following question:

> [I]s it correct that on August 10, 2007, when you met with Mr. Weber, that—and had him sign this promissory note, that you stated to him that you were using [Wangsness's] mortgages for collateral and [Wangsness] would be tying up his properties to back the note, and if there would be any default, Clem wouldn't have to pay prior to Mr. Wangsness losing all his properties.

Finer responded, "Yes, something to that effect. I don't know if it was exactly that but something to that effect, yes." He essentially agreed he assured Weber that the Wangsness properties would reduce Weber's exposure on the note. When he made this assurance, he knew the properties were already committed to the bank.

Weber's expert minced no words in characterizing this assurance as "false." He testified that when the promissory note was signed, "Mr. Weber was fully and unconditionally obligated to Manufacturers Bank for the debt" because, while his note "purport[ed] to be secured," neither the note nor a related hypothecation agreement executed by Wangsness in favor of the bank afforded Weber an interest in the Wangsness properties. Finer should have known this, as he acknowledged he was the loan officer in charge of Wangsness's loans with the bank.

The bank addresses Finer's damaging testimony in several ways. First, it argues his testimony was an impermissible attempt to orally modify a written agreement and should have been excluded on that basis. The bank relies on Iowa Code section 535.17(1) (2009), which states: "A credit agreement is not enforceable in contract law by way of action or defense by any party unless a

writing exists which contains all of the material terms of the agreement and is signed by the party against whom enforcement is sought." That provision does not assist the bank, because Weber was not attempting to modify the note by eliciting the concession from Finer, but was attempting to establish a misrepresentation of material facts involving the loan. *See C & J Vantage Leasing Co*. *v*. *Wolfe*, 795 N.W.2d 65, 85–86 (Iowa 2011) (stating rule prohibiting the use of extrinsic evidence to modify an agreement "does not prohibit [a party] from introducing evidence of . . . alleged misrepresentations" where the evidence was being offered to prove fraud in the inducement). Accordingly, the district court properly overruled the bank's objection and properly admitted the answer cited above.

Second, the bank attempts to parse the words used by Finer in answering the question. However, a verbatim recounting of the representation is not required. *See Gray v*. *Sanborn*, 159 N.W. 1004, 1005 (Iowa 1916) ("Plaintiff properly pleaded the representations and statements claimed to have been made to him regarding the lands; but he was not required to prove them verbatim et literatim. He was required to prove representations which were substantially the same as those alleged; that is, statements having the same general meaning and effect."). Finer conceded he did not use the precise words contained in the attorney's question or the precise words Weber's expert used in summarizing his representation. What is important is that he agreed he told Weber the bank would first attempt to cure a default by pursuing the collateral pledged by Wangsness, collateral that he knew to be worthless in this context.

Finally, the bank attempts to obfuscate Finer's misrepresentation by pointing to subsequently-executed promissory notes obligating Wangsness to pay Weber $100,000. These notes were secured by mortgages on four pieces of Wangsness's Minnesota property. The notes were entirely independent of the agreement Weber executed with the bank and had no bearing on the omissions and misrepresentation made by Finer in the course of the 2007 loan transaction.

This brings us to the question of whether Weber relied on Finer's omissions and misrepresentation in entering into the 2007 loan transaction. *See Kurth*, 380 N.W.2d at 697 (stating there must be evidence borrower "relied upon the bank to render its advice in connection with this loan"). There is no question he did. The bank knew Wangsness lacked the resources to repay Weber; Weber did not know this key information when he agreed to borrow $150,000 on behalf of Wangsness.

We acknowledge evidence that Weber and Wangsness spoke to each other at least two to three times a week and, sometimes, daily. But, there is no evidence that Wangsness disclosed the status of the collateral he was pledging for the loan. For that reason, we are not persuaded by the bank's assertion that Weber could have determined what he needed to know about the 2007 loan transaction through his relationship with Wangsness. *See Brown*, 181 N.W.2d at 183 (acknowledging that, in a fraud action, "one having knowledge of the true facts cannot have relief for fraud or misrepresentation," but noting that bank agreed to make a loan "without mention of" its own liens on the property being purchased). For the same reason, we are not persuaded by the bank's reliance on independent loans Weber made to Wangsness. The bank contends Weber

would not have put his own money at risk if he knew Wangsness was in financial straits. The problem with this argument is that there is no evidence Weber received information in connection with those transactions that would have filled in the gaps created by Finer's omissions. What matters here is Finer's relationship with Weber and the circumstances surrounding the 2007 loan transaction. The bank proffered no material evidence to show that this particular transaction was "fair between the parties." *N. Lumber Co. v. White*, 96 N.W.2d 463, 466–67 (Iowa 1959) ("[C]ontracts between parties standing in a fiduciary relation . . . when attacked, are presumed to be fraudulent with the burden resting upon the one who has the fiduciary obligation to show that it was fair between the parties.").

We conclude the bank breached a fiduciary duty owed to Weber in connection with the 2007 loan transaction.[3] Accordingly, the district court did not err in refusing to enforce the 2007 promissory note. *See Lala*, 392 N.W.2d at 190–91 (reversing judgment of foreclosure where party "was not made aware of the legal effects of the note and mortgage on the homestead when she signed it").

IV. Fraud

The bank next contends the district court erred in concluding that the bank committed fraud. Fraud requires proof of 1) representation, 2) falsity, 3) materiality, 4) scienter, 5) intent to deceive, 6) reliance, and 7) resulting injury.

[3] The bank contends the doctrine of unclean hands bars this conclusion. This issue was not preserved for our review. *See Meier v. Senecaut*, 641 N.W.2d 532, 537 (Iowa 2002) ("It is a fundamental doctrine of appellate review that issues must ordinarily be both raised and decided by the district court before we will decide them on appeal.").

Hall v. *Wright*, 156 N.W.2d 661, 666 (Iowa 1968); *see also Sinnard v*. *Roach*, 414 N.W.2d 100, 105 n.1 (Iowa 1987). Because this case is a law action, the burden rested with Weber to prove these elements "by a preponderance of the evidence that is clear, satisfactory and convincing." *See Tripp*, 248 N.W.2d at 107; *cf*. *Brown*, 181 N.W.2d at 181 (stating "[t]he rules are less strict . . . in equity"). Weber satisfied this heavy burden.

With respect to the elements of representation, falsity, materiality, and reliance, our previous discussion is equally applicable here. *See Sinnard*, 414 N.W.2d at 105 (stating fraud case "parallels the same analysis in a breach of fiduciary or confidential relationship case").

We turn to the scienter requirement. Scienter can be proven by showing any of the following:

> (1) actual knowledge of the falsity of the representation; (2) that the statement was made as of the knowledge of the party or in such absolute unqualified and positive terms as to imply his personal knowledge of the fact, when in truth he had no knowledge whether the statement was true or false; or (3) that the party's special situation or means of knowledge were such as to make it his duty to know as to the truth or falsity of the representation.

Wright, 156 N.W.2d at 667 (quotation marks and citation omitted). Finer, and therefore the bank, had actual knowledge of the falsity of the representation that Weber's exposure on the loan was limited. Accordingly, scienter was established.

For the same reason, intent to deceive was also established. *Id.* at 669 ("The same evidence that proves that a defendant made misrepresentations known by him to be false, upon which plaintiff relied to his injury, is ordinarily

sufficient, also, to establish the intent to deceive." (quotation marks and citation omitted)).

Remaining is the element of resulting injury or damage. As discussed, Weber took out an unsecured loan on behalf of Wangsness not knowing Wangsness's true financial picture and after being told that the bank would pursue Wangsness's properties to satisfy the loan obligation in the event of a default. The real estate underlying the mortgages pledged as security for Weber's loan was in fact transferred to the bank in satisfaction of Wangsness's indebtedness to the bank. The bank then sued Weber on the note. Based on this evidence, injury was established. *See Brown*, 181 N.W.2d at 184 ("[I]ndicative of the bank's deceptive conduct is the fact that having lured defendants into a borrowing transaction by failing to reveal its own interest in the deal it then required application of a major portion of the loan proceeds to ease its own . . . difficulties.")

We conclude the district court did not err in concluding that Weber established fraud in the inducement.

We affirm the district court's judgment in favor of Weber.

AFFIRMED.