

Court Voids \$1.5M Contract For Lack Of Consideration

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In the early 2000s, a group of doctors founded and developed Heartland Memorial Hospital in Munster, Indiana. Yessenow was one of the founding doctors. In 2005, the hospital ran into financial trouble, and the doctors decided to sell it. In March 2006, an investment group led by Wright Capital bought the majority of the doctors' interests in the hospital through a complex series of merger agreements.

Wright Capital did not have the money necessary to finance the transaction, so it raised almost \$19 million by selling part of the hospital's ancillary properties to a Texas finance company called NL Ventures. NL Ventures then leased the properties back to the hospital. As part of the merger, NL Ventures required a promissory note for a year's rent, approximately \$1.5 million. Yessenow agreed to provide the note, which he secured with a mortgage on his \$3 million Chicago condominium, by signing several written contracts in early March 2006. Hudson was one of the minority investors in Wright Capital and a new doctor at the hospital, but he was not involved in negotiating the merger agreements. Nor did Hudson sign any documents in connection with Yessenow's promissory note. The merger was completed in mid-March 2006.

Two weeks after the merger, on March 31, 2006, Yessenow asked Hudson and several other individuals to sign an indemnification agreement and guaranty for Yessenow's note. Yessenow told Hudson that the agreement would spread the responsibility for the note should the hospital fail to pay its rent. Hudson signed the agreement, not knowing that the agreement shifted to him the risk of having to pay the entire note. The rest

of the story did not take long to unfold. Less than a year later, the hospital was driven into bankruptcy by several creditors. The hospital failed to make the lease payments, and a company that purchased the note from NL Ventures sought payment from Yessenow. Yessenow sued Hudson for indemnification of the note, as well as for fees and costs.

Yessenow argued that the note was part of the merger agreements signed in mid-March 2006. The court analyzed a mountain of paper and considered half a dozen arguments proffered by Yessenow, but ultimately the indemnity agreement was held to be unenforceable because it lacked any consideration. The court applied long-standing contracts law providing that a contract requires consideration, which is a “bargained for exchange” with either “a benefit accruing to the promisor or a detriment to the promisee.” A benefit is a legal right given to the promisor to which he would not otherwise be entitled. If a party “[receives] nothing in return,” he may be excused from performing under a contract.

The court held that the only consideration extended to Hudson was past consideration, i.e., the acquisition of the doctors’ interests in the hospital that closed in mid-March, almost two weeks prior to the execution of the indemnification agreement. Past consideration generally cannot support a new obligation or promise. The court rejected the argument that a “throwaway” phrase providing the parties received “good and valuable consideration” actually constituted consideration. The court found: “And addressing the *existence* of consideration, it is also black-letter contract law that a ‘false recital of consideration’ is ‘a mere pretense of bargain [that] does not suffice’ to create a contract.”

There are a couple of valuable lessons to be learned from this case. First, all parties to a contract must read and have legal counsel review it, regardless of how well the parties know each other or how good their intentions are. Hudson and Yessenow ended up serving on the Board of Directors for the hospital, yet both offered conflicting versions of what was said in connection with the signing of the indemnity agreement. Second, as the court held, there is no socially useful reason for a legal system to enforce agreements that are not supported by consideration. Even though courts are hesitant to invalidate written agreements, a court will not allow one party to off-load its risk to another party unless the party receiving the burden of that risk receives something in return. Since Hudson received nothing in return for signing the indemnity agreement, the court held it was not enforceable.

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