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How To Rebuff Lender Liability Lawsuits

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They're back! Just like in the late 1980s, lender liability lawsuits are on the rise. Commercial borrowers who cannot meet the terms of their loan – or who do not qualify for funding – are asserting: "It's the bank's fault." Can lenders stop these claims? No, since anyone with the capacity to pay the filing fee can bring a complaint or counterclaim. However, lenders can take certain steps either to reduce the likelihood of such claims being brought or, if brought, to set up a quick dispositive motion and avoid lengthy litigation.

"Lender liability" claims are really an umbrella term for different types of actions against lenders. These claims are usually – but not always – brought by commercial borrowers claiming that the lender: (i) failed to provide a loan; (ii) failed to fund the loan; (iii) interfered with the project (*e.g.*, the lender "made" the borrower enter into contracts or undertake various actions that prevented the project from proceeding); and/or (iv) failed to act in accordance with the loan documents or the implied covenant of good faith and fair dealing. Borrowers often use common law theories – such as breach of contract, breach of the implied covenant of good faith and fair dealing, tortuous interference, alter ego/control, breach of fiduciary duty – although they sometimes rely on Federal statutes as well. They can be brought either as a complaint against the lender or as a counterclaim to a suit on a note or foreclosure proceedings.

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Commercial borrowers who bring these claims are often trying to gain leverage in order to renegotiate and/or do a workout. Sometimes, they are just looking to blame someone (with deep pockets) for their own errors in business judgment. And sometimes they are viewing the lender as a lottery ticket to a big payday. So what is a commercial lender to do? Set forth below are some strategies to put the leverage back on the lender's side.

1. Is The Right Party Suing The Lender?

This sounds basic, but is sometimes overlooked. The lender owes contractual duties to the borrower, not to others who may have an interest in the project. Nevertheless, persons associated with the borrower will sometimes bring suit, as will "assignees" of the borrower. Such suits should be met with an immediate motion to dismiss.

Generally speaking, the shareholder of a corporate borrower and the partner in a partnership do not have standing to bring a suit in lieu of the corporation or partnership. For example, a 50 percent shareholder generally cannot bring a lender liability lawsuit claiming that the lender's acts or omissions destroyed the value of his/her interest. Either the borrower itself brings the action, or the shareholder/partner must bring the action derivatively on behalf of the borrower (and then meet the standards for derivative suits). If not, lack of standing is considered a "threshold" issue that most courts will address first before significant time and money are expended.

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Most loan documents have non-assignment clauses. If that is the case in your lawsuit, then an initial motion to dismiss or for summary judgment should be brought, as these clauses are generally enforceable. Even if the loan documents are bereft of such a clause – or the clause does not apply to the particular claim at

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issue – the lender still may be able to dismiss the claim. Various states prohibit the assignment of torts. If the claim is one of "tortuous interference" or "prima facie tort," it may not survive a motion to dismiss

2. Every Lender Needs A Good Release

Workouts can be a "win-win." Commercial borrowers get an opportunity to perform and additional time that may be the key to their success. Commercial lenders would rather have a performing than a non-performing loan. But commercial lenders often miss the opportunity created by an amendment to the loan terms to obtain a release from any claim that the borrower had through the time of the amendment.

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As an example, assume that the commercial lender was providing construction financing on a new project. Assume further that the project missed certain milestones, and that the lender was not permitting the borrower to draw down the remaining financing. The borrower wants to do a workout – perhaps an extension of time, with different milestones and even reduced interest rates. In this scenario, it is most likely that the borrower's project has not met the borrower's expectations. There can be many reasons for this: poor management, bad economy, missing the market, construction/union issues, etc. But the borrower may also look to blame the lender for "causing" him to miss the market or interfering with the management of the project. A workout without a release still allows the borrower to have a claim down the road – *i.e.*, if the project ends up less successful than anticipated – against the lender.

That's where a general release is most helpful. Courts will usually enforce releases, given that they serve a great public policy need to resolve differences without resorting to judicial intervention (imagine, if you can, settling a dispute without obtaining a release). With no claim for purported acts – or failure to act – by the lender up to the date of the release, the borrower is less likely to commence an action. If the borrower does bring suit, the release will allow either for a quick summary judgment motion or can be used to limit the case to just acts occurring after the release.

Are there defenses to releases? There are weak ones, such as "duress" or "mistake." In order to reduce potential defenses, it is best if the release is in a separate document, in a good sized font, with a title "Release." Also, make sure that the release is duly executed by an authorized person for the commercial borrower.

3. Stop The E-Mails

In terms of defending a lender liability litigation, the worst invention of the past 100 years is the e-mail. Some loan officers, committee members and bank employees somehow seem to think that what is put in an e-mail: (i) will never see the light of day; and (ii) will have no effect on the lender's rights under the loan documents. Wrong! Worse, unlike a letter to a borrower that will likely have been thought through, with citations to relevant provisions in the loan documents and preservation of all of the lender's rights at law or in equity, e-mails are written quickly and colloquially, without thinking about the consequences (or preserving rights).

E-mails are not going away. Crafty borrowers will still try to use e-mail exchanges to argue that the lender has waived and/or amended certain terms of the loan documents. So what should lenders do? First, limit e-mail use. If a borrower wants to modify terms of the loan documents or act in a manner inconsistent with the loan documents, that request should be made in writing. Any response should also be in writing and contain language preserving rights. Second, where e-mails are the mode of communication, the lender needs to make it clear that it is not waiving its rights and not agreeing to some open ended modification for the borrower's benefit. In other words, treat the e-mail like a formal letter or modification agreement.

Third, treat internal e-mails just like external e-mails. Borrowers will try to use internal e-mails to show that the bank "understood" and "agreed to" what the borrower wanted. In this regard, assume that internal e-mails will some day be seen by the other side, and avoid "joking" or disparaging comments . . . they will come back to haunt the lender.

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4. Choice Of Law: New York

Some states are more liberal than others on lender liability. New York is a state that takes a stricter approach to enforcing the terms of the loan documents and the exercise of lender rights. Other states may be more lenient, particularly if the borrower is a "home town favorite" while the lender comes from outside of the jurisdiction. What can lenders do to use more favorable law to increase their chances of defeating lender liability suits?

Choice of law provisions in loan documents – or in loan modification documents – can be the answer. Most jurisdictions will enforce a choice of law provision in a commercial context. Moreover, if the note has some connection to the favorable jurisdiction – e.g., the collateral, borrower and/or lender are found in that jurisdiction – then a choice of forum provision will also benefit the lender. For example, New York's state courts have exclusive "commercial parts" where generally experienced jurists familiar with New York law favoring enforcement of loan documents and lender's statutory and common law rights can quickly determine the frivolous "lender liability" claim from the legitimate one.

In sum, commercial lenders can – and should – take the above simple steps now to reduce the likelihood of lengthy lender liability litigations in the future.