4 Lender Claims

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Andy the Aging Athlete is a former college basketball star who, after admitting to himself that his dreams of going pro were unlikely to be realized, decided to attend law school. After graduation from law school, Andy worked for a local law firm and practiced commercial litigation for several decades before retiring from the practice of law. Never one to sit still for long, Andy decided to open a local gymnasium, Andy's Athletics, as an investment. Andy is the owner-manager of Andy's Athletics and handles all the finances himself. He set up Andy's Athletics, LLC, in which he is the sole member. At the ripe age of 85, Andy is staying busy but is starting to wonder if he can keep up with all the important day-to-day operations of the gym. His daughter, Caroline, tries to help where she can, but Andy

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is a cantankerous old man and refuses her offers of help. Caroline is concerned that Andy in his advancing age will be taken advantage of and that the gym is too much for him to handle.

One day, Caroline sends her good friend, Lisa Lawyer, an email with an ominous tone. The subject line reads, "Call me." Lisa telephones Caroline to ask what is wrong. Distraught, Andy's daughter tells Lisa that she thinks something went terribly wrong at Andy's Athletics. She tells Lisa that she thinks her father will have to file for bankruptcy soon, and she is worried about what will happen to him. Lisa schedules a meeting with Caroline and Andy to discuss the situation.

Andy and Caroline visit Lisa's office the following day, and Andy starts to tell Lisa the story of what has happened with his business. Cash flow is typically tight at Andy's Athletics. Members are charged a monthly fee, but Andy pays for a lease on the building and taxes on the property. Additionally, the gym requires periodic maintenance. Andy also maintains a small staff, comprised of several front desk managers, an administrative assistant, and several trainers. Though Andy makes a profit on the gym, there is not much left over at the end of each month.

Andy recently wanted to make renovations to the gym and also wanted to upgrade the equipment, particularly the cardio machines. Andy expected that the renovations and the new equipment would attract a new crowd of young professionals who would be likely to pay a higher monthly membership fee. Andy made plans to move forward with the renovations but determined that his current cash flow would not be enough to cover the expenses. He needed a loan.

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This chapter should not be construed as giving legal advice. If you would like to receive legal advice, contact Braden or Jo. The views expressed in this chapter are Braden's and Jo's and are not necessarily the views of Cozen O'Connor.

Andy grew up in the same small town as Biff Banker. The two of them were childhood friends, and Andy relied on Biff for his advice in both personal and professional matters. In fact, Biff had helped Andy set up Andy's Athletics, LLC, had looked at the financial statements of Andy's Athletics on several occasions, and frequently gave Andy unsolicited advice on how to grow his business. Andy knew that Biff would be able to help him acquire financing for the renovations to Andy's Athletics. Andy reached out to Biff and scheduled a time to meet with him at Biff's bank. Caroline asked Andy if she could join Andy to make sure he understood everything before signing any financial commitments, but Andy, stubborn as ever, refused.

I. CLAIMS ARISING OUT OF THE LOAN APPLICATION PROCESS

Andy arrived on the day of the meeting and began discussing his plans with Biff. Biff listened intently and seemed to take careful notes. Andy told Biff that he estimated that he would need a loan for $150,000 to complete the renovations and might need additional capital in the future. "This is going to be expensive, isn't it?" Andy asked. Biff, eager to make the sale, told Andy not to worry about the costs and that the bank can offer him "special rates" that charge "very low interest," and even stated that these rates could be "as low as 3 percent interest." When Andy asked Biff what the interest rate would be, exactly, Biff rebuffed Andy and again told him to "not worry about it" and that he would "take care of Andy."

Biff gave Andy the loan application, and Andy immediately had questions. The loan application indicated Andy was applying for a loan and a line of business credit. Additionally, the paperwork indicated the application was for a loan "up to $300,000." Andy expressed concern that he may not be able to afford the interest on such a high loan, but Biff assured him that they are just building in additional capital should Andy need it. Biff further reassured Andy that "Andy's Athletics is in the driver's seat here" and that he should just "trust" Biff, who would be there with him every step of the way. Biff continued, telling Andy that he knew Andy's Athletics, that he had "run the numbers," and that the expansion was the only way forward for the business. As part of the loan process, Biff also referred Andy to Craig Contractor to help with the renovations. Biff told Andy that Craig has worked with several of Biff's clients and has always done a great job.

A week later, Andy received a letter from Biff informing him that he has been approved for a $300,000 loan and is eligible for an additional personal line of credit up to $150,000. When Andy read the fine print, he discovered that the loan was being charged a 20 percent interest rate. The loan was also collateralized by Andy's Athletics and the profits made on member revenue. Despite having reservations, Andy signed the loan paperwork and made his first payment.

At this point, Lisa stops Andy so she can write down some initial thoughts about Andy's potential claims.

A. Issues with Formation of the Contract

First, the lender should always know who they are going into business with. Lisa knows, from years of being around Caroline, that Andy's age has really crept up on him. She suspects that, due to his age, he is particularly susceptible to being convinced of things that are not necessarily good for his business. Lisa makes a note to ask Andy who else was present during his meeting with Biff, whether Biff committed things to writing or just made oral promises, and whether Andy really seemed to comprehend everything Biff was saying when they were discussing how Andy's Athletics would be impacted by the loan.

Lisa briefly considers whether any pretransaction discussions between Andy and Biff could negate the contract entirely for lack of a meeting of the minds over an agreement. Lisa quickly dismisses this possibility, as noncommittal preliminary exchanges normally do not constitute binding agreements.[1] Further, as Lisa will examine when she looks at Andy's claims for breach of contract, oral promises in lender liability claims are particularly problematic. Lisa also contemplates whether Biff issued any preliminary letters of intent, but then dismisses this possibility as a source of Andy's claims, as she suspects that the bank, being a diligent lender, would have included a merger clause, which typically states that the final loan agreement provided to the debtor reflects the entire agreement between the parties and that all prior agreements are null and void. Indeed, Lisa finds such a clause upon further inspection.

1. *See* Frutico S.A. de C.V. v. Bankers Trust Co., 833 F. Supp. 288, 297–98 (S.D.N.Y. 1993) (no contractual agreement when parties did not intend to be bound absent contractual agreement); Kyle v. Apollomax, LLC, No. CV 12-152-RGA, 2013 WL 5954782, at *3 (D. Del. Nov. 1, 2013) ("[P]reliminary discussions and negotiations cannot form the basis for a valid contract, and without a contract there can be no breach of contract.").

B. Negligence

Lisa ponders whether a general claim for negligence might also make sense. She quickly realizes, however, that negligence may be the least helpful path for her to follow to advocate on Andy's behalf.

A typical negligence case will require Lisa to show (1) the bank owed Andy a cognizable duty of care as a matter of law, (2) the bank breached that duty, and (3) Andy suffered damage as a proximate result of that breach.[2] While that seems straightforward, Lisa thinks that several problems might give her pause to bring this claim. First, it will be an uphill battle to prove the bank owed an ordinary duty of care to Andy.[3] For that reason, this claim may get dismissed at the pleadings stage, making the rest of Andy's claims seem less substantiated. Second, and relatedly, in many jurisdictions the economic loss rule will prevent Andy from bringing this claim at all; that is, "[i]n general, there is no recovery in tort for negligently inflicted 'purely economic losses,' meaning financial harm unaccompanied by physical or property damage."[4] Courts limit these negligence theories because such claims would "disrupt the parties' private ordering, render contracts less reliable as a means of organizing commercial relationships, and stifle the development of contract law."[5]

Lisa also knows that in the jurisdictions that would allow such a claim, there is generally no duty for the borrower to competently handle a loan application.[6] Lisa thinks Andy may be out of luck with respect to a pure negligence cause of action, but she may still be able to claim certain kinds of torts, even those that somewhat sound in negligence, specifically negligent misrepresentation. Lisa will have to show that these causes of action

2. Millennium Partners, L.P. v. U.S. Bank Nat'l Ass'n, No. 12 Civ. 7581(HB), 2013 WL 1655990, at *4 (S.D.N.Y. Apr. 17, 2013).

3. *See, e.g.*, Wilcox v. Sec. State Bank, 2023 WY 2, ¶ 36, 523 P.3d 277, 286 (Wyo. 2023), reh'g denied (Feb. 14, 2023) (refusing to recognize a noncontractual "reasonably competent banker" duty on lender).

4. *See, e.g.*, Sheen v. Wells Fargo Bank, N.A., 12 Cal. 5th 905, 922, 505 P.3d 625, 632 (2022), reh'g denied (June 1, 2022); Mayotte v. U.S. Bank Nat'l Ass'n as Tr. for Structured Asset Inv. Loan Tr. Mortg. Pass-Through Certificates, Series 2006-4, 985 F.3d 1248, 1251 (10th Cir. 2021).

5. *Sheen*, 12 Cal. 5th at 922, 505 P.3d at 627–28.

6. *See* House v. U.S. Bank Nat'l Ass'n, 2021 MT 45, ¶ 18, 403 Mont. 287, 300, 481 P.3d 820, 828 (Mont. 2021) ("[a]lleged errors or omissions by a lender in the servicing or administration of a mortgage loan is thus generally compensable only in contract on a claim for breach of express contract terms or the covenant of good faith and fair dealing").

did not "arise from—or are . . . independent of the parties' underlying contracts."[7] Therefore, negligent misrepresentation, fraud, and breach of fiduciary duty, just to name a few, may still be viable tort theories against Biff and the bank.

C. Negligent Misrepresentation

Lisa also identifies that Biff made material misrepresentations to Andy in the placing of the loan and wonders whether Biff might be liable for negligent misrepresentation.

To prove the tort of negligent misrepresentation, Andy would need to show (1) a representation made by Biff and the bank in the course of their business or in a transaction in which the bank has a pecuniary interest, (2) the representation conveyed false information for the guidance of others in their business, (3) Biff and the bank did not exercise reasonable care or competence in obtaining or communicating the information, and (4) Andy suffered pecuniary loss by justifiably relying on the representation.[8]

Lisa believes there is no doubt that Andy relied on Biff and his representation in taking out the loan. However, Lisa is aware that Andy will likely again run into issues proving this claim because of the nature of the oral misrepresentations that were made.

Even if Andy relied on Biff's representations regarding the low interest rate, many courts hold that the contradicting terms of the contract prevail, which would prevent Andy from claiming he materially relied on the contradicting oral promise.[9] Additionally, as Lisa previously determined, there are a multitude of hurdles in presenting a cause of action alleging reliance on oral promises in the context of lender claims.

First, Lisa is aware that many states have enacted credit agreement statutes that prevent debtors such as Andy from bringing claims arising out of oral promises related to credit agreements.[10] Even if Lisa successfully

7. *Sheen*, 12 Cal. 5th at 922, 505 P.3d at 633.

8. *See* J.P. Morgan Chase Bank, N.A. v. Orca Assets G.P., L.L.C., 546 S.W.3d 648, 653–54 (Tex. 2018).

9. *See, e.g.*, Silver v. Countrywide Home Loans, Inc., 760 F. Supp. 2d 1330, 1341 (S.D. Fla. 2011), aff'd, 483 F. App'x 568 (11th Cir. 2012) (finding that any reliance upon alleged oral misrepresentations expressly contradicted by the terms of a loan is "objectively unreasonable as a matter of law").

10. *See, e.g.*, 815 Ill. Comp. Stat. 160/2. (Illinois Credit Agreement Act); La. Rev. Stat. Ann. § 6:1122 (2005) (Louisiana Credit Agreement Statute).

navigates the case past one of these credit agreement statutes, Andy's testimony regarding the oral promises might still be barred by his jurisdiction's applicable statute of frauds and, failing that, by the parol evidence rule. Finally, the bank would likely argue that Biff's statements were mere puffing or opinion. Lisa concludes that alleging negligent misrepresentation will not bear much fruit at this stage.

D. Fraud and Fraudulent Inducement

Lisa also considers whether Biff's actions might amount to fraud. In many jurisdictions, a claim of fraud will require her to show that Biff either intentionally or recklessly[11] made misrepresentations by clear and convincing proof.[12] Generally, it will also require Andy to show that Biff made specific statements that he relied upon, to show when and where those statements were made, and to explain why those statements were fraudulent.[13] In any event, Lisa realizes she will encounter some of the same problems as she did trying to prove the negligence causes of action, and she thinks a court would likely not find Biff's reference to a rate "as low as 3 percent" to be sufficiently specific to give rise to a cause of action for fraud.

E. Breach of Fiduciary Duty

Finally, Lisa wonders how a court might classify the relationship between Andy and Biff, and whether Biff owed Andy certain duties above and beyond that of an ordinary banker. Lisa knows that most consider the lender-borrower relationship to be that of creditor-debtor, and not a fiduciary relationship.[14] Lisa also knows that, in determining whether a fiduciary relationship was established, courts will not only look to the degree to which Andy relied on Biff's advice, but also to the "common disparity in pertinent knowledge and expertise" between the lender and the borrower.[15]

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11. *See* Of A Feather, LLC v. Allegro Credit Servs., LLC, No. 19CV9351 (DLC), 2020 WL 3972752, at *6 (S.D.N.Y. July 14, 2020).

12. *See* Freeman v. Pittsburgh Glass Works, LLC, 709 F.3d 240, 256–57 (3d Cir. 2013).

13. *See* Loreley Fin. (Jersey) No. 3 Ltd. v. Wells Fargo Sec., LLC, 797 F.3d 160, 171 (2d Cir. 2015).

14. *See* In re Bailey Tool & Mfg. Co., No. 16-30503-SGJ-7, 2021 WL 6101847, at *41 (Bankr. N.D. Tex. Dec. 23, 2021).

15. *See House*, 2021 MT at ¶ 18, 403 Mont. at 300, 481 P.3d at 829.

Lisa wonders how Andy's prior expertise as a commercial litigator might affect a court's likelihood of finding that a fiduciary relationship was established. Given these challenges, she anticipates that she will likely need to get an expert to explain financial advisory guidelines and the reasonableness of Andy's reliance on Biff's advice. Lisa decides she might need to revisit this claim after she learns more about the relationship between Biff and Andy.

Lisa considers it ironic that, had Biff not gone through with the loan at all, Andy wouldn't be in the position he is in, and may not have even been able to hold the bank and Biff liable for failing to extend the loan to him.[16]

F. Redlining Is Still Prevalent

Redlining is a discriminatory practice that first emerged in the early 20th century and remains in effect,[17] and it has had a profound impact on shaping the spatial, social, and economic landscape of the United States. Redlining has kept individuals out of more affluent or desirable neighborhoods based on their race. With the creation of the Home Mortgage Disclosure Act, redlining was formally outlawed by banking regulators.[18] Though most jurisdictions have foregone the complete designation of areas related to a specific race, the practice of redlining still continues, but in a subtle and less complex way in the banking industry,[19] making it harder for regulators to identify. Following is an example of redlining with Amanda, who is attempting to secure a loan from her local community bank, only to be offered a loan from the bank at a higher interest rate than her friend, Fran, because of where the home address is.

Redlining Example

Amanda, a young millennial in her early thirties with a stable job as a nurse, wants to become a homeowner. She saved up several years' worth of wages to make a down payment and has been fiscally responsible and

16. *See, e.g.*, Albino Constr. Co. v. Wells Fargo Bank, Nat'l Ass'n, No. CV 21-35, 2021 WL 2529811, at *4 (E.D. Pa. June 17, 2021) (lender generally owes no duty of care to borrower in processing of loan application).

17. *See, e.g.*, *Redlining*, Consumer Credit and the Law (June 2023).

18. *Id*.

19. *See* Khristopher J. Brooks, *Redlining's Legacy: Maps Are Gone, but the Problem Hasn't Disappeared*," CBS News (June 12, 2020), https://www.cbsnews.com/news/redlining-what-is-history-mike-bloomberg-comments.

possesses no current outstanding debts. Amanda wants to purchase her home in a vibrant, up-and-coming neighborhood with a great school system and local amenities.

When she is ready to finance her chosen home, Amanda applies for a mortgage from a local bank. Her application notes her great credit history, her income as a nurse, and provides all the necessary documentation needed. She submits the application to her local banker, Biff, for his review.

Biff is an experienced banker with over thirty years of experience in the banking industry. He has personally worked on more than 1,000 applications for mortgages and prides himself on his client interaction and service. Biff reviews Amanda's application, assesses the supporting documents she provided, and then begins looking at the home's location. The property is in a predominantly minority neighborhood, and Biff is concerned that the home will not appreciate in value as other homes in other parts of the local community. Biff feels he is left with no choice but to apply a strict approach to Amanda's application.

Biff agrees that the bank should approve Amanda's mortgage application, but under terms that are different from those she expected. Because of the property's location, Biff offers the mortgage to Amanda at a high interest rate that requires a large down payment. The interest rate and the down payment are higher than what she expected or saved for, and more than what someone in her income bracket and with her credit score would normally require. As Biff relays to Amanda the proposed loan terms, Amanda gets the sense that Biff is attempting to discourage her from pursuing the loan. He just keeps talking about concerns for the neighborhood's future development.

Amanda is concerned about the bank's assessment of the neighborhood, and she's worried she will not be able to afford the home she's had her eye on for years. She applies for another mortgage loan with another local bank, providing the same information she provided to Biff. In the meantime, Amanda asks her friend Fran to reach out to Biff to test his interest in providing Fran with a loan. Fran applies for a loan with Biff and provides him with information that is essentially the same as the information Amanda included with her loan application, except that Fran's chosen property is in the more affluent part of town. While Amanda waits for the second bank to provide the terms of her loan, Fran has been preapproved for a loan with Biff's bank at an interest rate that is a half percentage point better than the one Biff offered to Amanda.

Amanda realizes that Biff's biases against her chosen neighborhood is a classic example of redlining and contacts the consumer protection group at the bank's primary regulator.

II. CLAIMS ARISING DURING THE LIFE OF THE LOAN

Andy started making payments on the loan. Several months later, a junior banker calls Biff and says he has some bad news about the loan to Andy's Athletics. When Biff inquires as to the situation, the junior banker tells him that something went wrong during the due diligence period and that they miscalculated Andy's monthly revenue. The younger banker explains that Andy's monthly revenue is only about half of what they expected. Worse, when the risk is adjusted for Andy's updated revenue projections, the bank simply cannot afford to extend a personal line of credit to Andy. Despite his concerns, the junior banker knows that Biff is insistent on the bank profiting on the loan, and that Biff change his image as a manager who makes bad loans to the bank's detriment.

Biff calls Andy and explains that Andy's Athletics was actually "overleveraged" and that, as a result, the bank would need additional capital to continue financing the loan or Andy could be in default. Andy is perplexed, but Biff reassures Andy and tells him this happens all the time. Andy doesn't recall any terms in his loan that defined what it meant for Andy to be "overleveraged," and as Lisa later discovers, that term was not defined anywhere in the paperwork. Biff just needed Andy to put up another $15,000 in cash and the bank could then continue to finance the original loan on the same terms. Biff assures Andy that the additional capital is just temporary and that the bank would hold the $15,000 for Andy as additional security on the loan. Andy, distressed, starts to think about how he can secure this additional funding. He reaches out to Larry the Local Lender, who specializes in bridge loans. Larry assesses Andy's outstanding debt and offers to loan the additional funds to Andy at a 30 percent interest rate and requires the loan to be repaid within a year. Without any other options, Andy accepts. He receives the loan proceeds and pays them over to Biff, who says nothing to Andy about the personal line of credit being unavailable but does reiterate that he has "run the numbers" and that this deal continues to make sense for Andy's Athletics.

Meanwhile, the contractors reach out to Andy to let him know that they reviewed the construction plans and would be able to add a yoga

studio, a sauna, and a rehabilitative whirlpool at Andy's Athletics for an additional $75,000. Fortunately, the contractors are willing to take credit from cash-strapped Andy. Andy, unaware that the personal credit line had been rejected, accepts the contractors' proposal.

A. Modification of the Loan Terms

Lisa's first thought is whether the additional $15,000 collateral is enforceable. Of course, even if she can get the additional collateral obligation reversed, this would not necessarily clear Andy's obligation with Larry the Local Lender. But Lisa thinks she might have other strategies for getting Andy out of that obligation, or at least she might be able to have Biff and the bank pay for it. Lisa again faces the problem of whether an oral promise made by a lender is enforceable. In this case, however, Lisa thinks the parol evidence—i.e., Andy's testimony regarding the modification of the loan—could be admissible because some jurisdictions allow parol evidence to be admitted for purposes of proving an oral modification of a written contract.[20] If the bank were smart, Lisa thinks, they would have insisted that the original loan agreement contain a clause forbidding oral modifications. Further, the bank could have insisted that the loan modification documentation require Andy to reaffirm his original obligations under the loan and waive any defenses or offsets to his obligations under the loan. None of those things were done, and Lisa thinks there could be traction here. But what about Andy's obligation to repay Larry the Local Lender?

B. Promissory Estoppel

Lisa feels optimistic about her chances of making the bank cover the bridge loan to Larry the Local Lender under a theory of promissory estoppel. Typically, promissory estoppel would require Andy to show (1) a promise; (2) that the promisor, as a reasonable person, could foresee would induce conduct of the kind that has occurred; (3) actual reliance on the promise; and (4) that results in a substantial change in position.[21] Here, Andy clearly

20. Barinaga v. J.P. Morgan Chase & Co., 749 F. Supp. 2d 1164, 1173 (D. Or. 2010).

21. *See* Dane v. U.S. Bank, N.A., No. 3:12-CV-00333-ST, 2013 WL 11319046, at *2 (D. Or. May 31, 2013).

changed his position by obligating himself to Larry based on the promise made by Biff and the bank that the additional collateral payment would be held in trust. If the bank goes back on its word as to the additional $15,000 collateral, Lisa should be able to get Andy out of the obligation. Lisa thinks the same analysis could apply to Andy's decision to obligate himself to the tune of an additional $75,000 to the contractors.

C. Breach of Contract

Lisa begins to contemplate claims Andy might assert arising out of issues with the additional collateral and the unfulfilled personal credit line. It seems to Lisa that the request for additional collateral and the unfulfilled line of credit could be a clear breach of contract by the bank. Although breach of contract is perhaps the most intuitive cause of action for lender liability, Lisa knows that, in practice, the complexity of loan agreements and the many provisions they contain in favor of the lender make these claims difficult if not impossible to pursue.[22] She knows that Biff probably did not do his due diligence if he was claiming Andy's Athletics was overleveraged only months after the initial loan paperwork was signed. She also knows that parol evidence might not work in Andy's favor to prove that the contract did not actually mean what it said. Further, the loan agreement provides that the bank can declare Andy in default at any time.

Lisa also starts to have doubts about the unfulfilled personal line of credit. While it is true that the bank issued a letter approving Andy for the line of credit, it is not clear whether the contract guaranteed that the credit would be automatically available or whether it was subject to further approval by the bank. After all, Andy had not actually used the line of credit yet; he had only relied on the likelihood that he could access those funds when he chose to accept the contractors' proposal for the additional construction. But Andy might have a strong case for negligent misrepresentation.

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22. *See, e.g.*, In re Bailey Tool & Mfg. Co., No. 16-30503-SGJ-7, 2021 WL 6101847, at *37 (Bankr. N.D. Tex. Dec. 23, 2021) ("While this court believes that [the lender's] conduct was in many ways tortious (and shocking), the breach of contract analysis here is actually quite vexing . . . the [loan] Agreements are amazingly one-sided [and] there seem to be very few breaches of contract. In other words, many of the alleged bad acts articulated by the Trustee were seemingly permitted by the terms of the Agreements.").

III. ISSUES WITH WORKOUTS

Andy thinks he is in the clear, and for a while, things seem to have calmed down. Unfortunately, Andy's prosperity does not last. Some of the gym members are frustrated with the construction work in the gym and the resulting inconveniences, and a newer, cheaper gym opened on the other side of town. Andy started to lose members. Cash flow dipped again, and Andy again fell behind on his loan payments to the bank.

One day, Andy received a call from Biff. "We're going to have to foreclose on the gym," Biff told him. Biff also told Andy that the bank would have to seize all the member revenues directly. Biff also said that if Andy wanted the bank to forbear on foreclosing on the gym until he got back on his feet, Andy would need to install one of the bank's employees as CFO of Andy's Athletics. Finally, to further protect their outstanding debt, the bank would control how Andy's Athletics disbursed funds to some of the equipment suppliers from whom he had bought equipment on credit. Biff told Andy he would send a revised loan addendum that reflected these terms. Andy, anxious about the state of his business, was quick to tell Biff that he would sign anything to keep the business, but Biff never sent him an addendum. Nonetheless, Andy complied with the terms, and the bank appointed Biff as CFO of Andy's Athletics.

A. Breach of the Duty of Good Faith and Fair Dealing

As Lisa listens to Andy, she realizes there may be some red flags raised by Biff and the bank's insistence on being overly involved in the day-to-day affairs of Andy's Athletics. Though it is not uncommon for a lender to take extra precautions to protect its investment when it is imperiled, she also knows that, when it comes to lender liability claims, one of the most frequently litigated issues is the lender being overly involved in the borrower's business decisions. In particular, actions such as taking over the borrower's business, controlling the business's workforce, and controlling the priority and distribution of the business's profits and debt payments raise red flags that might cause a court to find that the lender's actions support one or more causes of action alleged by the borrower.[23]

23. *See, e.g.*, In re Bailey Tool & Mfg. Co., No. 16-30503-SGJ-7, 2021 WL 6101847, at *40–41 (Bankr. N.D. Tex. Dec. 23, 2021).

Moreover, Lisa knows that a lender's undue influence over a borrower's business operations is an important concept in lender liability, and one that courts might apply to support several different causes of action other than just a breach of the duty of good faith and fair dealing.

First, Lisa recalls that most if not all states require contracts to be performed in good faith,[24] and that this might be a basis on which to assert liability against the bank for undue influence over Andy's Athletics. The covenant of good faith and fair dealing is implied in contracts by state law, and it "prevents one party from 'unfairly frustrating the other party's right to receive the benefits' of the contract."[25] The covenant generally comes into play in the parties' discretion in their exercise of contractual rights and looks to the "agreed common purposes and consistency with the justified expectations of the other party."[26]

Lisa is also aware that she will need to be intimately aware of the contours of her jurisdiction's law, because the duty of good faith and fair dealing varies greatly among jurisdictions. For example, Lisa could bring this claim as an independent cause of action in some states, but not in others.[27] In those states where she could bring the claim as an independent cause of action, Lisa might be required to show that Andy and Biff were in a fiduciary relationship with each other.[28] Additionally, some jurisdictions will require Andy to show a breach of an express provision of the contract before he can assert a breach of the duty of good faith and fair dealing, while other jurisdictions will not require such a showing.[29]

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24. *See, e.g.*, La. Civ. Code art. 1983; Grisaffi v. Dillard Dep't Stores, Inc., 43 F.3d 982, 983 (5th Cir. 1995) ("Good faith performance is an implied requirement of every contract under Louisiana law."); Klamath Off–Project Water Users, Inc. v. Pacificorp, 237 Or. App. 434, 445, 240 P.3d 94 (2010) (Under Oregon law, "every contract has an obligation of good faith in its performance and enforcement under the common law.").

25. Villegas v. Wells Fargo Bank, N.A., No. C 12-02004 LB, 2012 WL 2931343, at *9 (N.D. Cal. July 17, 2012).

26. Amoco Oil Co. v. Ervin, 908 P.2d 493, 498 (Colo. 1995).

27. *Compare* Nicholson v. United Pacific Ins. Co., 219 Mont. 32, 710 P.2d 1342, 1348 (1985), *with* Williams v. Fed. Home Loan Mort'g Corp., No. PWG-13-2453, 2013 WL 6713278, at *4 (D. Md. Dec. 18, 2013).

28. *See* Pension Trust Fund v. Fed. Ins. Co., 307 F.3d 944, 955 (9th Cir.2002) (applying California law); Morrow v. Bank of Am., N.A., 2014 MT 117, ¶ 31, 375 Mont. 38, 45, 324 P.3d 1167, 1176.

29. *Compare* Silver v. Countrywide Home Loans, Inc., 760 F. Supp. 2d 1330, 1344 (S.D. Fla. 2011) ("A duty of good faith 'is not an abstract and independent term of a contract' but must relate to performance of an express contractual obligation."), *with* Elizabeth Retail

It seems to Lisa that the bank's actions in appointing Biff as CFO of Andy's Athletics, in addition to controlling the majority of the revenues and expenses of Andy's Athletics, crossed the line of what could be considered good faith and fair dealing under the loan agreement. Although a lender is entitled to have some say in the borrower's hiring and firing of corporate officers, the borrower is typically also "entitled to have its affairs managed by competent directors and officers who would maintain a high degree of undivided loyalty to the company,"[30] and here, it is questionable whether Biff, an employee of the bank with the bank's interests first in mind, would fit that bill. Further, the closer the lender gets to "assum[ing] actual, participatory, total control of" the borrower, the more likely a court is to find impermissible overreaching by the lender.[31] Lisa also realizes that the bank has made a major mistake by not memorializing the change of terms in the written loan workout agreement. Such an agreement could include a waiver of claims against the lender and make clear that the changes in operating procedure were a condition of the bank's forbearance on defaulting the loan. Though a court might cast a skeptical eye towards the bank's overinvolvement, the lack of a written agreement worsens the bank's position here because it makes the additional conditions seem arbitrary and perhaps outside the boundaries of the original contract terms to which Andy and the bank agreed.

Lisa is mindful of the bank's duty of good faith and fair dealing as she assesses the events related to Andy's Athletics. Some courts hold that this duty attaches as early as the contractual negotiations stage.[32] Lisa realizes that Biff and the bank may have breached their duty of good faith and fair dealing when they failed to inform Andy that they would not be extending to him the personal line of credit.[33]

Properties LLC v. KeyBank Nat'l Ass'n, 83 F. Supp. 3d 972, 990 (D. Or. 2015) (a "party may violate its duty of good faith and fair dealing without also breaching the express provisions of a contract") (citing Elliott v. Tektronix, Inc., 102 Or. App. 388, 396, 796 P.2d 361 (1990)).

30. State Nat'l Bank of El Paso v. Farah Mfg., 678 S.W.2d 661, 690 (Tex. App.1984), writ dism'd by agr. (called into question on other grounds by Wal–Mart Stores, Inc. v. Sturges, 52 S.W.3d 711, 724 (Tex. 2001)).

31. *See* Schwan's Sales Enterprises, Inc. v. Com. Bank & Tr. Co., 397 F. Supp. 2d 189, 195 (D. Mass. 2005).

32. *See, e.g.*, High v. McLean Fin. Corp., 659 F. Supp. 1561, 1569 (D.D.C. 1987) (holding that duty of good faith and fair dealing could arise between loan broker and loan applicant).

33. *See* K.M.C. Co., Inc. v. Irving Trust Co., 757 F.2d 752, 1 Fed. R. Serv. 3d 1095, 92 A.L.R. Fed. 661 (6th Cir. 1985).

B. Duress

Andy recounts to Lisa how incredibly distraught he was when he received the phone call from Biff. Pushed to his wit's end, Andy would have signed anything to keep the gym open. Lisa wonders whether she could convince a judge that Biff took advantage of Andy, and thus have rescinded what Andy agreed to due to duress.

A showing of duress typically requires (1) a threat to do something a party has no legal right to do, (2) an illegal exaction or some fraud or deception, and (3) an imminent restraint that destroys the victim's free agency and leaves him without a present means of protection.[34] Lisa realizes not all jurisdictions will recognize duress as an independent cause of action. At most, it might be considered an affirmative defense to enforcement of the bank's rights related to the loan. The other problem Lisa acknowledges is that, as much as Andy was likely stressed out, it is not entirely clear that Biff and the bank took actions that they were not entitled to under the loan agreement. Even if the loan agreement did not provide specifically for the bank's overinvolvement in the day-to-day operation of Andy's Athletics, the loan itself was collateralized by the gym and allowed the bank to foreclose on the gym in the event of a default. Lisa is not sure that a claim for duress is viable because it requires her to show that the bank threatened an action it had no legal right to enforce.[35]

IV. CLAIMS ARISING OUT OF DEFAULT ON THE LOAN

Once more, things spiral out of control for Andy's Athletics. The construction continues to run into delays, and the contractors begin to demand that Andy start making payments on the additional projects. Andy, believing the bank granted him the personal line of credit, goes to the bank to draw on that credit line. He is, unfortunately, informed that he has no line of credit. To make matters worse, Biff stops paying Andy's trainers. The trainers quit and Andy loses more clients who had stayed on as members

34. *See* Lockwood Int'l, Inc. v. Wells Fargo, Nat'l Ass'n, No. 20-40324, 2021 WL 3624748, at *3 (5th Cir. Aug. 16, 2021) (citing Wright v. Sydow, 173 S.W.3d 534, 544 (Tex. App.—Houston [14th Dist.] 2004, pet. denied).

35. *See, e.g.*, Leal v. Bank of Am., N. A., No. CIV.A. M-11-346, 2012 WL 1392089, at *5 (S.D. Tex. Apr. 20, 2012).

specifically for training sessions. To save what they can on their loan, the bank directs Biff to stop paying Larry the Local Lender and Andy's equipment suppliers.

When Andy's Athletics misses two payments on the bridge loan, Larry the Local Lender puts Andy's in default. Andy continues to lose gym members as he now cannot keep up with operations and maintenance. Even with the bank's accommodations, Andy again falls behind on the loan payments to the bank.

Biff is nervous and plans to put Andy's in default, figuring that he can seek to foreclose on the gym, sell it, and sell all the equipment to make up for the loan. Biff is concerned that the default he caused by not paying Larry could be an issue in foreclosing on the gym. To ensure there will be no problems, Biff enlists his friend, an appraiser, to conduct an appraisal of Andy's Athletics and asks him to "make the numbers work for him" by devaluing the business.

Biff and the bank then claim Andy is in violation of the lending agreement because of the default declared on other debt obligations owed to Larry the Lender and because of a decline in the value of collateral securing the bank's loan. The bank thus puts Andy's Athletics in default and claims that the entirety of the balance on Andy's loan is now accelerated and due.

Andy is in dire financial straits and out of options. The loan had years left to be repaid. He feels as though Biff misled him, and he wants to seek rescission of the loan in its entirety. Lisa contemplates Andy's options.

A. Breach of Contract

Lisa begins to evaluate the possibility of alleging breach of contract for the bank's attempted default on the loan. She knows that the bank has the right to default on the loan under the contract and that the terms of allowable default are generic—the bank can move to default any time if there was an "event of default" under the loan, defined as Andy's "failing to observe or perform any of the covenants, conditions and agreements contained herein or in any of the other Financing Documents."[36] The conditions of Andy's loan agreement require him not to experience (1) an "insolvency event," which includes any event in which Andy's Athletics defaults on a debt obligation; or (2) a "material adverse change" in the financial condition of

36. In re Bailey Tool & Mfg. Co., No. 16-30503-SGJ-7, 2021 WL 6101847, at *37 (Bankr. N.D. Tex. Dec. 23, 2021).

Andy's Athletics.[37] Because these conditions are worded so broadly, Lisa determines that the bank likely did not breach its contract with Andy by moving for default based upon the financial condition of Andy's Athletics and after receiving notice of default on his loan from Larry the Lender.

"How could that be?" Andy asks Lisa. "This just isn't fair. Isn't there something else we can claim?"

B. Breach of Duty of Good Faith and Fair Dealing

Lisa considers the circumstances that led to the bank finally putting Andy's Athletics in default, and questions whether a court would find that the bank breached its duty of good faith and fair dealing. It certainly seems that the bank's directing Biff to cease paying Larry the Local Lender crosses the line of control and places the bank's interests above preserving Andy's Athletics. Lisa thinks the same analysis should apply to the bank's decision to stop paying the trainers. In fact, she is reasonably certain that some courts would find this to be grossly overreaching conduct that ultimately caused Andy's Athletics to suffer damages.[38] Lisa also recalls that the specific reason Andy even needed the loan from Larry was due to the bank declaring that Andy was "overleveraged," a term that was undefined in the loan agreement and which seemed like nothing more than an excuse to require Andy to front additional collateral on the bank's loan.

Further, when Lisa learns that Biff asked the appraiser to devalue the gym, it becomes clear that the bank and Biff committed a "dishonest or unreasonable deviation from prevailing commercial standards of reasonableness in the trade, thereby denying [Andy] the benefit of the bargain."[39]

C. Breach of Fiduciary Duty

Lisa jots down some thoughts about whether Biff and the bank would now be considered to have been in a fiduciary relationship with Andy in light of the entirety of the developments between the bank and Andy's Athletics.

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37. *Id*.

38. *Id*. at *41.

39. House v. U.S. Bank Nat'l Ass'n, 2021 MT 45, ¶ 18, 403 Mont. 287, 304, 481 P.3d 820, 831 (Mont. 2021); *But see* Silver v. Countrywide Home Loans, Inc., 760 F. Supp. 2d 1330, 1344 (S.D. Fla. 2011), aff'd, 483 F. App'x 568 (11th Cir. 2012) ("under Florida law, there can be no cause of action for breach of implied covenant of good faith and fair dealing absent an allegation that an express term of the contract has been breached").

Lisa thinks it likely that Andy "repose[d] trust in a bank and rel[ied] on the bank for financial advice,"[40] or at least that special circumstances here made the bank Andy's fiduciary.[41] Assuming that to be true, the bank should have "refrain[ed] from misleading or concealing information" from Andy, and the bank was "required to make decisions in the best interests of the borrower, even if contrary to the best interest of the lender."[42]

Lisa considers the relationship between Andy and Biff. Biff certainly hid information from Andy. Andy had also come to heavily rely on Biff's financial advice through the years, and a court would likely find that Andy's reliance on Biff's advice was reasonable. Certainly, it seems as though Biff did nothing to disabuse Andy of the notion that Biff was his financial adviser. Lisa believes that Andy's claims for breach of fiduciary duty will be bolstered by the excessive control and influence exerted by the bank on Andy's Athletics.[43] Lisa will have to show, however, that Andy's relationship with Biff transcends the "mere fact that [he] subjectively trusts [Biff]."[44] Assuming she can do so, Lisa believes she can certainly prove the bank put its interests ahead of Andy's and his business: the bank fabricated the "overleveraged" classification to extract additional collateral; it touted the alleged "personal line of credit" as inducement for Andy to enter into the loan; it ultimately seized control of Andy's finances and operational control of his business to the bank's benefit and to the detriment of Andy's Athletics; and the bank's actions caused Andy's Athletics to default on both the bank loan and the bridge loan from Larry.

D. Tortious Interference

In some states, Andy could have a claim against Biff and the bank for tortious interference with his business relationships. This is particularly so

40. Black Creek Station Homeowner Ass'n, Inc. v. MUFG Union Bank, N.A., No. 2:22-CV-132-MHH, 2023 WL 3111727, at *4 (N.D. Ala. Apr. 26, 2023) (citing K & C Dev. Corp. v. AmSouth Bank, 597 So. 2d 671, 675 (Ala. 1992)).

41. *See id.*; *See also* High v. McLean Fin. Corp., 659 F. Supp. 1561, 1568 (D.D.C. 1987); Christianson v. First Nat'l Bank Alaska, No. S-13985, 2012 WL 6062124, at *21–22 (Alaska Dec. 5, 2012).

42. In re Bailey Tool & Mfg. Co., No. 16-30503-SGJ-7, 2021 WL 6101847, at *41 (Bankr. N.D. Tex. Dec. 23, 2021).

43. *See* Bowman v. CitiMortgage Inc., No. 3:14-CV-4036-B, 2015 WL 4867746, at *7 (N.D. Tex. Aug. 12, 2015) (citing In re Absolute Res. Corp., 76 F. Supp. 2d 723, 734 (N.D. Tex. 1999)).

44. Smith v. Deneve, 285 S.W.3d 904, 911 (Tex. App.—Dallas 2009, no pet.).

when the lender intentionally interferes with things such as management selection and the borrower's business contracts.[45] A typical cause of action for tortious interference might require Andy to show (1) a contract subject to interference exists, (2) the act of interference was willful and intentional, (3) the intentional act proximately caused the plaintiff's damage, and (4) actual damage or loss occurred.[46] The fact that Biff was installed as CFO of Andy's Athletics and his subsequent directives to stop paying the trainers and Larry the Local Lender will not serve the bank's case. The bank could be subject to additional liability if it also upset the contracts between Andy's Athletics and its equipment suppliers due to its control of Andy's finances.

E. Fraud, Fraudulent Inducement, and Consumer Protection Act Violations

Finally, Lisa turns to other potential tort-based claims. To establish fraud, Lisa would have to prove that (1) the lender made a representation to the borrower; (2) the representation was material; (3) the representation was false; (4) when the lender made the representation, it either knew the representation was false or positively asserted the representation recklessly and without knowledge of whether it was true; (5) the lender made the representation with the intent that the borrower act on it; (6) the borrower did rely on the representation; and (7) the representation caused the borrower injury.[47] Fraudulent inducement is a closely related cause of action that requires a showing of the same elements, in addition to an allegation that the fraud perpetrated caused the plaintiff to fraudulently enter into a contract.[48] Lisa carefully evaluates these elements. While Biff said many false statements, she is unsure whether a jury would find these representations to be willfully or intentionally misleading, rather than simply negligent. However, Lisa feels more confidence with respect to the appraisal. In using the fraudulently obtained lower-than-market-value appraisal as a basis to default Andy's Athletics on the loan, it is likely that Biff committed an actionable fraud.[49]

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45. *See* In re Bailey Tool & Mfg. Co., No. 16-30503-SGJ-7, 2021 WL 6101847, at *41 (Bankr. N.D. Tex. Dec. 23, 2021).

46. *See id* at *47.

47. *See id.* at *44.

48. *See* Kevin M. Ehringer Enters., Inc. v. McData Servs. Corp., 646 F.3d 321, 325 (5th Cir. 2011).

49. *See In re Bailey Tool & Mfg. Co.*, 2021 WL 6101847, at *54.

Finally, Lisa entertains whether she might bring a consumer protection claim under the jurisdiction's applicable statutes. Most jurisdictions have such protections, but the extent to which they apply to loan transactions varies.[50] Lisa thinks this claim is less likely to be successful.

V. LITIGATION AND DAMAGES

So what? That's the question that strikes Lisa after all this back and forth. So what if all of this happened? What does Andy get out of it? How is it likely to play out?

Lisa first figures she needs to set realistic expectations for Andy. Discovery in a case such as this can be burdensome. It could take more than a year from the date of filing a complaint against Biff and the bank for the dispute to wind its way through the courts. Even if they are successful, Andy's business may be long gone by the time he sees a nickel.

On the other hand, the bank will almost certainly need to hire counsel to defend against the litany of claims that Andy will seek to bring against the bank and Biff. The bank should begin by assessing liability at an early stage by conducting interviews with those people associated with Andy's loan, and in particular with Biff. The bank should be careful about sending internal communications regarding Andy's loan because any such communications could be discoverable. This is particularly important if there is a chance that Andy can prove any cause of action that requires malicious intent, such as fraud. These subsequent statements could give a jury insight into the mind of the bank and its employees to determine how they thought of Andy, of Biff, and of Andy's Athletics. The bank should also examine Biff's prior course of conduct and what the bank knew or should have known about his business practices prior to his dealings with Andy's Athletics. If Biff's practices fell outside the bank's ordinary practices and procedures, the bank should strategically consider whether to argue Biff was outside the course and scope of his employment and authority to

50. *See e.g.*, Guajardo v. J.P. Morgan Chase Bank, N.A., 605 F. App'x 240, 249 (5th Cir. 2015) (dismissal of claims under the Texas Deceptive Trade Practices Act regarding a mortgage loan transaction upheld on appeal as pure loan transactions are generally not considered to be a good or service and thus claimant not considered to be a consumer under Texas law); Dellos Farms, Inc. v. Sec. State Bank, 2022 WY 107, ¶ 15, 516 P.3d 846, 849–50 (Wyo. 2022) (in case involving promissory notes securing agricultural loans, Supreme Court of Wyoming found that loans did not fall within Wyoming Consumer Protection Act because the notes pertained only to commercial operations and not consumer transactions).

transact in the manner in which he did with Andy. The bank should be prepared to defend against Andy's claim that, regardless of the bank's position, Biff had actual or apparent authority to act in the way that he did.

When the bank receives a copy of Andy's lawsuit, it should immediately forward it to its counsel for review. Biff is likely to be named as a defendant along with the bank, and chances are that Biff is a citizen of the same state as Andy. If Biff and the bank happen to be citizens of a different state than Andy (i.e, diverse citizens), there will be limited time to remove the case to federal court.

Although pleading practice may draw out the litigation, the fewer claims that are viably pled against the bank, the less Andy can pry into the bank's operations during discovery. Nonetheless, the bank should be prepared to do damage control in the discovery phase. Andy will likely be entitled to a wide range of documents, policies, and correspondences relating to his loan and potentially also relating to others like his. The bank should be prepared to depose Andy, certainly, but it should also be aware that Andy will seek to depose bank employees as well as a corporate representative of the bank.

The bank should take inventory of how much Andy's business is worth and what he is claiming is the lost value of his business as a going concern. Even for a modest business, the lost "legacy" value may amount to millions of dollars. Additionally, if Andy can plead a cause of action for an intentional tort, such as fraud, he may be entitled to punitive damages. If the bank takes inventory of the facts likely to come out during discovery and finds that they are likely to hurt its case, the bank may consider attempting early resolution of Andy's claims. Perhaps the bank can consider what Andy really wants (rescission of the loan) and try to put Andy back in the same condition he was in prior to the loan, without paying additional damages for Biff's actions. The bank otherwise should be prepared for extensive and hard-fought litigation, in which case it will need a good lawyer.

This is all just the tip of the iceberg, and Lisa knows that there may be additional facts she has not yet uncovered that give rise to liability against Biff and the bank under other causes of action.[51] She thanks Andy for coming in, walks him out of the office, and calls it a day. She has a lot of work ahead of her.

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51. For example, depending on what Lisa discovers, Biff may have violated provisions of the Truth in Lending Act or other state-specific regulations.