

PUBLICATION

"I Knew You Were Trouble": Recent Trends in Lender Liability Litigation

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Lender liability claims generally arise in one of following contexts: (i) claims seeking recovery of damage or "leverage" to accept discounted payoffs; (ii) counterclaims to foreclosure/receivership/guarantor actions; or (iii) "first strike" lawsuits in anticipation of collection/foreclosure actions.

Borrowers typically go after commercial lenders on one of the following grounds: (i) breach of contract/violation of obligation of good faith and fair dealing; (ii) tort claims (e.g., negligent servicing); (iii) deepening insolvency; and (iv) breach of fiduciary duties. Typically, lender liability allegations are about leverage.

When it comes to alleged interference with or control of a borrower's business, we have seen claims relating to required lender approvals of material leases or renewals, allowing or refusing use of escrows and reserves (tenant improvement/leasing commissions, replacement reserves, etc.), cash waterfalls with hard lockbox that provide for disbursement of funds for operations, and conduct of due diligence by lender prior to exercise of remedies or by possible note purchaser, including the presence of third parties at property. It is important to consider the ramifications of these types of actions as it is critical that the lender comply with the contractual terms of the loan documents. Lenders can get into trouble when they start taking action that is not provided for in the loan documents.

Another area that borrowers have attempted to litigate is alleged oral modification of loan documents. These arguments typically take the form of either a course of conduct, where the borrower argues that the lender's actions have waived defaults due to lack of action or objection, or a borrower alleging that verbal or informal written communication constitutes a modification or extension of loan terms. The underlying loan documents should contain express provisions prohibiting any oral modification of the terms of the written documents and non-waiver provisions based on action or inaction. Assuming those type of provisions are in the documents, the lender should have a strong argument against these types of claims.

In order to avoid lender liability allegations in dealing with a defaulted loan, in our experience some of the best practices are:

1. Develop a strategy at the front end of the matter.
2. Do not "run" the borrower's business.
3. **Do not become the borrower's advisor in any context.**
4. Do not act suddenly or erratically in your dealings with the borrower.
5. Honor your agreements and act honorably in your interactions with the borrower.
6. Know your opposition, including opposing counsel.
7. Determine whether a guarantor claim is worth pursuing.
8. Follow the Golden Rule.