Stemming the Tide of Lender Liability: Judicial and Legislative Reactions

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I. Navigating the Waters of Lender Liability

Banks and lending institutions have recently found themselves engulfed in a wave of lender liability actions. Troubled borrowers have successfully turned to the doctrine of lender liability to assert their legal rights. Fraud, breach of the implied obligation of good faith and fair dealing, breach of the fiduciary duty, liability for excessive control re-

1. See Richfield Bank & Trust Co. v. Sjogren, 309 Minn. 362, 244 N.W.2d 648 (1976) (Banks have a moral duty to the community in which they do business, and a bank which had actual knowledge of the fraudulent activities of one of its depositors was under an affirmative duty to disclose this knowledge before making a loan in furtherance of the fraud.). Farah Mfg. v. State Nat'l Bank, 678 S.W.2d 661 (Tex. Ct. App. 1984) (The lenders' statements implied that they would declare default on the loan if the former chief executive officer of the corporate borrower were reinstated. A default declaration would result in the borrower's bankruptcy. Such statements established a claim of fraud for injuries arising from a promise which was not intended to be performed.). See also Barrett v. Bank of America, 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986) (lender liable to third party guarantor on theory of constructive fraud when the court found a special relationship of trust and confidence). Compare Denison State Bank v. Madeira, 230 Kan. 684, 640 P.2d 1255 (1982) (Absent a fiduciary relationship between the borrower and the bank, constructive fraud did not exist on the part of the bank in allegedly failing to make full disclosure of the financial involvement of the dealership owner with the bank.).


3. See Deist v. Wachholz, 208 Mont. 207, 678 P.2d 188 (1984) (debtor and creditor relationship between bank and its customer does not usually give rise to fiduciary responsibilities, however, when bank officer and customer share a relationship of reposed trust
sulting in the finding of a principal-agent relationship, 4 interference, 5
duress, 6 negligence, 7 misrepresentation 8 and breach of contract 9 are ex-
and confidence, the bank officer who renders financial advice takes on the role of a fiduciary.
See also Reid v. Key Bank, 821 F.2d 9 (1st Cir. 1987) (While adhering to the majority view that a fiduciary relationship can arise in certain situations, the court noted a split between those courts that refuse to find a fiduciary relationship in the lender-borrower context and those that prescribe to the majority view that a fiduciary relationship in the lender-borrower context may arise in certain situations.).

But see In re Teltronics Services, 29 Bankr. 139, 169-70 (Bankr. E.D.N.Y. 1983) (This case shows judicial reluctance to find a fiduciary relationship between a creditor and a debtor: “A creditor is not ordinarily a fiduciary of either his debtor or fellow creditors, and owes them no special obligation of fidelity in the collection of his claim . . . . [A] creditor normally has an unqualified right to call a loan when due, to refuse to extend a loan for any cause or no cause at all, and to lawfully enforce collection.”); accord In re W.T. Grant, 699 F.2d 599 (2d. Cir. 1983), cert. denied, 464 U.S. 822.


4. See In re American Lumber, 5 Bankr. 470 (Bankr. D. Minn. 1980) (lender’s claim equitably subordinated to the claims of other unsecured creditors because of the lender’s use of its power as a controlling creditor); A. Gay Jenson Farms Co. v. Cargill, Inc., 309 N.W.2d 285, 291 (Minn. 1981) (The creditor was found to be an active participant in the debtor’s operations and was thus subject to the following rule: “[a] creditor who assumes control of his debtor’s business for the mutual benefit of himself and his debtor, may become a principal, with liability for the acts and transactions of the debtor in connection with the business.” Restatement (Second) of Agency § 14-O (1958)); Farah Mfg. v. State Nat’l Bank, 678 S.W.2d 661 (Tex. Ct. App. 1984).


5. Melamed v. Lake County Nat’l Bank, 727 F.2d 1399 (6th Cir. 1984) (court found that bank’s actions in requiring corporate borrower’s president to take a 50% reduction in salary, replacing the corporate accountant with one chosen by the bank, and a 13 point memorandum prepared by the bank to salvage the corporate borrower were sufficient evidence to bring a claim of tortious interference to the jury); Farah Mfg., 678 S.W.2d at 661 (court expanded the traditional concept of tortious interference beyond protecting specific contracts or prospective contracts to include the corporate governance process).

6. See Pecos Constr. Co. v. Mortgage Inv. Co., 80 N.M. 680, 459 P.2d 842 (1969) (mortgagee liable to mortgagee for duress because of mortgagee’s refusal to provide financing coupled with its refusal to release its financing commitment to another lender in the wake of the mortgagee’s fear of economic loss); Farah Mfg., 678 S.W.2d at 661 (actionable duress may exist when one enforces or threatens to enforce legal rights in bad faith or acts oppressively to further his own economic interests by implying that loan would be called if former chief executive officer resumed management). But see F.D.I.C. v. Linn, 671 F. Supp. 547 (N.D. Ill. 1987) (economic duress was not available to the borrowers as a defense to an action brought against them to collect on a note and guarantees or as a countermotion against the lender, since, under Illinois law, the lenders were entitled to extract substantial concessions from borrowers on renegotiation of the note.).

7. See Brunswick Bank & Trust Co. v. United States, 707 F.2d 1355 (Fed. Cir. 1983) (lender liable for negligently failing to service a loan properly); First Nat’l City Bank v. Gonzalez, 293 F.2d 919 (1st Cir. 1961) (lender liable for negligently failing to post loan payments to borrower’s account); First Fed. Sav. & Loan Ass’n v. Caudle, 425 So.2d 1050 (Ala. 1982) (lender held liable for negligently failing to inform borrowers that their loan had been approved); Connor v. Great W. Sav. & Loan Ass’n, 69 Cal.2d 850, 73 Cal. Rptr.
amples of the "plain vanilla" types of common law theories that borrowers and third party creditors have successfully asserted under the auspices of lender liability.

The umbrella of lender liability extends beyond traditional common law principles and into the statutory arena. Violations of the Federal Bankruptcy Code, the federal securities laws, tax and wage laws, and state consumer fraud statutes also are potential weapons within the borrower's arsenal. Other statutory claims against lenders have been premised under the Racketeer Influenced and Corrupt Organization Act ("RICO") and the Comprehensive Environmental Response, Com-
Despite this apparent flood of litigation directed at the financial community, in which borrowers have been victorious under a myriad of legal theories, there are signs that the tide may be shifting in favor of the lender. This article provides an analysis of the recent appellate court decisions in Penthouse International v. Dominion Federal Savings & Loan Association,13 Kruse v. Bank of America,14 and Gillman v. Chase Manhattan Bank.15 Collectively, these cases have instilled in lenders a guarded sense of optimism leading them to believe that following sound commercial lending policies will tip the scales of justice in their favor. In addition, this article will address significant statutory reforms at the state

12. 42 U.S.C.A. §§ 9601-9657 (West 1981 and Supp. 1989). Indeed, the environmental arena has been projected as the new frontier for lender liability litigation. Lenders are increasingly finding themselves liable for clean-up costs relating to contaminated property over which they have exercised too much control or which they own through foreclosure. See United States v. Maryland Bank & Trust, 632 F. Supp. 573 (D. Md. 1986) (lender who takes title at foreclosure sale is liable for cleanup of hazardous waste discovered after foreclosure sale); United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) § 20994, (E.D. Pa. 1985) (In recognizing a distinction between parties who are involved in the actual operation of a contaminated facility and those who are involved in the financial aspects of the business conducted at the facility, the court held that a lender who involves himself in the borrower's operations may be liable.). But see United States v. Fleet Factors Corp., 724 F. Supp. 955 (S.D. Ga. 1988) (The secured lender disposed of repossessed collateral as a measure to protect its security interest. This did not give rise to ownership or operator status. Therefore, the lender was not held liable for hazardous cleanup costs.). CERCLA provides an exception for lenders who have not participated in the management of the facility and whose interest is merely an indicia of ownership to protect a security interest in the facility. Thus, unless it can be shown that the lender has exercised actual control over the contaminated facility, there can be no liability under CERCLA.

13. 855 F.2d 963 (2d Cir. 1988), cert. denied.


level which are designed to limit the ability of borrowers to bring lawsuits against lenders.

II. CASES REVERSING THE TIDE OF LENDER LIABILITY

A. Penthouse International v. Dominion Federal Savings & Loan Association

In *Penthouse International v. Dominion Federal Savings & Loan Association* \(^{16}\) ("Penthouse") the United States Court of Appeals for the Second Circuit held that Dominion Federal Savings and Loan Association ("Dominion") was not liable for anticipatory breach of a loan commitment to Penthouse International, Ltd. ("Borrower").\(^{17}\) The court further held that neither Dominion nor its legal counsel engaged in fraud.\(^{18}\) As a result, the court vacated the staggering $129 million judgment that had been awarded to Borrower.\(^{19}\)

1. Facts

On or about June 20, 1983, Borrower entered into a $97 million written loan commitment with Queen City Savings & Loan Association ("Queen City") for construction and permanent financing in connection with a hotel and casino project in Atlantic City, New Jersey. By its terms, the loan commitment was to expire 120 days after the original June 20, 1983, commitment date, unless mutually extended in writing by Queen City. Upon expiration of the loan commitment, Queen City was to have no further obligation to Borrower other than refunding any origination fees which were received from Borrower. Despite its status as lead lender, Queen City retained only $7 million of the loan and conditioned closing upon Borrower getting other lenders to contribute $90 million to make up the difference. Lending institutions which decided to participate in the loan syndicate were required to enter into a Loan Participation Sale and Trust Agreement ("participation agreement"). Dominion was one of thirteen financial institutions to participate in the loan syndicate and committed $35 million — double its legal lending limit — to the transaction.\(^{20}\)

17. *Id.* at 983.
18. *Id.* at 987.
19. *Id.*
20. Dominion was able to sell $17.5 million of its original $35 million interest in the loan syndicate to Community Savings and Loan Association ("Community"). Community initially demonstrated reluctance in joining the project. After expiration of the loan commitment, Community withdrew its $17.5 million interest from the loan syndicate. There was a factual difference between the district court finding and the court of appeals finding as to when Community withdrew its interest from the loan syndicate. The district court concluded that Community withdrew its interest prior to the loan commitment expiration date and that therefore Dominion "was in the awkward position of having committed itself to lend more than the amount it was legally permitted to lend." *Penthouse Int'l v. Dominion Fed. Sav. & Loan Ass'n*, 665 F. Supp. 301, 310 (S.D.N.Y. 1987). The district court thus concluded that Dominion had no choice other than to "withdraw from its commitment or breach its agreement." *Id.*

The court of appeals rejected the district court's finding as to the timing of Commu-
The loan commitment imposed a number of preclosing requirements upon Borrower before Queen City would be obligated to provide the financing. Borrower was required to provide an "insurable first mortgage lien on the project, copies of contracts with the architects and major trade contractors, evidence that all utilities required for the development would be available, and evidence that satisfactory alternate licensing arrangements were available if [Borrower] failed to obtain the required license to operate a casino."21

Neither the loan commitment nor the participation agreement provided that Queen City was authorized by the other participating lenders to waive Borrower's compliance with any of the preclosing requirements. Furthermore, the participation agreement stipulated that Queen City would serve as a trustee with fiduciary duties in protecting the rights of the other participating lenders. The participation agreement also contained an integration clause preventing modification except by written agreement and a clause designating New Jersey law as the governing law. There was never a separate written agreement between Borrower and Dominion concerning the financing of the transaction.22

On November 21, 1983, Borrower and Queen City agreed to extend the expiration date of the loan commitment to December 1, 1983. After negotiation as to the timing of the loan closing between Borrower, Dominion, and Queen City, a letter dated November 21, 1983, ambiguously recited that Borrower and Queen City agreed to "close th[e] loan no earlier than February 1, 1984 or later than March 1, 1984."23

Once the loan syndicate was complete, Borrower and Queen City focused on closing the deal which required satisfaction of the preclosing conditions. Discussions took place in a series of informal status meetings at which only representatives of Borrower and Queen City were present. Neither Dominion nor any of the other loan syndicate participants attended these meetings. The significance of the meetings was that Borrower sought to arrange substitute performance rather than comply with the required preclosing conditions. Without seeking Dominion's consent for a waiver of Borrower's full compliance with any of the preclosing conditions, Queen City allowed Borrower to proceed toward closing because it was satisfied that the transaction could close based on Borrower's proffered substitute performance in lieu of the preclosing requirements.24
Prior to the preclosing meeting, Borrower's outside counsel for the loan transaction received a letter from a title insurance company revealing that title problems would prevent Borrower from conveying the mortgage security required by the loan commitment. Furthermore, there were encumbrances on certain leases that would prevent Borrower from complying with preclosing conditions unless negotiations could result in a discharge or subordination of the existing interests.25

The preclosing meeting was held on February 9, 1984. Dominion and its counsel, Philip Gorelick ("Gorelick"), of Melrod, Redman & Gar- tla, P.C. ("Melrod Firm") were present. After reviewing the draft loan documentation, Gorelick determined that "the loan transaction was not in a position to close, explaining that, in light of the unresolved title problems, problems with the leases, the unfulfilled status of some of the preclosing conditions and the inadequacy of the draft loan documents, he could not advise his client to proceed."26 Gorelick also was tactless in conveying his belief to Queen City and others that the whole deal had to be overhauled. To alleviate his concerns, Queen City agreed to allow Gorelick to prepare appropriate closing documents and to review the preclosing requirements in order to close the deal. With respect to the problem leases at issue, Gorelick proposed amendments to the lease which he described as being "required" in order to have the leases properly prepared for closing.27 However, when these amendments were sent to Borrower, a cover letter by a partner at the Melrod Firm "indicated that the proposed amendments reflected a 'nearly final version of what the lender will be looking for ...'"28

Shortly before March 1, 1984, Gorelick indicated to Borrower that the loan commitment expiration date should be extended. Borrower rebuffed this suggestion, believing instead that the loan commitment could not expire unless and until it was presented with the closing documents. After trying to replace Queen City as the lead lender, Dominion sent Borrower a letter on March 22, 1984, lobbying for a specific construction company that Borrower did not want, as well as demanding that Borrower implement a formal hotel management program. After receiving this letter, Borrower broke off communication with Dominion. On March 20, 1984, the loan syndicate collapsed as participating lenders believed that the loan commitment had expired on March 1, 1984. Borrower was unsuccessful in finding alternative financing and brought suit against Dominion claiming anticipatory breach of its loan commitment. Borrower also sued the Melrod Firm for fraud in connection with the transaction.

2. District Court Opinion

The district court held that Dominion's conduct amounted to an

25. Id. at 969.
26. Id. at 970.
27. Id.
28. Id.
anticipatory breach of the loan agreement. The court analyzed the anticipatory breach issue by stating that "[w]here a party to a contract indicates its refusal to perform unless entirely new or different conditions are first met, then it has breached the agreement." The court considered the following factors dispositive in its finding that Dominion’s actions amounted to an unambiguous refusal to close, constituting an anticipatory breach: 1) Gorelick’s demand that Borrower obtain amendments to the problem lease; 2) Dominion’s insistence that a hotel management agreement be entered into prior to closing; 3) Dominion’s demand that Borrower hire a specific construction company; and 4) Dominion’s insistence that it replace Queen City as lead lender.

Responding to Dominion’s argument that there could be no anticipatory breach because Borrower was not in a position to close as of March 1, 1984, the court determined (without making any findings as to Queen City’s authority to waive any preclosing conditions on behalf of Dominion) that “all of the conditions precedent had been met, waived, or were in a position to have been met by the date set for closing the loan.”

The court also held that the Melrod Firm engaged in active fraud. Despite a proposed judgment submitted by Borrower which sought $1.7 million against the Melrod Firm, the district court sua sponte amended the proposal to hold the firm joint and severally liable for the full $129 million.

3. Second Circuit Opinion

The Second Circuit reversed the district court’s holdings that Dominion anticipatorily breached its loan commitment and that the Melrod Firm engaged in active fraud. Unlike the flamboyant language that characterized the district court’s opinion, the tenor of the court of appeals’ decision was marked by a return to the traditional principles of contract law.

a. Reversing the Anticipatory Breach Claim Against Dominion

The Second Circuit found that March 1, 1984, was the date upon which the loan commitment expired by its own terms. The court read the expiration date clause of the loan commitment together with the clause relating to the closing date and determined that the parties must

30. Id. at 310 (citations omitted).
31. Id. at 311.
32. Id. at 310.
33. The following illustrates the colorful language that prevailed throughout the district court’s opinion: “Gorelick took the stand and attempted brazenly to lie to the court. During cross-examination, the crucible of truth, Gorelick continuously shifted uneasily in the chair, sweated like a trapped liar, and the glaze that came over his shifty eyes gave proof of his continuing perjury. His total lack of veracity was shown not only by his demeanor but by the shady practices he seemingly reveled in.” Penthouse Int’l, 665 F. Supp. at 306 n.1.
have intended to extend the expiration date of the loan commitment to March 1, 1984. "Any other construction of these documents would leave the parties agreeing to close the loan after the commitment had expired which would make no sense."34 The Second Circuit emphasized the primacy of the written document over informal conduct between the parties. "[W]e simply construe the terms of relatively unambiguous documents. The parties bargained for a loan commitment that remained open only for a stated duration and we are not at liberty to construe that agreement in a manner inconsistent with its clear language."35

Having determined that the loan commitment expired by its own terms on March 1, 1984, the Second Circuit held that Dominion could not be liable for anticipatory breach of contract for actions it took after that date.36 Of the four factors that the district court found as evidence of an anticipatory breach, the only one that took place before March 1, 1984, was the demand for amendments to the defective leases. The Second Circuit thereafter determined that Dominion could be liable for anticipatory breach only if there were "'a clear and unequivocal declaration' that 'the agreed upon performance would not be forthcoming.'"37 The court found that Gorelick's action with respect to the defective leases did not meet the "clear and unequivocal" refusal to perform standard.38 Furthermore, Gorelick's conduct at the preclosing meeting, in which he was reluctant to proceed with the loan transaction until the title problems affecting the Lender's mortgage lien were resolved, was deemed to be a reasonable course of action thereby precluding an anticipatory breach claim.39

In a further rejection of the district court's findings, the Second Circuit again relied on familiar contract doctrine noting that to successfully sustain an anticipatory breach claim "the plaintiff must demonstrate that it had the willingness and ability to perform 'before the repudiation and that the plaintiff would have rendered the agreed performance if the defendant had not repudiated.'"40 The district court found that Borrower was in a position to perform because Queen City had effectively waived the preclosing requirements. The Second Circuit looked to the loan commitment and the participation agreement and concluded that "although Queen City had the final word on whether the preclosing conditions had been satisfied, [Borrower] nevertheless was required to satisfy each of the preclosing conditions."41

In addition, Queen City was not empowered to waive Borrower's compliance with the preclosing conditions, nor was it empowered to

34. Penthouse Int'l, 855 F.2d at 976.
35. Id.
36. Id. at 977.
37. Id. (emphasis in original) (citations omitted).
38. Id.
39. Id. at 978-79.
40. Id. at 979 (citing 4A. Corbin, Corbin on Contracts § 978, at 925 (1951)).
41. Id. at 980.
modify the terms or conditions of the participation agreement without obtaining Dominion's approval. In its conclusion that Queen City could not waive Borrower's preclosing requirements in favor of substitute performance without first obtaining Dominion's approval, the court was persuaded by an amicus curiae filed by the Federal Home Loan Bank Board ("FHLBB").

The FHLBB advanced several public policy arguments limiting the lead lender’s ability to modify essential terms of an agreement without consulting the other participating lenders. The court properly noted that the FHLBB’s policy considerations would not be binding if parties to a loan transaction were to agree to give the lead lender this authority. However, it is apparent that the court was also impressed by the thrust of the FHLBB argument that “[a] savings and loan association’s independently and prudently underwritten participation in a loan could be changed into an entirely reckless act if fundamental terms and conditions of the loan are altered prior to closing by the lead lender on its own initiative and without consulting the participant.”

b. Reversing the Fraud Claim Against Melrod Firm

The Second Circuit found that the district court made its decision to hold the Melrod Firm jointly and severally liable sua sponte for active fraud based on the Melrod Firm’s alleged intentional sabotage of the loan transaction coupled with Dominion’s secret intent not to proceed with the deal beyond the preclosing meeting originally scheduled for February 2, 1984. The district court placed great weight on its finding that Community Savings & Loan ("Community"), Dominion’s sub-participant who purchased $17.5 million of Dominion’s interest in the loan syndicate, had backed out by February 29, 1984, thereby forcing Dominion to breach its commitment to the loan because it had exceeded its legal lending limit. Thus, since the district court was relying on facts which occurred in late February, there was no support for its conclusion that the Melrod Firm committed fraud upon Borrower at the preclosing meeting on February 9, 1984. Additionally, the Second Circuit’s finding that Community did not withdraw until March 20, 1984, and that the loan commitment had expired on March 1, 1984, removed the motive behind any alleged fraud. In sum, the Second Circuit reversed the fraud claim due to insufficient evidence to support the claim.

4. Lessons Derived from Penthouse

a. Emphasis on the Written Document

The most important lesson from Penthouse is that in complex com-

42. Id. at 987.
43. Id. at 981.
44. Id. at 986-87.
45. See generally Calbreath, Long Year Ends For Dominion, Wash. Bus. Journ., Sept. 5, 1988; Chaitman, On Lender-Liability Claims, Appeals Court Applies the Brakes, Legal Times, Oct. 17, 1988, at 18; Focus on Enforcement of Written Agreements is Message To Be Derived From
mercial transactions between sophisticated parties with access to counsel "the parties will not be presumed to intend to vary material terms of the deal that had previously been committed with care and specificity to writing by off-the-cuff or informal dealings thereafter."46 The Second Circuit's message appears to be that complicated lending transactions should be governed by well-established principles of contract law in order to inspire confidence that the loan documents will set out the rights and obligations of the various parties to the transactions and that oral conversations or waivers are an inappropriate means of varying the terms of the loan agreement. "The court just reaffirmed that when you have sophisticated contracting parties, represented by able counsel in a very complex commercial transaction, they are going to have to live by the words of the documents they draft."47

b. Lead Lender Without Authority to Waive Preclosing Conditions

Commercial reality in the lending arena dictates that lead lenders include loan participants in the decision-making process with respect to extensions of credit and other lending issues. Penthouse judicially reinforces this commercial reality by standing for the proposition that, absent consent by all the loan participants, a lead lender may not waive any terms that materially affect the substance of the transaction. While this sweeping proposition deserves support, there are some fundamental flaws which may hamper enforcement of this rule.

First, with respect to those conditions which do not substantially affect the terms of a transaction, a lead lender may feel compelled by the Penthouse decision to require, in the absence of express authorization, strict compliance with all conditions of the commitment regardless of how burdensome this may be to all parties involved.48 Furthermore, the Penthouse decision does not define any standards or guidelines as to how a lender determines which terms of a loan commitment are "material" or "substantial".49 Moreover, the Penthouse decision leaves the borrower in the unwieldy position of determining whether the lead bank has obtained the consent of participants to waiver of preclosing conditions. "[B]orrowers are now on notice that the lead has no apparent authority to waive conditions to closing; hence, even if the lead misrepresents its authority to the borrower, the participants will not be bound by its waivers."50 This issue dovetails into the problem of who bears the risk of unauthorized acts of the lead lender — the borrower or the participating

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49. Id.
50. Id. (emphasis in original).
Furthermore, if the loan participants agree to grant full waiver power to the lead lender, does this comport with sensible underwriting practice? These questions must be addressed in the aftermath of Penthouse.

c. Other Implication

If the district court decision had been sustained on appeal, Dominion would have been forced to liquidate. "In today's economy, with the federal savings-and-loan bail-out estimated at tens of billions of dollars, no court is going to want to create another failed institution." The Penthouse decision suggests that before the Second Circuit will remove the last lifeboat from a sinking financial institution, the court will carefully scrutinize the law as applied to the facts in each case.

B. Kruse v. Bank of America

In Kruse v. Bank of America ("Kruse") the California Court of Appeals held that Bank of America ("Bank") was not liable for fraud, bad faith denial of contract, interference with prospective economic advantage or intentional infliction of emotional distress. Consequently, the court vacated a $47 million judgment which had been awarded to two families of apple growers and processors.

1. Facts

George Jewell ("Jewell"), an apple farmer, and the O'Connell Company ("O'Connell"), an apple processing company, had been longstanding customers of Bank. When Bank abruptly terminated O'Connell's customary annual line of credit in 1975, Jewell agreed to render financial assistance in order to aid his fellow farmer and keep a viable market open for his apples. Jewell negotiated with William Sullivan ("Sullivan"), branch manager of Bank, to borrow money from Bank which would be used to provide loans to O'Connell. In 1976 and 1977, Jewell borrowed in excess of $400,000 from Bank, which he in turn lent to O'Connell to finance equipment purchases and repayment of loans to Bank. During these years Jewell provided other assistance to O'Connell in the form of increased financial advice, negotiating with O'Connell's creditors to extend payment terms and supplying O'Connell with large quantities of apples on credit alone.

In late 1977, O'Connell decided to build a new apple dehydration facility ("facility"). Since Bank was unwilling to provide further loans to O'Connell, Jewell again "undertook responsibility to obtain the neces-

51. Focus on Enforcement of Written Agreement is Message to be derived from Penthouse Case, Attorneys Say, 51 Banking Rep. (BNA), No. 11, at 506 (Sept. 19, 1988).
While initially believing that Bank would provide the long-term financing, Jewell was forced to find an alternate source of funds when Bank refused to lend the money while Dan O'Connell remained as manager of the facility. Jewell was successful in obtaining a $650,000 loan from North Coast Production Credit Association ("PCA") evidenced by a seven-year promissory note. Jewell later borrowed another $500,000 from PCA to buy a new dehydrator. Construction of the facility began in May, 1978.

After obtaining the PCA loan, Sullivan and Jewell reopened negotiations with Bank regarding the long-term financing necessary for the facility. During these discussions, "Jewell knew that Sullivan did not have authority to approve large loans." After receiving another $209,000 loan from Bank to purchase equipment for the facility, Sullivan strongly urged Jewell to obtain a controlling interest in O'Connell as it was becoming more difficult for Bank to continue investing in the facility without Jewell possessing a controlling interest. Believing that Bank would not provide the long-term financing without an equity ownership position in O'Connell, Jewell met with Irene Kruse ("Kruse"), the sole owner of O'Connell, who "reluctantly agreed to transfer a majority of her stock to [Jewell's son] for $180 with the expectation that the stock would be returned once the Bank funded the long-term loan enabling O'Connell to repay [Jewell]."

Cost overruns for construction of the facility forced Jewell to borrow more money from Bank creating a total indebtedness of over $1 million to Bank. However, Jewell was still optimistic that he would be able to secure long-term financing which would permit consolidation of the several debts under a favorable repayment schedule. Still, Jewell knew that Sullivan did not have authority to commit Bank to such long-term financing. Aware of Sullivan's limited authority, Jewell took great comfort when one of Sullivan's superiors visited the Facility and exclaimed, "[W]e're going to be able to help you." Jewell took this statement to mean that the long-term loan would be approved. However, in August 1979, when Bank's appraisal of the Facility reflected a value inadequate to warrant a $1.9 million loan, Bank declined to provide the long-term financing.

In 1980, an economic downturn in the apple industry caused O'Connell to sustain heavy losses, leaving it unable to repay the construction loans advanced by Jewell. Similarly, O'Connell was unable to repay Jewell for the tons of apples which Jewell had supplied on credit. O'Connell was indebted to Jewell for over $2.7 million. Jewell, in turn, was heavily indebted to his growers, PCA, and Bank. Recognizing Jew-

55. Id. at 221.
56. Id.
57. Id. at 222.
58. Id. at 221.
59. Id. at 222.
60. Id. at 223.
61. Id. at 222-23.
ell's economic plight, Bank informed him that it would not lend him any more funds. After an emotional breakdown, Jewell was assured by Bank that, if he would provide deeds of trust on his real property to secure the outstanding loans as well as agree to apply any proceeds derived from the sale of such property to repay the loans, Bank would advance sufficient funds to pay off the growers and protect him from the demands of the PCA. Bank also insisted that Jewell liquidate O'Connell properties to provide additional funds to pay off the outstanding indebtedness. In May, 1981, Jewell filed a petition in bankruptcy. O'Connell filed for bankruptcy one year later.62

Both Jewell and Kruse filed lender liability claims. The jury returned a verdict in favor of Jewell in the amount of $17.25 million in compensatory damages and $20 million in punitive damages.63 The jury also returned a verdict in favor of Kruse in the amount of $2.77 million in compensatory damages and $6.68 million in punitive damages.64

2. Reversing the Jewell Fraud Claims

Jewell claimed that Bank was liable for actual and constructive fraud by failing to disclose facts concerning O'Connell while at the same time encouraging Jewell to obtain loans to rescue O'Connell from dire financial straits. Thus, Jewell argued that the 1976-1977 loans which he obtained to rejuvenate O'Connell's general financial condition were of paramount significance in his later financial ruin.65 Jewell posited that, but for his reliance on Bank in encouraging him to rescue O'Connell, he would have escaped economic devastation. However, in overturning the trial court, the California Court of Appeals disagreed and opined that "[t]he record convincingly and conclusively demonstrates that the 1976-1977 loans made to finance [O'Connell] were not a substantial factor in [Jewell's] financial collapse."66 In reaching this conclusion, the court looked to the following intervening factors as the reasons Jewell ultimately experienced financial difficulties: 1) the heavy indebtedness incurred in 1978-1979 in order to assist O'Connell in construction of the facility; 2) O'Connell's failure to repay construction funds borrowed from Jewell; 3) the economic downturn of the 1979-1980 apple season; 4) O'Connell's failure to repay nearly $2 million owed to Jewell for apples delivered on credit; and 5) the bankruptcy of one of Jewell's major customers.67

Jewell also claimed that Bank fraudulently induced him to incur heavy indebtedness for short-term borrowing without disclosing the possibility that his request for long-term financing for the facility would be denied. The court reasoned that there was no basis for justifiable

62. Id. at 224.
63. Id. at 224-25.
64. Id. at 231.
65. Id. at 225.
66. Id. at 226.
67. Id.
reliance by Jewell concerning Bank's failure to disclose that the long-
term loan might be denied and further noted that Jewell was aware of
Sullivan's limited lending authority. "If the conduct of [Jewell] in the
light of his own intelligence and information was manifestly unrea-
sonable, . . . he will be denied recovery." 68 With respect to comments made
by Sullivan's supervisor, the court determined that Jewell's "hopeful ex-
pectations cannot be equated with the necessary justifiable reliance" to
establish a claim of fraud. 69

Jewell also claimed to have been fraudulently induced into short-
term borrowing based on Bank's promise to commit to a long-term loan
secured by Jewell's ranch. This claim was premised upon discussions
between Sullivan and Jewell in which Sullivan suggested that Jewell use
his ranch as security for the loan. The court found it significant that on
more than one occasion Jewell refused to use his ranch as security for
the loan. Furthermore, it wasn't until after Bank had terminated any
further unsecured loans that Jewell sought to use his ranch as collateral
for a loan. At this point, however, Jewell's economic picture was so
bleak that not even presenting the ranch as collateral would warrant an
additional loan. Dismissing any justifiable reliance, the court found that
Jewell "could not reasonably have expected that the Bank's promise or
assurances of a loan secured by the Jewell Ranch would extend indefi-
nitely, notwithstanding such a staggering debt picture." 70

Jewell also claimed that Bank was liable for the tort of bad faith
denial of contract. 71 In rejecting this claim, the court of appeals decided
not to "navigate [the] murky waters" of whether there was a breach of

68. Id. (citations omitted).
69. Id.
70. Id. at 228.
71. In support of this argument Jewell cited Seaman's Direct Buying Serv. v. Standard
Oil, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). Seaman's is often cited in
the lender liability context because it is the leading case extending the reach of the tort of
breach of the covenant of good faith and fair dealing. The Seaman's court redefined the
contours of the tort by holding that "a tort action is available for breach of the covenant
[of good faith and fair dealing] in an insurance contract . . ." and "emphasized the 'special
relationship' between insurer and insured, characterized by elements of public interest,
adhesion, and fiduciary responsibility." Seaman's 686 P.2d at 1166 (citation omitted). The
court went on to hold that in an ordinary commercial contract where a special relationship
between the parties does not exist, a party to a contract may incur tort liability only when,
in addition to breaching the contract, it seeks to shield itself from liability by denying, in
bad faith and without probable cause, that the contract exists." Id. at 1167.

The Seaman's rationale was applied by analogy in Commercial Cotton Co. v. United
California Bank, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985). Based upon its conclusion
that "banking and insurance have much in common, both being highly regulated
industries performing vital public services substantially affecting the public welfare," the
Commercial Cotton court held that "[t]he relationship of bank to depositor is at least quasi-
fiduciary." Commercial Cotton, 209 Cal. Rptr. at 554.

Relying upon the Commercial Cotton rationale, the court in Barrett v. Bank of America,
183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986), held that "a relationship of trust and
confidence exists between a bank and its loan customers . . . [which] gives rise to a duty of
disclosure of facts which may place the bank or a third party at an advantage with respect
 to its customer;" Barrett, 229 Cal. Rptr. at 20 (citation omitted).

See generally Comments, Seaman's Direct Buying Service, Inc. v. Standard Oil Co.: Tortious
Breach of the Covenant of Good Faith and Fair Dealing in a Noninsurance Commercial Contract Case,
the duty to disclose based on a confidential relationship between Bank and Jewell. Instead, the court preferred a traditional contract law approach by reasoning that "[t]he inherent precondition to such a tort claim is the existence and breach of an enforceable contract." The court had little difficulty finding that there was no contract, oral or written, between Jewell and Bank providing for long-term financing. The court found Jewell merely had a hopeful expectation that a loan agreement would be reached with Bank in the future. Relying on well-established contract doctrine the court held that when the subject matter that is under consideration is left open for further negotiation and agreement, "there is no contract, not for vagueness or indefiniteness of terms but for lack of any terms."

3. Reversing the Kruse Claims of Fraud, Interference with Economic Advantage, and Intentional Infliction of Emotional Distress

Kruse asserted that Bank fraudulently induced her to transfer her controlling stock interest in O'Connell to Jewell's son by misrepresenting that long-term financing would then be made available. The court held that recovery for fraud was not available unless Kruse "changed her position in justified reliance on the fraudulent misrepresentation resulting in damage." The court found no evidence that Bank promised to make long-term financing available for the facility. The court's conclusion was reinforced by the fact that Kruse conceded there was no contract to lend money since no terms had been negotiated. Kruse claimed damages for diminution in value of the stock and sought the difference between the fair market value of her stock, $490,393 and the amount she received for it, $180. However, the court concluded that Bank played no part in setting the price for the stock purchase and thus could not be liable for any resulting loss of value. Hence, Kruse's fraud claim against Bank could not be sustained because there was no evidence supporting either an implied promise to lend or the essential element of justifiable reliance.

Kruse premised her claim against Bank for interference with economic advantage upon the theory that Bank's refusal to provide long-term financing and its efforts to liquidate O'Connell were deliberately motivated to disrupt her business relationship with O'Connell. The court disposed of this argument with a two-pronged attack. First, the court determined that intentional interference with economic advantage applies only when there is "wrongful interference with an economic relationship by a third party." In this case there were only two parties

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73. Kruse 248 Cal. Rptr. at 228 (emphasis added)(citations omitted).
74. Id. at 229 (citation omitted).
75. Id. at 232 (citations omitted).
76. Id.
77. Id. at 234 (emphasis in original).
involved — Bank and O'Connell. Second, in analyzing whether interference by Bank was tantamount to a breach of contract, the court relied on the established principle that "interference with business relations is ordinarily privileged if one has a financial interest in one of the parties." Thus, Bank was not liable in tort for interference with an economic advantage merely by protecting its vested economic interest.

In rejecting Kruse's intentional infliction of emotional distress claim, the court reaffirmed Bank's right to protect its economic interest. The court found that Bank's liquidation of the O'Connell properties was a reasonable step in asserting its legal right to repayment for the debt owed by Jewell. It held that a party is not subject to liability for infliction of emotional distress when it has merely pursued its own economic interests and properly asserted its legal rights. The court qualified its remarks by asserting that Bank could not protect its economic self-interest in an impermissible or illegal manner. However, in this case there was no such evidence because Bank never had any direct contact with Kruse.

4. Lessons Derived from Kruse

Perhaps the most important message to be derived from Kruse can be found in what the court did not hold. The facts in Kruse presented a prime opportunity for the court to expand the application of tort and fiduciary principles to banks and other lending institutions. With respect to the extension of fiduciary duties to banks, the Kruse court recognized that the plaintiffs' claims arose in the context of the commercial lending arena and, rather than applying fiduciary law, the court preferred to premise its legal analysis upon fundamental contract doctrine. With respect to the tortious breach claims, it has been stated that the Kruse court "emasculated the tort of breach of the implied covenant of good faith and fair dealing, within the context of lender-borrower relationships."

Other important teachings from Kruse include the following: 1) words of encouragement do not commit a bank to provide long-term financing; 2) if a borrower knows that a loan officer has limited lending authority he cannot be said to have justifiably relied on any promises made by the officer which exceed his authority; and 3) a bank is not liable for a borrower's emotional distress merely because the bank lawfully protected its economic self-interest. Moreover, the Kruse opinion suggests that appellate review will emphasize the need for certainty and definiteness in a loan commitment and that the written loan agreement will be the barometer of the lender's conduct.

78. Id. (citations omitted).
79. Id. at 234-35.
80. See supra note 71.
C. Gillman v. Chase Manhattan Bank

In Gillman v. Chase Manhattan Bank\(^8\) ("Gillman"), the assignee for creditors of Jamaica Tobacco and Sales Corporation ("Jamaica") brought a lawsuit against Chase Manhattan Bank ("Chase") which had segregated Jamaica's checking account thereby putting the funds beyond Jamaica's reach. The New York Court of Appeals held that Chase's security agreement with Jamaica was neither procedurally nor substantively unconscionable. Moreover, the court determined that Chase proceeded in good faith and acted in a commercially reasonable manner in setting off Jamaica's deposit account without notice.

1. Facts

Jamaica applied to Chase for a $400,000 irrevocable letter of credit to be issued for the benefit of Aetna Casualty and Surety Company ("Aetna"). On the face of the application was a bold-faced declaration stating: "The Security Agreement on the reverse hereof is hereby accepted and made applicable to this Application and the Credit."\(^8\) The security agreement gave Chase the right to set-off against any Jamaica accounts at Chase when in good faith Chase deemed itself insecure. Chase's right to set-off could be executed without notice or demand.\(^8\) Chase was authorized to deposit funds obtained from any set-off of Jamaica's account into a separate account to which Jamaica would not have access. As additional security for the letter of credit, Jamaica provided Chase with a "negative pledge" agreement stating that it would not knowingly allow any other creditors to perfect security interests against the assets of the company under the Uniform Commercial Code until repayment of Jamaica's indebtedness to Chase. Jamaica also provided a "loan restriction" agreement confirming that Jamaica would not incur any loan debts while indebted to Chase as well as a "subordination" agreement executed by Jamaica's president stipulating that Jamaica's debt to him would be subordinate to its obligation to Chase. Finally, Jamaica provided personal guarantees executed by Jamaica's principal officers and their spouses for any indebtedness owed by Jamaica to Chase.\(^8\) In August, 1981, Chase issued the irrevocable letter of credit in favor of Aetna.

In August, 1982, Chase learned that Jamaica was experiencing serious financial difficulties. In October, 1982, Chase discovered that Jamaica had violated the terms of the negative pledge agreement, the loan restriction agreement, and the subordination agreement. Chase subsequently deemed itself insecure and, without notice to Jamaica, transferred $372,920 from Jamaica's checking account to an account over which Jamaica had no control. As a consequence, checks drawn on the Jamaica account were dishonored. Jamaica executed a deed of assign-

\(^8\) Id.
\(^8\) Id.
\(^8\) Id.
ment for the benefit of creditors and the assignee brought suit against Chase.

In awarding compensatory, consequential and punitive damages, the trial court held that the security agreement was unconscionable and that Chase acted in bad faith by failing to notify Jamaica about the transfer of funds which prevented Jamaica from paying its creditors. 87

2. Reversing the Unconscionability Claim

The New York Court of Appeals determined that the record was devoid of any evidence to sustain a claim against Chase based on unconscionability. In disposing of the procedural element of unconscionability, the court examined the “contract formation process and the alleged lack of meaningful choice.” 88 The assignee’s claim of procedural unconscionability was based solely on the testimony of Jamaica’s president who was unaware of the security agreement when he signed the letter of credit application. The court was unimpressed with this argument as evidenced by its conclusion that “[t]he contract concerned a type of commercial transaction routinely entered into in the course of [Jamaica’s] business and one with which [Jamaica’s president] was necessarily familiar from his several years of running the business.” 89 Thus, the court looked to the relative bargaining power and presumed sophistication in business matters of the parties to the transaction and found that there was no evidence to support a determination of procedural unconscionability. 90

The court was equally unimpressed by the assignee’s claim based on substantive unconscionability. In evaluating whether the terms of the security agreement were unreasonably favorable to Chase, the court again looked to the commercial context of the transaction. It concluded that by any reasonable standard the terms of the security agreement were not so overbalanced in favor of Chase as to be found substantively unconscionable. 91 In construing the commercial reasonableness of the terms in the security agreement authorizing Chase to segregate Jamaica’s funds without notice, the court took notice of Chase’s unconditional obligation to disburse funds under the letter of credit. The purpose of the security agreement was to provide Chase “with the means of protecting itself from potential loss due to the financial inability of [Jamaica] to make the promised reimbursement for any payment Chase is required to make to [Aetna].” 92 The court held that Chase’s segregation of Jamaica’s funds without notice was a contractual right which served as a protective measure in Chase’s favor. The court reasoned that if advance notice had been required, Jamaica could have “defeated the purpose of the security interest by the simple expedient of

87. Id. at 826.
88. Id. at 828.
89. Id.
90. Id. at 829 (citations omitted).
91. Id.
92. Id. at 830.
withdrawing its funds." The court concluded by stating that since the policy of the Uniform Commercial Code's unconscionability provision is to prevent oppression and unfair surprise and not to readjust the agreed allocation of the risks in light of some perceived imbalance in the parties' bargaining power, it would not disturb the allocation of risks to which the parties agreed.

3. Reversing the Commercial Bad Faith Claim

The assignee claimed that Chase acted in commercial bad faith by segregating Jamaica's funds without notice and dishonoring Jamaica's checks after the segregation had occurred. Furthermore, the assignee claimed that Chase was liable for commercial bad faith because Chase segregated Jamaica's funds before there was ever any request for disbursement by Aetna.

With respect to the bad faith claim premised on failure to notify Jamaica of the impending segregation, the court found there was no evidence of commercial bad faith because complying with a notice requirement could have resulted in the depletion of the account and the destruction of the security interest. The court's reasoning continued that, since there was no bad faith with respect to notice, there could be no basis for a finding of bad faith when checks drawn on the segregated account were subsequently returned unpaid. Finally, the court determined that, although Aetna had not yet requested a disbursement, it was likely that such a reimbursement request would be forthcoming given Jamaica's insolvency. Therefore, in segregating Jamaica's account in anticipation of disbursement to Aetna pursuant to its obligation under the letter of credit, Chase would not be held to have acted in bad faith when it took steps to safeguard the fund in which it had an existing security interest and which was the only available asset for its reimbursement from Jamaica.

4. Lessons Derived from Gillman

The Gillman opinion "followed a well-established rule of law in New York: that courts only overturn contracts for unconscionability for parties who could not be expected to understand the contract terms." The court reaffirmed that sophisticated parties to a commercial transaction will not be able to avoid the transaction by claiming they did not understand the ramifications of their actions. The court's emphasis on the transaction's commercial setting intimates that when business dealings run aground there are higher thresholds of wrongdoing which must

93. Id.
95. Id.
96. Id.
97. Id. at 831.
98. Id. at 832.
be proved before liability will attach from one commercial entity to another.

_Gillman_ also parallels the messages derived from _Penthouse_ and _Kruse_. As in _Penthouse_, the _Gillman_ court stresses the primacy of the written document when commercial entities become engaged in a legal dispute. However, while _Penthouse_ was instructive in issuing a caveat about deviating from the written terms of a loan commitment, _Gillman_ teaches that the courts expect sophisticated parties to read and understand the written documents that will govern the transaction. Like _Kruse_, the _Gillman_ court declined to expand the application of the implied obligation of good faith and fair dealing in the commercial lending arena beyond its previously defined parameters. By distinguishing an important lender liability case based on the good faith obligation, the court intimated that the implied obligation of good faith is not relevant with respect to a “bank’s actions... [involving] a security interest specifically granted in a bank deposit.”

**III. State Statutory Reform in Response to the Deluge of Lender Liability Litigation**

The increased torrent of lender liability litigation resulting in enormous verdicts has prompted some state legislatures to consider measures limiting litigation against the financial community. While some states have formally enacted legislation to stem the rising tide of lender liability, others are in the process of drafting and debating similar measures to decelerate the lender liability cascade.

**A. California**

One of the lender liability concepts currently in vogue is that of holding banks liable for oral promises or oral commitments to lend based on estoppel and breach of contract theories. Before its reversal, _Kruse_ was the leading case standing for the proposition that an oral commitment to lend money may be considered binding. To alleviate litigation arising from oral commitments to lend, the California Legislature has joined the ranks of many states in amending its Statute of Frauds. As of January 1, 1990, California borrowers are barred from suing on an oral commitment to make a commercial loan in an amount exceeding $100,000. As amended, California's Statute of Frauds reads as follows:

> The following contracts are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged or by the party's agent:

> (g) A contract, promise, undertaking, or commitment to loan money or to grant or extend credit, in an amount greater than one hundred thousand dollars ($100,000), not primarily

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100. K.M.C. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985).
101. _Gillman_, 534 N.E.2d at 831.
for personal, family, or household purposes, made by a person engaged in the business of lending or arranging for the lending of money or extending credit. For purposes of this section, a contract, promise, undertaking or commitment to loan money secured solely by residential property consisting of one to four dwelling units shall be deemed to be for personal, family, or household purposes.\footnote{102}

This amendment is expected to significantly reduce lender liability litigation in California since "more than half the disputes between commercial lenders and borrowers arise from such oral commitments."\footnote{103} California's message is clear that in the commercial context, the writing as embodied in the loan commitment will prevail over informal dealings.\footnote{104}

The status of other legislative reform addressing lender liability is uncertain at this time. While the following discussion clearly is not law in California, it provides a useful insight into some of the issues on the lender liability front that may soon be addressed by statutory reform.\footnote{105}

On the environmental front, Senate Bill Number 842 of the 1987-88 regular session (a bill which passed the California Senate but died before enactment) would have allowed lenders to seek personal judgments against borrowers rather than foreclose on them where the value of the property owned by the borrower was diminished or rendered val-


\footnote{103. \textit{California Legislature Approves Limits on Liability For Oral Promises}, 51 Banking Rep. (BNA), No. 10, at 435 (Sept. 12, 1988).}

\footnote{104. Texas, Delaware and Oklahoma are also debating measures to limit lawsuits by borrowers based on oral statements made by the lender. The Texas bill would not allow for lawsuits based on oral representations involving transactions greater than $50,000; however, the bill's liability restrictions were recently dealt a setback from the lender's perspective due to the Senate Economic Development Committee's decision to add an amendment which would bring lenders under the coverage of Texas' Deceptive Trade Practices Act ("DTPA"). The DTPA allows for lawsuits for oral representations on a limited basis.}


\footnote{Delaware's bill, in preventing the use of a lender's oral representations as the basis of a lawsuit, would disallow any oral testimony to be introduced in a suit involving transactions greater than $25. See \textit{Texas to Hear Liability Testimony}, 13 Bank Letter (Institutional Investor, Inc.) No. 8, at 10 (Feb. 27, 1989).}

\footnote{Oklahoma's measure stipulates that "no lender or borrower may maintain an action on a credit agreement in an amount greater than $5,000, unless the agreement is in writing, sets forth the relevant terms and conditions, and is signed by the party against whom the agreement is sought to be enforced." \textit{Oklahoma House Approves Bill Limiting Lenders' Liability}, 52 Banking Rep. (BNA), No. 5, at 229 (Jan. 30, 1989).}

ueless by hazardous substance contamination. The bill was designed to avoid California's "one-action" rule requiring that "if a loan is secured by realty, a lender may only enforce the loan by proceeding against the real property, as in a foreclosure action." A proposed amendment would have helped keep lenders responsible for their actions by providing that the exception to the one-action rule "would not apply when a lender substantially caused or contributed to the release or threatened release of the hazardous substance." At this time, no further inroads have been made in the environmental arena of California's lender liability reform.

An agricultural lender liability bill, Assembly Bill Number 1717, introduced in 1987, also did not survive California's 1987-88 session. The bill would have required mandatory mediation of farm lending disputes. Inserting mandatory arbitration provisions in loan agreements has been one measure that banks have used to thwart lender liability suits in the drafting stage. A legislative blessing would merely codify this evolving practice between commercial lenders and borrowers; however, this bill has yet to resurface.

One final measure which has been hotly contested is whether the California legislature will limit punitive damage awards against lenders. The California Bankers Association has been lobbying for a proposal to limit punitive damage awards to the lesser of $1 million or one percent of the lender's net worth, or cap the award at two times the amount of any compensatory damages awarded. This proposal has been successfully opposed as of this date by the California Trial Lawyers Association. Other states are also wrestling with whether to limit punitive damage awards against banks and lending institutions.

B. Colorado

Colorado has joined other states in requiring credit agreements to

108. Id.
113. The Texas Trial Lawyers Association has vigorously opposed a lender liability draft bill which would "place a cap on punitive damages of either two to three times the actual loss or an amount equal to a bank's entire lending limit..." Texas Trial Lawyers to Battle Bank Bill, 12 Bank Letter (Institutional Investor, Inc.), No. 47, at 5 (Nov. 28, 1988).
be in writing. On July 1, 1989, the following provisions took effect:

No debtor or creditor may file or maintain an action or a claim relating to a credit agreement involving a principal amount in excess of twenty-five thousand dollars unless the credit agreement is in writing and is signed by the person against whom enforcement is sought.

A credit agreement may not be implied under any circumstances, including, without limitation, from the relationship, fiduciary or otherwise, of the creditor and the debtor or from performance or partial performance by or on behalf of the creditor or debtor, or promissory estoppel.

It should be noted that the legislation applies only to credit agreements with "financial institutions" which are defined as "a bank, savings and loan association, savings bank, industrial bank, credit union, mortgage or finance company." Thus, the "Colorado law does not protect non-institutional lenders, regardless of the regularity with which they engage in loan transactions."

Colorado's legislation is unusual in several respects. First, Colorado has not been inundated with the lender liability lawsuits that have led other states to enact similar measures. Colorado's legislation should thus be recognized as a preemptive measure to fend off any would-be law suits based on undocumented oral promises. In addition, the statutory language suggests that while Colorado might recognize a fiduciary relationship between a creditor and a debtor in certain situations, the relationship will never give rise to an implied credit agreement. Finally, the Colorado legislation differs from other states because the bill eliminates exceptions to the Statute of Frauds based on partial performance or promissory estoppel.

As the author points out, Colorado's legislation differs from the other states in the following areas: (1) the Colorado statute protects a significantly narrower class of creditors than in California, Georgia, Minnesota, Texas and Oklahoma; (2) Colorado's definition of "credit agreement" is vastly different from the other state statutes in that it covers any financial accommodation whatsoever, and unlike any of the other states, the Colorado law covers agreements to borrow or repay in addition to agreements to extend credit; (3) unlike Oklahoma, Texas, and California, the Colorado statute does not provide for exclusions from the definition of credit agreement; (4) the minimum dollar amount in Colorado for which a claim is subject to the new legislation is $25,000; whereas, in Oklahoma it is $15,000; in Texas it is $50,000; and in California it is $100,000; and (5) Colorado law also differs from other states in that it eliminates traditional exceptions to the Statute of Frauds.

115. See generally Colo Lender Liability Close to Signing, 13 Bank Letter (Institutional Investor, Inc.), No. 9, at 6 (Mar. 6, 1989); Colorado Adopts Bill to Limit Liability on Credit Agreements, Rejects Branching, 52 Banking Rep. (BNA), No. 9, at 481 (Feb. 27, 1989).


117. Id.

118. Shafer, supra note 114, at 1296.


120. Colorado Adopts Bill to Limit Liability on Credit Agreements, Rejects Branching, 52 Banking Rep. (BNA), No. 9, at 481 (Feb. 27, 1989).
C. Kansas

Kansas has also conformed its law respecting credit agreements to bar bank customer lawsuits "for failing to carry out a particular promise relating to extension of credit or a financial accommodation unless that promise [is] specifically in writing and signed by both parties." Kansas defines a credit agreement as "[a]n agreement by a financial institution to lend or delay repayment of money . . . or . . . to otherwise extend credit or to make any other financial accommodation." On January 1, 1989, the requirements for an enforceable credit agreement became:

(a) A debtor or a creditor may not maintain an action on a credit agreement unless the agreement is in writing and is signed by the creditor and the debtor.

(b) All credit agreements shall contain a clear, conspicuous and printed notice to the debtor that states that the written agreement is a final expression of the agreement between the creditor and debtor and such written agreement may not be contradicted by evidence of any prior oral agreement or of a contemporaneous oral agreement between the creditor and debtor. A written credit agreement shall contain a sufficient space for the placement of nonstandard terms, including the reduction to writing of a previous oral agreement and an affirmation, signed or initialed by the debtor and the creditor, that no unwritten oral agreement between the parties exists.

Initially there were two criticisms of the Kansas statutory scheme. First, the imprecise definition of credit agreement led to the uncertainty of whether security agreements, mortgages and promissory notes were included within the definition. Second, there was confusion over whether a credit agreement would be unenforceable if the notice provision in section 2(b) of the act were not included in the agreement. To resolve these ambiguities, the Kansas Attorney General issued a general opinion at the behest of the Kansas Bankers Association.

The Attorney General's opinion addressed the concerns of the Kansas Bankers Association in two-step fashion. First, the opinion concluded that security agreements, mortgages, and promissory notes were not credit agreements within the meaning of the act; however, the document creating the interest may become a credit agreement if its terms include a promise to lend or delay repayment of money or make any other financial accomodation. Second, if the required notice in section 2(b) is absent, the opinion concluded that the credit agreement is still enforceable as written, but it may be varied if there is evidence of misrepresentation upon which a party to the credit agreement relied.

125. Id.
It must be remembered that the Attorney General's opinion is not the law. Until the statute is judicially construed, the prudent lender should reference all written agreements that are part of the transaction in the notice provision of the credit agreement to avoid a later dispute over whether these other written documents are part of the deal.126

D. Louisiana

The Louisiana legislature has responded to the lender liability challenge by amending its version of the Uniform Commercial Code ("UCC") to limit the lender's "potential for liability for breach of the covenant of good-faith and fair dealing."127 Louisiana's version of U.C.C. § 1-203 (the good faith obligation in performing or enforcing a contract), as amended,128 now directs that the standard of good-faith performance is based on Article 1997 of the Civil Code which provides that "[a]n obligor in bad faith is liable for all the damages, foreseeable or not, that are a direct consequence of his failure to perform."129 The official comments to Article 1997 relate that "[a]n obligor is in bad faith if he intentionally and maliciously fails to perform his obligation."130 Thus, by heightening the standard upon which a lender may be sued for breach of the good-faith duty, the Louisiana "amendment is intended to limit good-faith and fair-dealing litigation in Louisiana to situations in which a party has acted intentionally and maliciously."131

E. Other States

In addition to the state statutory reform discussed above, the following states have also amended their Statutes of Frauds to require certain credit agreements to be in writing in order to be enforceable: Georgia,132 Texas,133 Oklahoma,134 and Minnesota.135

IV. Conclusion

After much publicized success for borrowers, the tide of lender liability seems to be shifting in favor of lenders. Recent judicial decisions at both the state and federal appellate level are "giving hope to lenders that their salvation lies on appeal from emotional juries and trial
judges.

Moreover, statutory reform at the state level also functions to limit the borrower's ability to bring a cause of action against its lender. The financial community should regard these developments as a positive sign in stemming the flow of lender liability. However, lenders should also take heed of the lesson that courts will no longer tolerate intertemporal conduct by a lender when dealing with its borrower. The judicial and legislative developments discussed in this note by no means indicate that lenders are now magically insulated from liability. "It is a well-recognized phenomenon that the thrust of legal decisions shift like the ocean from high tide to low but then in proper season and time shift back again to high."137 While lenders may be enjoying a respite from the tidal wave of lender liability they must be ever vigilant that their conduct does not give rise to a cause of action under the expanding doctrine of lender liability.

William N. Medlock

137. Hellman, In the Court's the High Tide of Lender Liability May Be Receding, American Banker, April 4, 1989, at 17.