



SIMMONS PERRINE
MOYER BERGMAN PLC

Lender Liability Overview: Part I

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What is Lender Liability?

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Lender Liability

Lender liability is a variety of factual situations in which a lender can be held liable for claims based on contract breaches, tortious behavior, common law duties, violations of state and federal statutes, and other alleged wrongful behavior.

Best Way To Limit Exposure In Lender Liability Cases Is With Good Drafting

- Jury waiver
- Consent to venue, jurisdiction and Iowa law
- Indemnification of bank

Jury Waiver Language

Jury waiver language must be mutual and conspicuous to be enforceable

Waive Jury. All parties to this Agreement hereby waive the right to any trial in any action, proceeding, or counterclaim brought by any party against any other party.

Choice of Venue

If there is a lawsuit, Borrower agrees upon Lender's request to submit to the jurisdiction of the courts of _____* County, State of Iowa.

* Pick county where bank or branch located

Governing Law

This Note will be governed by federal law applicable to Lender and, to the extent not preempted by federal law, the laws of the State of Iowa without regard to its conflicts of law provisions. This Note has been accepted by Lender in the State of Iowa.

What is Indemnification Language?

Agreement by borrower to pay the bank for any losses the bank incurs in connection with certain actions.

Indemnity Contract

- Iowa law enforces an indemnity contract where:
 - The contract is valid and properly formed
 - Language is “clear and unequivocal” that Borrower will indemnify even where Lender causes damage (“whether or not Lender is responsible”)
 - Damage caused by Lender was not intentional

McNally & Nimergood v. Neumann-Kiewit Constructors, Inc., 648 N.W.2d 564, 570-74 (Iowa 2002)

Indemnity

The Iowa courts will not enforce indemnity provisions for intentional or wrongful action

Wright v. Haskins, 260 N.W.2d 536, 538 (Iowa 1977) (“Defendant asserts no contribution or indemnity is allowed in this state where there has been a showing of intentional wrong, or of moral turpitude or of concerted action by the tortfeasors We agree.”).

Contract claims are the most difficult
to defend

Contract Claims Generally

Breach of Contract Elements

Borrower must prove:

- (1) the existence of a contract,
- (2) the terms and conditions of the contract,
- (3) that borrower has performed all the terms and conditions required under the contract,
- (4) the lender's breach of the contract in some particular way, and
- (5) that borrower has suffered damages as a result of lender's breach.

Contract Claims

Two types of Contract Claims

- Written
- Oral

Oral Agreements to Lend

Iowa Code § 535.17 requires that a commitment to lend money must be in writing, containing all material terms and signed by lender, to be an enforceable contract.

- An oral agreement by a bank to honor overdrafts up to a certain amount of A/R constitutes an agreement to lend money and must meet requirements of § 535.17. Clinton Nat. Bank v. Saucier, 580 N.W.2d 717 (Iowa 1998).
- A lease that does not state the rate of interest but does state “the subject matter, price, payment terms, and duration” of the lease satisfies the requirement of § 535.17(1). C&J Vantage Leasing Co. v. Wolfe, 795 N.W.2d 65, 82 (Iowa 2011).
- Query whether e-mail with all material terms and a v-card with no signature would meet the requirements.

Read Before Signing Language

IMPORTANT: READ BEFORE SIGNING. The terms of this agreement should be read carefully because only those terms in writing are enforceable. No other terms or oral promises not contained in this written contract may be legally enforced. You may change the terms of this agreement only by another written agreement.

- Must be in boldface and 10 point type

Past Practice and Course of Dealing

Read Before Signing Language also prevents any subsequent modification that is unwritten from being enforceable.

- The allowance of past overdrafts based on specific A/R amounts did not create the duty to permit future overdrafts and no notice was required by bank that this past practice would cease.

Contract Formation

Commitment Letters

- There are frequent lawsuits by borrowers attempting to enforce the terms of a commitment letter.
- Commitment letters may constitute a contract depending on whether there was an intent to be bound by the letter, partial performance of the contract, and whether the letter includes all of the essential elements of a contract.

Letter of Interest

- Clients may request them.
- Avoid providing them if at all possible.
- If they must be used be sure to include prominent disclaimers that the letter of interest does not constitute an agreement to lend money.

Letter of Interest Language

This term sheet sets forth the principal terms and conditions upon which the Lender may make credit facilities described herein available to the Borrower **but does not constitute a binding commitment to do so**. This term sheet does not contain all the terms and/or conditions of this credit facility and therefore the Lender may negotiate additional terms. The Lender shall have no duty to make any advance under any of such credit facilities until execution and delivery of loan documents described herein and in form and substance satisfactory to the Lender and such satisfaction of all conditions precedent set forth in such loan documents.

Duty of Good Faith and Fair Dealing

Every contract has an implied duty of good faith and fair dealing.

- Generally defined as “the obligation of good faith, diligence, reasonableness, and care” as determined by professional standards.
- Seminal lender liability case that found obligations of good faith and fair dealing despite express terms and “demand” feature of note. KMC v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985).

Iowa Law and Most States are Different

- Duty of good faith and fair dealing does not add to or modify the express terms of the contract. Cox v. Mortgage Elec. Registration Sys., Inc., 685 F.3d 663 (8th Cir. 2012).
- Good faith and fair dealing does not create a separate cause of action, the borrower must be able to point to a term of the agreement that the lender has breached. Audio Odyssey, Ltd. v. Brenton First Nat. Bank, 284 F. Supp. 2d 1159, (S.D. Iowa 2003).
- Demand notes should **not** include financial or other restrictive covenants.

Duty of Good Faith and Fair Dealing

Generally the duty is litigated in instances where the bank can exercise discretion under the terms of the agreement:

- Accelerating the amount due under a note when lender feels insecure. Jensen v. State Bank of Allison, 518 F.2d 1 (8th Cir. 1975).
- Refusal to lend additional sums under an operating loan when borrowers projections show that value of crops would not exceed operating income. Jackson v. State Bank of Wapello, 488 N.W. 2d 151 (Iowa 1992).
- Refusing to loan additional funds out of malice or spite.
- Failing to give reasonable notice of refusing to loan additional funds or attempting to place borrower in default without notice.
- Failing to follow normal procedures in exercising discretionary functions under an agreement.

Duty of Good Faith and Fair Dealing

Additional examples:

- Failure to provide reasonable notice when deciding not to fund under a line of credit.
- Decision by bank not to make additional advances.
- Decision by bank not to extend a maturity date.
- Decision by bank not to restructure a credit facility.
- Decision by bank not to waive covenants in agreements.
- Decision by bank not to release its lien on assets.

There are few, if any, reported cases of banks being ultimately held liable for breach of the duty of good faith and fair dealing.

Tort Claims

- More difficult to prove
- Preferred by borrower because punitive damages can be recovered

Tort Claims Generally

A tort is generally defined as “a civil wrong, other than breach of contract, for which a remedy may be obtained.”

- Essentially all non-contractual and non-statutory claims.

Fraud

Elements of fraud:

- Borrower must prove:
 - (1) lender made a representation to the plaintiff,
 - (2) the representation was false,
 - (3) the representation was material,
 - (4) the lender knew the representation was false,
 - (5) the lender intended to deceive the plaintiff,
 - (6) the borrower acted in justifiable reliance on the truth of the representation,
 - (7) the representation was a proximate cause of the borrower's damages, and
 - (8) the amount of damages.

Fraud

There are several “types” of fraud:

- Fraudulent misrepresentation, fraudulent concealment, or ordinary fraud.
- Factual scenarios:
 - Affirmative misrepresentation of fact.
 - Concealment of material facts.
 - Lending to a borrower knowing that the asset the borrower is buying is otherwise encumbered. First Nat. Bank in Lenox v. Brown, 181 N.W.2d 178 (Iowa 1970).

Bad Faith

Bad faith is similar to the duty of good faith and fair dealing in contracts, but is separate from the terms of the contract.

- Example: The acceleration of a note where there is no cause for acceleration may be tortious bad faith. First Nat. Bank in Libby v. Twombly, 213 Mont. 66, 689 P.2d 1226 (Montana 1984).
- This claim has not been recognized in Iowa but several states have followed the theory.

Breach of Fiduciary Duties

A fiduciary is “someone who is required to act for the benefit of another person on all matters within the scope of their relationship.”

- A breach of that duty is an actionable tort.
- The existence of a fiduciary relationship is heavily fact specific inquiry.

Breach of Fiduciary Duties

In general the lender-borrower relationship does not create a fiduciary relationship. Kurth v. Van Horn, 380 N.W.2d 693, 696 (Iowa 1986).

- However there are exceptions depending on the nature of the agreement, the types of services being provided by the lender, and the personal relationship between the originator of the loan and the borrower.

Manufacturers Bank & Trust Co. Lake Mills v. Weber, 829 N.W.2d 589 (Iowa Ct. App. 2013).

One of the few cases of breach of fiduciary duty by a bank.

- Pre-existing relationship and banker solicited the loan.
- Personal loan against bank policy.
- Use of bank documents for personal loan.
- Banker didn't disclose 2nd mortgage and told customer not to file mortgage which would have protected customer.
- Testimony by customer's accountant that change in mental functioning.

Bank Owed No Duty to Shareholder of Borrower Who was Also a Guarantor

Any action by bank was against borrower not shareholder so even if bank agreed that shareholder/guarantor could be involved in liquidation there was no separate cause of action. Engstrand v. W. Des Moines State Bank, 516 N.W.2d 797, 799 (Iowa 1994).

Negligence

Elements

- Borrower must prove:
 - (1) lender owed a duty to the borrower,
 - (2) lender breached that duty,
 - (3) the breach of duty by the lender caused the borrower's harm, and
- borrower suffered damages.

Economic Loss Doctrine

- As a general rule where there is a contractual relationship a party can only sue on the contract, not for negligence. However, fraudulent and negligent misrepresentation claims are not barred by the economic loss doctrine even if the damages are purely economic. Van Sickle Const. Co. v. Wachovia Commercial Mortgage, Inc., 783 N.W.2d 684 (Iowa 2010).

Negligence

Negligence claims are generally decided based on whether the lender owes the borrower a duty.

- The determination of the existence of a duty is fact specific.

Negligence Misrepresentation

- If the lender is acting in the business of selling products or services then the lender generally doesn't owe the borrower a duty.
 - Bank is not in the business of supplying sewage inspection reports so not liable. Greatbatch v. Metropolitan Federal Bank, 534 N.W.2d 115, 117-18 (Iowa App. 1995).
- Negligent misrepresentations in the negotiation of an arm's length transaction does not make the lender liable. Haupt v. Miller, 514 N.W.2d 995 (Iowa 1994).
- Lender is only liable for negligent misrepresentations if lender is in the business of supplying information.
 - If the lender agrees to provide an appraisal as part of the loan closing then the lender may be liable for negligence in performing the appraisal since the lender is acting in the business of providing information. Larsen v. United Fed. Sav. & Loan Ass'n of Des Moines, 300 N.W.2d 281, 286-87 (Iowa 1981).

Negligence

If there is a duty the following actions may constitute a breach of that duty:

- Lender's lack of experience to make a loan.
- Erroneous calculation of number on a loan application.
- Failure to identify issues relating to the title of property that is subject to a mortgage.
- Failure to follow proper lending procedures.
- Failure to identify or release mortgages on a property.
- Improper distribution of loan proceeds.

Tortious Interference with Contracts

A lender could be liable for tortious interference if bank made a commitment to borrower or otherwise induced borrower to enter into a contract with a third party. Iowa courts have yet to recognize a claim of tortious interference.

Elements of Intentional Interference with Contracts

Borrower must prove:

- (1) borrower had a contract with a third-party,
- (2) lender knew of the contract,
- (3) lender intentionally and improperly interfered with the contract,
- (4) the interference caused the third-party not to perform, or made performance more burdensome or expensive, and
- (5) damage to the borrower resulted.

Intentional Interference with Contracts

Factual Scenarios

- If lender has made a commitment to the borrower or otherwise induced the borrower to make or enter into contracts with third parties and then does not lend the money lender may be liable for interference with contract.
- For example, lender may be liable if lender agrees to write check to borrower's farm landlord, then refuses to do so causing the landlord to terminate the lease. First Nat. Bank of Iowa v. Peterson, 392 N.W.2d 158 (Iowa Ct. App. 1986).

Duress

Duress is also known as business compulsion or economic coercion.

- Duress occurs when a lender threatens to do something that it has no right to do, which results in the borrower doing something it was not legally obligated to do, and the borrower acted because its freedom to act was overcome by the lender's threats.
- Example: lender threatens to repossess borrower's house unless borrower agrees to a new mortgage with a higher interest rate even though borrower is not currently in default

Intention Infliction of Emotional Distress

Elements

- Borrower must prove:
- (1) “outrageous conduct” by the lender,
 - “Outrageous' conduct” may broadly be defined as conduct exceeding all bounds usually tolerated by decent society.
- (2) outrageous conduct was done with the intent of causing the borrower distress or reckless disregard of the probability of causing the borrower distress,
- (3) the borrower suffered extreme distress, and
- (4) a causal connection between lender’s conduct and borrower’s distress.

These claims rarely succeed

- Ordinary breaches of contract or collections practices do not amount to intentional infliction of emotional distress.

Defamation

Made up of two different torts, libel (written) and slander (oral)

- Elements:
 - Borrower must prove:
 - (1) lender published a statement,
 - (2) the lender's statement was defamatory
 - Defamatory means a statement that tends to harm a person's reputation
 - (3) lender's statement was of and concerning the borrower, and
 - (4) the statement resulted in injury to the borrower.

Example

- Bank held liable for labeling borrower a “liar, cheat, and deadbeat”
- In general, avoid discussing the reasons for denying a loan or the status of a borrower's payments with third parties to prevent claims for defamation

Vicarious Liability

- Bank may be liable for the acts of its employee or agents.
 - Employer is liable for the actions of the agent or employee if there is an employer-employee or principle-agent relationship and the acts were within the scope of the relationship
- Corporate officers can be personally liable for negligent acts if corporate officer personally involved in actions. Haupt v. Miller, 514 N.W.2d 995 (Iowa 1994).



Questions?

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