Counseling a Commercial Loan Banker to Avoid Lender Liability Claims

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Old school commercial bankers commonly use the "3 C's"—Collateral, Capacity, and Character—to analyze a borrower's credit for a commercial loan. When a commercial loan is in default the banker first looks to the repayment components—Collateral and Capacity. Foreclosure upon loan collateral is a garden variety lawsuit. However, when the borrower tries to shift loss or default responsibility to their banker by asserting a lender liability counterclaim in the foreclosure action the banker realizes the error of the initial assessment on the borrower's Character. Early detection of a potential lender liability claim triggers special strategies to counsel the banker and defend against liability as well as avoid any misinterpretation of the banker's behavior throughout the loan transaction. This paper begins with a brief summary of the Iowa common law lender liability rules and ends with some practice pointers to counsel the banker so the banker's behaviors stay out of court.

Scope of Lender Liability Duty. The first key in counseling or defending against a common law lender liability claim is to determine the "duty" source the borrower claims was owed by the banker to the borrower. Iowa recognizes a lender's common law duty to a borrower sourced from the banker/borrower acts occurring during the loan transaction that sound in tort[1] or contract, whether that contract is express or implied[2].

Claims Sounding in Tort. Breach of fiduciary duty[3] and misrepresentation[4] are common torts recognized in Iowa to support a lender liability claim. To establish a breach of fiduciary duty a borrower must first establish the banker is the borrower's fiduciary for the specific transaction[5]. The Iowa Supreme Court described fiduciary duty[6] as:

> A fiduciary duty imparts a position of a peculiar confidence placed by one individual in another. A fiduciary is a person with a duty to act primarily for the benefit of another. A fiduciary is in a position to have and exercise, and does have and exercise influence over another. A fiduciary relationship implies a condition of superiority of one of the parties over the other. Generally, in a fiduciary relationship, the property, interest or authority of the other is placed in the charge of the fiduciary. (Emphasis added)

A fiduciary relationship is determined by reviewing all the facts and circumstances giving rise to the borrower's grant of an implicit trust to a banker fiduciary and acceptance of that implicit trust by the banker fiduciary[7] . Relevant factors evidencing a fiduciary relationship include the extent which the banker has taken control of a transaction[8] , will receive any undisclosed benefits from the outcome of the transaction[9] , has given extensive business advice relied upon by the borrower[10] , or has a self-interest in the transaction[11] . For borrowers, the courts review the borrower's educational[12] and business experience[13] , facts alerting the banker to "know or should know" that the borrower is relying upon the bank information[14] , and any indicia that the borrower is recognizing the banker as a business confidant[15].

The legal consequence of a fiduciary relationship is an independent duty requiring the bank to act in the best interest of the beneficiary borrower[16]. Acting in the borrower's best interest has included the duty to disclose information to avoid the default or loan loss[17] or a duty of loyalty[18].

A false representation[19] or omission[20] by the banker to the borrower which the borrower reasonably relied is another lender liability duty source. That is, the borrower asserts the banker made certain false explicit or implicit representations that borrower relied upon that caused the default or loan loss[21].

Claims Based in Contract. Claims based in contract require as a condition precedent the existence of an implied (whether implied in law or implied in fact by the circumstances [22]) or express contract. Ordinary contract rules apply, including requirements of the existence of an agreement containing definite mutually agreeable terms[23] . Typical claims include a lender's failure to follow through with a commitment to loan money[24] or discontinuance of loan advances as previously agreed[25].

Most alleged oral contract claims can be eliminated by including a statutory notice that limits enforceability of loan terms to the written terms[26]. If properly used, the statutory notice will bar parol evidence of an alleged oral representation[27]. Specifically, the required notice to include in loan documents is:

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.

Counseling a Banker to Avoid the Lender Liability Claims. The attorney's value-add service to the banker is to keep the lender's challenged behaviors out of court and keep the defaulted loan a garden variety collection case. 10 ways to counsel a banker to avoid lender liability are:

1. **Second Review of Loan Status After Loan Delinquency**. Once a loan becomes delinquent or full payment concerns exist for a delinquent loan, have the banker choose another banker to review the delinquency causes and collectively develop a repayment plan. For a more complex loan, the banker should add the delinquent loan as an agenda item to the next loan committee meeting for a group review.

2. **Analyze Benefits to Bank or Loan Officer**. Review the pros and cons of the repayment plan to determine whether the bank or loan officer have a private, personal interest in any of the planned resolution transactions to resolve the loan delinquency with the borrower. If the lender-borrower involves more than a loan relationship where the bank will receive repayment of the loan and some additional benefit then review the fiduciary rules to make sure any potential fiduciary duties–whether duty of disclosure or loyalty–are not breached.

3. **Review Loan Documentation**. Have the loan officer make a second review of the existing loan documentation to ensure nothing was missed when the loan was made. Typical inquiries are whether the bank's lien interest in the collateral correctly perfected, erroneous loan forms used that obligate the lender to follow consumer rules that were not intended to apply and, if multiple loans, is there a dragnet clause securing multiple borrower promissory notes. If there are document deficiencies then put a plan in place to shore-up the bank's perfected collateral position before enforcing the bank's collection rights.

4. **Perform an Inspection to Obtain a Current Collateral List**. Performing a current collateral inspection will highlight any change in the collateral list and value, help understand the borrower's repayment ability and show the lender's best exit plan for full payment.

5. **Double Up with Borrower Meetings**. Advise the banker to have two loan officers present during any face-to-face meeting with the borrower. This will eliminate any misunderstanding of what was stated at the meeting and, more importantly, corroborate words that weren't stated.

6. **Follow Up Meeting with Written Correspondence**. For bank-borrower meetings where the banker or borrower agree to perform post-meeting tasks, have the banker state the tasks to be performed with specific deadlines in a letter or email to the borrower. Having a written record will corroborate tasks to be completed, eliminate uncertainly of the consequences if a task is not timely performed, and establish the reasons changes in any prior course of dealing practice because of a loan delinquency.

7. **Confirm No Fiduciary Relationship** Exists. If a fiduciary relationship is shown the bank must accept responsibility to act as the borrower's fiduciary. During negotiations the banker should advise the borrower to have an attorney review any loan modification agreement and confirm that the banker is not acting for or on behalf of the borrower.

8. **Address Effect of Partial Performance**. Be mindful that the bank's acceptance of borrower's partial performance can waive a borrower's breach or default. Make sure if partial performance is made by a borrower that partial performance does not cure the loan default.

9. **Agreements Should Always Include Iowa Code § 537.16 Notice**. To eliminate alleged oral contracts after a final agreement is reached, the statutory notice provision of Iowa Code 537.16 stated above should be stated in all documents evidencing the agreement.

10. **Obtaining a Mutual Release to Conclude Matter**. Once an agreement is reached with the borrower, obtain a mutual release of past actions and have the banker be vigilant to not leave any tasks unfinished. There is no greater banker nightmare than thinking a matter is resolved in final form only to find out later the borrower can assert a claim.

Conclusion. A banker would never make a loan if the banker concludes the borrower lacks sound character. However, bankers, like lawyers, are not soothsayers. When a loan unexpectedly goes south and the borrower points the finger to the banker to fix, your review with the bank client of the lender liability rules and learned counsel on the 10 steps to avoid a lender liability claim will go a long way to salvaging that erroneous decision.

ENDNOTES

[1] *Kurth v. Van Horn*, 380 N.W.2d 693, 695 (Iowa 1986).

[2] *Irons v. Community State Bank*, 461 N.W.2d 849, 855 (Iowa 1990).

[3] *Kurth v. Van Horn*, 380 N.W.2d at 698.

[4] *First National Bank in Lenox v. Brown*, 181 N.W.2d 178, 182 (Iowa 1970).

[5] *Kurth v. Van Horn*, 380 N.W.2d at 698.

[6] *Id.*

[7] *Peoples Bank & Trust Co v. Lola*, 392 N.W.2d 179, 186 (Iowa Ct. App. 1986).

[8] *Mills County State Bank v. Fisher*, 282 N.W.2d 712, 714 (Iowa 1986).

[9] *First National Bank in Lenox v. Brown*, 181 N.W.2d at 183 (Iowa 1970).

[10] *Mills County State Bank v. Fisher*, 282 N.W.2d at 714.

[11] *First National Bank Ia Lennox v. Brown*, 181 N.W.2d at 184.

[12] *Manson State Bank v. Tripp*, 248 N.W.2d 105, 108 (Iowa 1976).

[13] *Id.*

[14] *Nie v. Galena State Bank*, 287 N.W.2d 373 (Iowa Ct. App. 1986).

[15] *Kurth v. Van Horn*, 380 N.W.2d at 698.

[16] *Peoples Bank & Trust Co v. Lola*, 392 N.W.2d at 188.

[17] *First National Bank in Lenox v. Brown*, 181 N.W.2d at 182.

[18] *Nie v. Galena State Bank*, 287 N.W.2d at 376.

[19] *Mills County State Bank v. Fisher*, 282 N.W.2d at 714.

[20] *State Bank of Iowa Falls v. Brown*, 119 N.W.2d 81, 83 (Iowa 1909).

[21] *Id.*

[22] *Irons v. Community State Bank*, 461 N.W.2d 849, 855 (Iowa 1990).

[23] *Clinton National Bank v. Saucier*, 580 N.W.2d 717, 720 (Iowa 1998).

[24] *Harsha v. State Sav. Bank*, 346 N.W.2d 791, 796 (Iowa 1984).

[25] *Peterson v. First National Bank of Iowa*, 392 N.W.2d 158, 166 (Iowa 1986).

[26] Iowa Code § 537.16.

[27] *Beal Bank v. Siems*, 670 N.W.2d 119, 126, 127 (Iowa 2003).

NEW LAWYER PROFILE

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In every issue of *Defense Update*, we will highlight a new lawyer. This issue, we get to know Graham Carl, Simmons Perrine Moyer Bergman PLC., in Cedar Rapids, Iowa.

Graham is a native of Mount Vernon, Iowa and attended Loras College where he was a member of the Iowa Conference All-Academic Team in basketball and track. He graduated with a degree in economics with a minor in business before attending the University of Iowa College of Law. While at the University of Iowa, Graham was a board member of Phi Delta Phi and the Sports Law Society, as well as a member of the Baskerville Moot Court Team. Graham graduated from law school in 2014 with highest distinction, earned the ALI/CLE Scholarship and Leadership Award, and was named Order of the Coif. Graham is an associate at Simmons Perrine Moyer Bergman PLC where his primary areas of practice are transportation, medical malpractice defense, appellate advocacy, municipal law, and personal injury.