CHAPTER 9
LENDER LIABILITY

John C. Murray

Raymond J. Werner

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§ 9.1 Introduction

Lender liability is often discussed generically because many theories of lender liability apply irrespective of the type of loan (residential or commercial, permanent or construction). The construction loan, however, presents greater risks to the borrower and the lender, and greater opportunities for disputes both between them and with third parties, leading to an increased potential for lender liability litigation.

Discussion of lender liability brings to mind recent litigation in which large verdicts were obtained against lenders. The theories of lender liability all present a framework within which both permanent and construction lenders must conduct their affairs.

LENDER LIABILITY ACTIONS IN GENERAL

§ 9.2 Breach of Loan Commitment
A common theory in lender liability actions is breach of contract, and the first contract that is considered in the borrower-lender relationship is the loan commitment. This is the most litigated loan contract, whether the initial contract to make the loan or a commitment to extend or recast the loan as a result of borrower difficulties.

Although the lender has the right to refuse to make a loan, the lender must comply with the laws governing the loan application process. For example, the lender cannot discriminate against the borrower on the basis of race, religion, national origin, sex, marital status, or age. The lender also has a duty to process a loan application with reasonable care. The negligent calculation of the applicant's qualifications under standard industry criteria may give rise to a cause of action against the lender for failure to use due care.

Processing the application is one thing; protecting the borrower from an improvident deal is quite another. In the commercial loan setting, the lender is generally not required to protect the inexperienced borrower from a bad business decision. A greater duty must be established for the lender to be held liable.

Once the borrower and the lender agree on the terms of a loan, a contract, usually a conditional contract, is formed. If a party breaches that contract, the usual contract remedies apply. Lender liability is found when the lender breaches its promise to extend financing. Similarly, the lender is liable for breach of its promise to forbear from the exercise of remedies otherwise available to it under the loan documents or failing to honor previously agreed-upon loan modification terms. For example, in one case a lump sum payment was due under a note. The borrower had financial difficulties and agreed with the loan officer to convert the obligation to an installment loan. When the loan officer went out of town, the loan officer's superior refused to convert the note, accelerated its due date, and exercised the lender-bank's offset rights against the other accounts of the borrower. The court held the lender liable for the borrower's damages.

This does not mean that the lender as a matter of course is obligated to extend the loan opening date. Rather, the lender is entitled to demand strict compliance with the terms of the commitment and, upon the borrower's breach, retain the commitment fee. The lender will not be liable for breach of the covenant of good faith and fair dealing when the loan commitment clearly states that the borrower was not entitled to a refund under any circumstances and there was no contractual obligation on the lender to grant an extension of time to perform. Further, the borrower must comply with the requirements of the loan commitment, notwithstanding alleged oral statements by an officer of the lender amending commitment requirements.

Although the lender may be liable for damages incurred by the borrower as a result of the lender's breach of the loan commitment, punitive damages are generally not recoverable. Damages for breach of contract are limited to those necessary to compensate the borrower for the lender's breach, that is, the excess interest required to be paid on replacement financing. The old rule that the borrower could not specifically enforce the loan commitment is falling into disfavor, and borrowers are being granted the right to do so. The opposite is not true, however; the courts generally do not allow the lender to enforce a long-term commitment against the borrower.

Lenders have not successfully defended against these claims on the basis that the loan agreement was not in writing. The courts have recognized causes of action for breach of oral loan
commitments. Similarly, the borrower is not barred by the parol evidence rule from proving a verbal commitment by the lender to make the loan and may recover lost profits upon the presentation of proper evidence. The lender will be liable if the borrower can demonstrate that an enforceable oral agreement was made. It is important that the borrower establish a meeting of the minds. The mere expression of intent may not be adequate to establish that a contract was formed. Words of encouragement do not constitute a binding commitment if the essential elements of a binding contract, such as the amount of the loan, the interest rate, repayment terms, and loan fees and charges, are not agree upon. The borrower must present evidence that, if fact, an agreement was made, and the terms of the agreement must be definite.

The statute of frauds defense may be available if the oral agreement is not capable of performance within one year. In several states, statutes have been enacted to bring some certainty to this area of the law. In 1986, Minnesota became the first state to require that all loan commitments be in writing in order to be enforceable. The Minnesota statute was essentially an expansion of the statute of frauds and has been upheld.

Borrowers may also breach their loan commitment obligations and be liable for improper conduct. Because the borrower has a duty to deal fairly and in good faith, a borrower who refuses to acknowledge or respond to the lender's request for comments on closing documents or to negotiate in good faith to close the loan breaches that duty. If the borrower fails to close the loan, the entire commitment fee may be forfeited. If the borrower fails to comply with the conditions contained in the loan commitment, the lender may refuse to fund the loan and may retain the commitment fee.

§ 9.3 Fraud

Generally, a cause of action for fraud requires false representation, concealment of a material fact, or the creation of a false impression in the mind of the borrower; scienter; reasonable reliance by the borrower; and damages. Lender liability founded upon this theory may run to both the borrower and to third parties. When the lender conspires with the borrower to defraud home buyers, it may be liable to them. Evidence of conspiracy may be found in the lender's participation in decisions to make cosmetic repairs to conceal defects that would otherwise be discovered by prospective buyers; decisions not to pursue those primarily responsible for the defects, such as contractors and architects; and decisions not to disclose information relating to the defects, even after inquiry.

Fraud liability to the borrower may arise in many contexts. For example, liability may follow when the lender threatens the borrower without the ability or intention to follow through with those threats. Constructive fraud may arise although there is no actual fraudulent intent when there is a breach of duty and a relationship of confidence and trust between the borrower and the lender. Silent fraud will be found when the lender is silent when it has a duty to speak. The courts carefully weigh the evidence to find a duty and its breach.

Fraud liability frequently arises for lenders in cases of misrepresentation. This cause of action will be found when a party is damaged as a result of a lender's material representation that is known to be false. This cause of action exposes the lender to both actual and punitive damages.
When a lender, as part of a fraudulent scheme, makes a promise regarding a future event without the current intent to perform, the lender will be liable,\(^{32}\) as it will when it makes a promise to induce a borrower to take certain action after having already decided not to honor the promise.\(^{33}\)

§ 9.4 Interference

A lender's interference with a borrower's contractual relationship with a third party is actionable when it is motivated by malice and no business purpose is served.\(^{34}\) This cause of action requires proof of a valid contract, or certainty that a contract would have existed without the lender's interference; the lender's knowledge of the existence of the contract; the lender's improper or unjustified interference with the contract; and damage as a result of the interference.\(^{35}\) A party is privileged to interfere with a contract between others when it does so in the bona fide exercise of its rights or when that party possesses an equal or superior interest in the subject matter.\(^{36}\) The fear of liability on this theory should not impede the legitimate exercise of the lender's remedies because they are privileged.\(^{37}\)

§ 9.5 Negligence

In some cases lenders have been found to be liable to their borrowers and others on a negligence theory. Any cause of action for negligence must arise out of a positive duty that the law imposes on certain people because of the nature of their relationship and must include some negligent act.\(^{38}\) A good example of such liability may be found when the purchaser relies to its detriment on an appraisal supplied by the lender.\(^{39}\) The lender owes a duty of care in preparing the appraisal if the lender can foresee that the borrower will rely upon the erroneous appraisal.\(^{40}\) If the lender becomes directly involved in the transaction or makes assurances of the value of the property, it may be held liable to third parties that it should have foreseen would rely upon its statements.\(^{41}\) Lenders will not be automatically liable when an appraisal obtained from an independent appraiser is erroneous unless the lender contractually agrees to assume such duty or makes representations to the borrower or to third parties about the accuracy of the appraisal.\(^{42}\)

§ 9.6 Good Faith

Perhaps the most talked-about theory of lender liability is the concept of good faith. Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.\(^{43}\) The covenant of good faith and fair dealing requires that neither party do anything to deprive the other of the benefits of the agreement.\(^{44}\) In the event of breach, general tort remedies may be available to the borrower.\(^{45}\) The obligation of good faith present in every contractual relation is not an invitation to the court to decide whether one party ought to have exercised the rights provided to it by agreement. Rather, it is an implied undertaking not to take opportunistic advantage in a way that could not have been contemplated at the time the agreement was made. When the contract is silent, the principles of good faith fill the gap.\(^{46}\) To should be noted that some courts have held that the implied duty of good faith and fair dealing does not apply to commercial loan transactions negotiated at arm's length.\(^{47}\) Obviously, there are
many contrary cases holding that every contract implies a duty of good faith and fair dealing between the parties.\textsuperscript{48}

There are two standards of good faith, subjective and objective. Under the subjective standard, the lender must have a good-faith belief that its action is justified. The burden of establishing a lack of good faith is on the party against whom the lender's power was exercised.\textsuperscript{49} This is not a "commercially reasonable" or "reasonable lender standard," but rather a subjective standard of whether the lender had information that would have allowed it to honestly believe that its position had become insecure.\textsuperscript{50}

The objective standard is one of honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.\textsuperscript{51} To prevail, the borrower must present evidence that the lender acted in an arbitrary, capricious, or unreasonable manner and exceeded the borrower's justifiable expectations.\textsuperscript{52} For example, in one case the borrower and lender operated for years under a line of credit loan secured by a blocked account into which all revenues were deposited and credited against the loan balance, giving the lender total control over the borrower's cash flow. When the bank refused to advance additional funds, the borrower, unable to use the blocked account, collapsed. The court held that the lender must have a legitimate objective for cutting off funding and must give adequate notice of its decision. The borrower was awarded $7.5 million in compensatory and punitive damages.\textsuperscript{53} Most courts apply the subjective standard in lender liability cases.\textsuperscript{54}

When the loan documents give the lender discretion, the covenant of good faith and fair dealing will be implied so that the lender must exercise that discretion reasonable and not arbitrarily and capriciously. It is a breach of contract to act in bad faith in the exercise of the discretion conferred by the agreement.\textsuperscript{55} These issues arise when the loan documents give the lender approval or consent rights. To protect the lender from liability, the lender's actions must be based on well-documented and commercially reasonable grounds.\textsuperscript{56}

Again, bad faith, or the absence of good faith, will not be found if the lender acts in the manner authorized by the loan documents and if the circumstances justify the lender's action and the way such action was taken.\textsuperscript{57} Of course, because this theory allows the court to second-guess the lender, the lender must take great pains to make sure that both the action it takes and the manner in which it is taken are justified and reasonable.

The covenant of good faith and fair dealing does not impose a duty of reasonable forbearance or moderation in the enforcement of legal rights and the use of the creditor's contractual remedies.\textsuperscript{58} The lender may enforce its remedies only if the default is material\textsuperscript{59} because the courts will consider whether the default is so substantial so as to justify the lender's exercise of its remedies.\textsuperscript{60} Further, the court may enjoin foreclosure and limit a lender's recovery by the amount of damages caused by the lender's breach of the duty of good faith.\textsuperscript{61} In addition, the lender is not liable for an alleged breach of a duty to select a reasonably capable receiver and for the damages resulting from the receiver's failure to obtain insurance coverage.\textsuperscript{62}

Generally, neither a course of dealing nor the implied obligation of good faith can modify the express terms of an agreement.\textsuperscript{63} There are some exceptions, however, and if the lender has historically accepted tardy performance, it cannot, without notice that it will henceforth insist
upon timely performance, enforce its remedies upon the late performance of the borrower. The
result may be the same even when the loan documents contain an antiwaiver clause.

§ 9.7 Fiduciary Duty

The breach of a fiduciary duty is another theory of lender liability that has attracted a lot of
attention recently. If a fiduciary duty is found to exist, the lender must put the borrower's interest
ahead of its own. This requirement makes it easier for the borrower to establish lender liability.
A fiduciary relationship is one in which one party places trust and confidence in another who
thereby gains domination and superiority over the first party. A claim of fiduciary duty may be
based on the existence of a special relationship between a lender and a borrower that justifies
abandonment of the normal debtor-creditor relationship and imposes liability on the lender to act
in a reasonable manner so as not to cause injury to the borrower. This relationship of trust and
confidence is more easily found in the residential or personal loan context because the normal
trust between businesses, plus a slightly dominant position, does not create a fiduciary
relationship. A creditor does not have any fiduciary duty to the borrower or other creditors
solely as the result of the borrower-lender relationship. Merely asking the lender for advice
does not create a confidential relationship in the absence of domination or influence by the lender
over the borrower. And a lender's involvement in a loan workout does not create a fiduciary,
joint venture, or "quasi joint venture" relationship between a lender and a borrower if the key
element establishing a fiduciary relationship or duty (control by the lender over the affairs or
property of the borrower) is lacking.

Factors to consider in determining a fiduciary relationship include:

1. unequal bargaining power
2. adhesive contract provisions
3. public policy concerns that conduct themselves in a particular manner
4. whether the financial dependence or personal security of the damaged party was entrusted to
   the other
5. the reasonable expectations of the parties

Modern banking practices, with their highly complex structures, may thrust the lender into the
role of an advisor, thereby creating a relationship of trust and confidence and a resulting fiduciary
duty. To establish liability, there must be control by the lender over the decision-making
processes of the debtor amounting to a domination of the debtor's will.

The existence of a fiduciary relationship may be shown when friendship, business relationship,
or agency results in one gaining influence or superiority over the other. If the lender acts in an
advisory role, such as advising a borrower to expand its business, or if the lender has acted as
financial advisor to the borrower for years and the borrower has relied upon the lender's advice,
it may have the confidential relationship that gives rise to a fiduciary obligation. For example, a
lender is liable when it loans money to a purchaser of a business, advising that the business is sound when in fact, and to the lender's knowledge, it is not, and the lender benefits from the transaction by reducing the size of its loan to this risky business. A commercial borrower is not entitled to punitive damages against a lender based on a claim for breach of the implied covenant of good faith and fair dealing unless the relationship between the lender and the borrower exceeds the ordinary arm's-length relationship between such parties and becomes a quasi-fiduciary relationship.

§ 9.8 Direct Liability as Principal

Under proper circumstances, a lender may be directly liable to third parties as a principal or alter ego of the borrower. For this liability to exist, more must be found than the holding and protection of a security interest and the monitoring of the borrower's operations. A form of this liability may be found when the borrower and lender are partners or joint venturers. The basic concept of this form of business association is the association of two or more persons to carry out a single enterprise for a profit. A joint venture may exist even if control of the venture is entrusted to one of its members. Seldom will a partnership or joint venture be found unless a profit participation arrangement in excess of normal loan interest exists. Joint ventures have other earmarks, the most important of which in intent. The courts will give due deference to loan document provisions negating any such relationship. However, merely including the usual boilerplate is not enough. If the underlying relationship is different than that portrayed in the boilerplate, the contract is viewed in its entirety and other provisions of the relationship may overcome the rubric that a debtor-creditor and not joint venture relationship has been established.

§ 9.9 Control

Closely related to theories of direct or joint venture/partnership liability is the theory that the lender is liable to the borrower and third parties because of the control it exercises over the borrower's day-to-day operations. See Chapter 10. In effect, the lender became the borrower. A lender exposes itself to liability to the borrower and third parties if it controls the borrower. Liability here is for direct conduct. Generally, a lender is not deemed to exercise control over a borrower if the lender acts solely to protect its security interest. More than normal monitoring of the borrower's business affairs and protecting collateral, such as day-to-day involvement in the management and operations of the borrower, is generally needed. Also, when a lender controls the borrower's assets, stock, and cash management, a fiduciary relationship is created between the borrower and the lender that exposes the lender to liability both to the borrower and to third parties. A long and close relationship between the borrower and lender and a high level of control over the borrower's activities may make the lender liable to third parties as an agent of the borrower.

When a lender takes over a borrower's operation, it may expose itself to liability to the IRS as an employer who fails to pay the borrower's unpaid withholding and social security taxes and unpaid state withholding taxes. Recently, a court held that a lender may be liable for unpaid withholding taxes of a borrower. An asset-based lender was found to be the "responsible
person" under the Internal Revenue Code and consequently liable for the entire amount of the borrower's unpaid but withheld federal employment taxes. When a lender supplies funds that will be used by the borrower to pay salaries or wages and the lender knows that the borrower does not intend to pay employment taxes on time, the lender will be liable for the unpaid taxes. Additionally, if the lender has taken over the borrower's financial affairs, it may face a 100 percent penalty for failing to pay the withholding taxes.

§ 9.10 Environmental Liability

It may be environmental liability that strikes the greatest fear into the hearts of lenders. Like other forms of lender liability, environmental liability exposes the lender to payments much in excess of the loan amount and the value of the security. If the lender becomes overly involved in the business affairs or management of the borrower or in effect operates the mortgaged property, the lender could be liable for hazardous waste cleanup costs as an "owner or operator" under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund Amendments and Reauthorization act of 1986 (SARA), if the business involves the operation of a hazardous waste facility or the disposal of hazardous materials. A lender involved in a loan workout must be especially careful. It usually wants additional control over the management of the borrower or the property to protect its interest in the mortgaged property and as additional security for concessions granted to the borrower.

Under CERCLA and SARA the definition of responsible person extends to the following:

1. current owners and operators of the hazardous facility
2. parties who were owners or operators of the property at the time of disposal
3. persons who arranged for the disposal of hazardous substances at the facilities
4. persons who transported hazardous substances for disposal at the site

If the lender fits into any of these categories, it may be required to remove hazardous wastes from the site, or it may be held strictly liable for the full cost to clean up the site.

Commercial real estate lenders may become liable as "owners or operators" under CERCLA even though they did not know of, and had no part in causing, the contamination at the site. However, CERCLA does provide that an "owner or operator" does not include one "who does not participate in the management of the property and holds the indicia of ownership primarily to protect his security interest in the property." In addition to affirmative defenses for acts of God and acts of war, CERCLA also establishes an affirmative defense for a person who would otherwise be liable as an owner if the release of the toxic waste was caused by a third party not an agent or employee of the defendant not engaged in a contractual relationship with the defendant. For this so-called third party defense to apply, there must be a lack of causal nexus between the defendant and the prior owner. Under this exception, a court will investigate the nature of the relationship between the borrower and the lender and the lender's knowledge of the hazardous waste located on the property.
CERCLA provides a statutory exception to the definition of "contractual relationship" if the defendant acquired the real property after the disposal of the hazardous substances and did not know and had no reason to know of the existence of any hazardous substances at the site. Under this exception, the defendant must establish by a preponderance of the evidence that it exercised due care with respect to the hazardous substances and took precautions against foreseeable acts and omissions by third parties. This provision establishes an environmental standard of due diligence and provides an innocent landowner defense for lender. This defense was narrowed by the inclusion of land contracts, deeds, or other instruments transferring title or possession of the property within the term "contractual relationship."

To qualify for the innocent landowner defense, the defendant must demonstrate that it conducted an appropriate inquiry into current and prior uses of the property, found no evidence of contamination, and did not itself contribute to the contamination. In evaluating the defendant's qualification for this defense, the courts consider the defendant's experience, the purchase price and its relation to the value of the property if uncontaminated, and whether the contamination was obvious upon an inspection of the property. Those engaged in commercial transactions are held to a higher standard of care than others with respect to the discovery and correction of hazardous waste problems.

Even if the lender qualifies for the innocent landowner defense, its responsibilities are not over. If it learns of contamination at the site, it is obligated to disclose the contamination to subsequent purchasers or forfeit the innocent landowner defense. The innocent lender may also be required to report such contamination to the EPA.

As a result of amendments to CERCLA, the innocent landowner defense may be unavailable to lenders. The lender is caught in a catch-22 dilemma. If the lender acquired the property with actual or constructive notice of contamination, it is liable as an owner or operator. On the other hand, if the lender performs the required due diligence but contamination is later discovered, it may be difficult to establish the innocent landowner defense in hindsight because commercial lenders are held to a higher standard of care and may be presumed to have known of the contamination or to have conducted a sufficient inquiry to determine the existence of the hazard. The focus has been shifted by CERCLA and SARA to actual and constructive notice on the part of the lender, with, lenders fear, virtual strict liability against lenders.

Various bills have been introduced in Congress to establish a due diligence standard; to exempt lenders, the FDIC, and the RTC from CERCLA liability with respect to property acquired through foreclosure; to exempt trustees and other fiduciaries from CERCLA liability; and to temper the holding of the Fleet Factors case. The EPA has issued a proposed interpretive rule on lender liability issues. Because there is much proposed legislative and regulatory activity in the area, the state of the law is far from certain. For example, is the lender protected after acquiring title to a property through foreclosure or by a deed in lieu of foreclosure because it acted to "protect its security interest in the property," or is the lender strictly liable once it acquired title? What level of participation by the lender in the management or operation of the property causes a lender to be deemed an owner or operator, regardless of whether the lender holds title to the property? Under what circumstances is a lender liable as a "non-owner" that "arranged for the disposal or treatment or transport of hazardous substances at the site"?
Despite the innocent landowner defense, recent case law establishes that a lender may be liable under CERCLA and SARA as an owner or operator. A secured lender was recently held liable for cleanup costs under CERCLA without being an operator, when the lender "Participated in the financial management of a facility to a degree indicating a capacity to influence an entity's treatment of hazardous wastes." Another court recently held to the contrary that the lender had not lost its secured creditor protection under CERCLA even though it had rights to inspect the premises and take possession upon foreclosure because it had never exercised those rights.

To avoid owner or operator status under CERCLA or SARA for exercising too much control over the borrower or the mortgaged property that secures the loan, lenders should not exert more control over the borrower than is necessary to protect their security interest. This is easier said than done.

§ 9.11 Lender's Checklist

The following is a checklist of steps that prudent lenders should take in connection with mortgage loans:

_____ Prior to making the loan, as part of its underwriting analysis, the lender should review the borrower's assets, business operations, and the use of the mortgaged property by the borrower, tenants, and other occupants to ascertain that there are no adverse environmental conditions or concerns.

_____ The loan documents should give the lender the right to monitor activities conducted on the mortgaged property by the borrower and the borrower's tenants and should provide that the lender receive copies of notices to the borrower or occupants of the mortgaged property from federal, state, or local environmental agencies.

_____ The loan documents should state that the lender's right to inspect the mortgaged property and monitor the operations and activities conducted on the mortgaged property are for the sole and express purpose of protecting the lender's security interest and are for the lender's sole benefit.

_____ The lender should not involve itself in the day-to-day operations of the borrower or directly control the use and operation of the mortgaged property, nor should the lender have the right to manage the borrower's affairs or control its financial or employment decisions.

_____ The lender should develop consistent policies and procedures, including recordkeeping, regarding environmental matters, especially in connection with workouts.

_____ Prior to making the mortgage loan and prior to foreclosure or agreeing to accept a deed in lieu of foreclosure, the lender should obtain a Phase I environmental report from a reputable independent environmental consulting firm to determine existing and potential hazardous waste liability. As part of the report, the chain of title should be searched, along with the records of the EPA and state and local environmental agencies, to determine whether the site, or property in the vicinity of the site, has a history of environmental contamination or use as a facility for the
generation, storage, or treatment of hazardous materials. The lender should also consider obtaining an additional, updated Phase I environmental report at the time of any subsequent loan modification or workout, because the value of the mortgaged property at each such occurrence and the lender's exposure to environmental liability may depend on the environmental condition of the mortgaged property.

_____ As part of the loan application, the lender should consider requiring the borrower to complete an environmental questionnaire and to execute an environmental risk agreement.

_____ The lender should consider maintaining the confidentiality of all environmental reports, evaluations, questionnaires, agreements, and other documents requested by the lender in connection with real estate transactions. There is no guarantee that a court will uphold these confidences in connection with a specific case. The lender's counsel should, however, attempt to protect the confidentiality of such documents under the attorney-client privilege or the attorney work product privilege.  

_____ If the environmental report or other information indicates environmental risks, the lender should retain an experienced environmental consultant to conduct more comprehensive testing to ascertain the existence and extent of environmental contamination. If environmental contamination exists, the lender must decide whether to make the loan at all, or possibly to exclude contaminated portions of the collateral from the mortgage security and reduce the amount of the loan accordingly.

_____ The description of the secured collateral in the loan documents should specifically exclude all hazardous materials and substances, asbestos, and underground storage tanks.

_____ The lender's loan documents should make the borrower and its principals personally liable for all costs in connection with environmental hazards. Any nonrecourse provisions in the loan documents should except liability for costs of compliance with environmental laws, and the lender should be indemnified for such costs by the principals of the borrowing entity. These indemnity provisions should survive the maturity and payment of the loan. Releases and indemnities executed by the borrower in favor of the lender cannot prevent the lender from being directly liable to the government and other third parties, although such agreements are enforceable as between the parties.

_____ It may be desirable to obtain personal guarantees of the loan from unrelated and unaffiliated guarantors with extensive financial resources, because CERCLA may impose liability on corporate officers and shareholders of the borrower. This would seriously dilute the value of guarantees from such parties. Recent cases indicate that environmental liability may be imposed on anyone with the ability and power to discover, prevent, control, and correct hazardous waste contamination, and therefore the environmental review by the lender should encompass the activities of all such parties.

_____ If the borrower defaults and a site inspection or an environmental audit reveals even the possibility of contamination at the site, the lender should consider the immediate appointment of a state court receiver, or even filing an involuntary bankruptcy proceeding against the borrower. This may insulate the lender from environmental liability and enable the mortgaged property to
be cleaned up under the foreclosure or bankruptcy court's direction and/or sold without involvement by the lender.

§ 9.12 RICO Requirements

A Racketeer Influenced and Corrupt Organizations (RICO) violation exists when the defendant participates directly or indirectly in an enterprise through a pattern of racketeering activity or engages in a pattern of racketeering activity to acquire an interest in an enterprise. In the context of lender liability, there must be a connection between the lender's acts and the predicate acts causing the plaintiff's injuries. A lender acting in the normal course of its business will not be liable, but the line between the normal course of business and illegal activities can be easily and unwittingly crossed. For example, the lender's participation in development and marketing activities creates RICO exposure for lenders. Further, a lender may be liable for aiding and abetting the predicate acts of the RICO violation if:

1. there was an unlawful act
2. the lender was aware of its role in the unlawful act
3. the lender knowingly rendered substantial assistance in the act.

This is illustrated in a recent case in which high-ranking officials of the lender made loans to the borrower, received ownership interests in the developer, and were otherwise intimately involved in the illegal act.

Legitimate workout negotiations and efforts of a lender to restructure the borrower's delinquent loan do not constitute RICO violations merely because the workout negotiations fail. If the borrower requests such negotiations and is represented by counsel, the lender will be free from liability unless there is clear evidence of a scheme by the lender to defraud the borrower and the lender's conduct has some "criminal dimension and degree."

A lender may be liable for a civil RICO violation even if the alleged violations do not result in any profit to the lender, because RICO requires only that the plaintiff suffer an economic injury. However, isolated threats by officers of the lender do not meet the RICO requirement of a pattern of racketeering activity. Nor do opinions and "puffing" by loan officers constitute conduct sufficient to establish a pattern of racketeering under RICO. In another context, several courts have held that a borrower that has overstated its prime rate and charged excessive interest may maintain a civil RICO action.

Lenders usually encounter RICO exposure when borrowers add RICO claims to lender liability suits. However, the forfeiture provisions found in the criminal laws may override the lender's perfected security interest in the borrower's property. Under these laws the government may claim that title to all the assets of an alleged racketeer vested in the government as of the first date of the racketeering activity.

§ 9.13 Economic Duress
The requirements for finding a cause of action for economic duress are:

1. a threat to do an act that a party has no right to do
2. the threat must overcome the free will of the threatened party and cause that party to do an act that it is not legally bound to do
3. the restraint caused by the threat must be imminent
4. the threatened person must have no present means of protection.

In the leading case in this area, the court held the lender liable when it had the right to accelerate the loan in the event of a management change, and threatened to use that right in a way that rose to the level of economic duress. The court stated that threatening to do that which a party has a legal right to do is not a basis for a claim of duress. The vice arises when the party employs extortionate measures or makes improper demands. Of course, merely exercising the lender's remedies in a proper manner does not cause the lender to be liable.

The problem is that it is difficult to divine what the improper means of exercising legitimate rights and remedies may be. Some courts have required that the threat be made in a wrongful manner or present an unreasonable alternative to the threatened party with the weaker bargaining position.

Duress does not exist when an agreement is secured because of hard bargaining or the pressure of financial circumstances. Instead, the conduct of the threatening party is usually tainted with some fraud or wrongdoing. For example, a lender may be held liable if it conditions the making of a loan upon the borrower's payment of a debt owed to a third party.

§ 9.14 Prima Facie Tort

A lender liability tort claim may be asserted by a borrower when no traditional tort such as fraud or misrepresentation exists. This type of tort is recognized and recovery allowed in only a few states. It occurs when the defendant commits a lawful act without sufficient justification and with the intent to injure the borrower who is in fact injured. A more general theory has been adopted in the Restatement (Second) of Torts, which extends liability to a party that intentionally injures another if the actor's conduct is generally culpable and not justifiable under the circumstances. The court must evaluate the nature and seriousness of the harm to the injured party, the nature and significance of the interests protected by the actor's conduct, the means used by the actor, and the actor's motive. Even with these standards, the test is vague. Conduct found to be wrongful by one court might be found innocent by another. The keystone for lenders, however, is found in the requirement that their conduct must be either motivated to harm the borrower, or be without justification.

Liability to a borrower may arise when the lender cuts off negotiations and repossesses collateral without notice, even though the loan documents allow the lender to repossess the collateral. The court found the lender's conduct culpable in taking enforcement actions without notice to the
borrower when the borrower and lender were in a context of cooperation and negotiation. Hard bargaining is not prohibited; there must be egregious conduct tantamount to fraud, overreaching, or spoilation to the detriment of others.\textsuperscript{128} If the lender can be characterized as an insider, its conduct will be subject to more exacting scrutiny.\textsuperscript{129}

\section*{§ 9.15 Duty of Confidentiality}

The release of mortgage loan information and a breach of the lender's duty of confidentiality are other actions that bring liability to the lender. The lender is subject to the implied obligation to keep a customer's financial affairs confidential. That the intimate details of a depositor's affairs must be kept secret is a fundamental precept of the relationship of a bank to its customers.\textsuperscript{130} The lender is confronted with the classic dilemma of liability to its customer on one hand and liability to third parties on the other. If a lender that otherwise has no obligation to provide information to third parties supplies information on a prospective borrower to another lender or other third party, it may be held liable if the information provided is false, misleading, or inaccurate.\textsuperscript{131}

\section*{§ 9.16 Securities Law Liability}

Certain lender activities may result in securities law liability to third party investors.\textsuperscript{132} The theory here brings liability to the lender as a participant seller if it solicited the securities purchaser and had some financial interest in the sale transaction\textsuperscript{133} or aided and abetted in the issuer's wrongful conduct.

\section*{§ 9.17 Duty to Insure}

Lenders have unwittingly found themselves exposed to liability when the lender is involved in the insurance of the property or the borrower. In such cases the lender may have the same malpractice exposure as an insurance broker.

Different financial relationships have led the courts to different result as they determine the lender's liability to the borrower when uninsured property suffers what would have otherwise been an insured loss. If the lender merely collected and escrowed funds to pay insurance premiums when they came due, the lender has no duty to notify the borrower of the cancellation of the insurance or to replace the canceled coverage.\textsuperscript{134} Typically, the courts will look for some expressed or implied agreement between the parties, and some courts have held that if a lender collects premiums it has a contractual obligation to obtain the insurance,\textsuperscript{135} and if the lender obtains the insurance, it is responsible to see that the coverage is proper.\textsuperscript{136}

Similarly, when a lender failed to comply with the National Flood Insurance Act requiring notification to the borrower that the property was in a flood plain, a common law tort action for negligence existed even though no private implied federal cause of action existed. The lender was liable for flood damage to the property even though the borrower had retained an inspector who reported that the property had no signs of major flooding and the loss may not have been insurable.\textsuperscript{137} Other courts have held that no such cause of action arises when a lender fails to
inform the borrower that the secured property lies in a flood hazard area and flood insurance is available.\textsuperscript{138}

In other contexts, a lender has been held liable for its failure to obtain credit life insurance for the borrower. \textsuperscript{139}

\textbf{CONSTRUCTION LENDER LIABILITY}

\textbf{§ 9.18 Additional Liability Issues}

The construction lender is confronted with all of the exposures to lender liability that other lenders face, plus exposures unique to construction settings. These special liabilities can expose the lender to both its borrower and to third parties.

For example, borrowers frequently seek their lender's advice in selecting an architect, contractor, lawyer, and the like. Making the wrong recommendation does not always cause the lender to be liable. \textsuperscript{140} Referrals like these are common and are not the kind of representation upon which a customer may generally rely.\textsuperscript{141}

\textbf{§ 9.19 Inspections}

By the nature of the lending vehicle that they deal in, construction lenders inspect the ongoing construction process to see that their disbursements are actually paying for the construction, that construction is proceeding on schedule, and that the work is being done in a competent manner. Sometimes these inspections are carried out by third-party architects or inspectors, and sometimes the inspection is done by the lender's in-house staff. Even though a lender may make the inspection, it generally has no duty to inspect the property for the borrower's benefit. The inspection may be made only to ascertain whether the property had sufficient value to secure the loan and may be solely for the lender's benefit. \textsuperscript{142} This result follows even when the lender charges an inspection fee. \textsuperscript{143} Similarly, federal inspection requirements needed to secure a federally insured mortgage will not of themselves impose upon the lender a duty of care to the borrower. \textsuperscript{144}

The lender does not have a duty to inspect the mortgaged property for the benefit of the borrower unless the lender otherwise assumes this duty. \textsuperscript{145} To prevent any impression that the lender has assumed this obligation, the loan documents should allow the lender to inspect, but specifically negate any duty to inspect for the borrower's benefit.\textsuperscript{146} If, however, it is the intent of the parties that the lender undertakes inspections for the borrower's benefit, and the borrower reasonable relies on the lender, the lender will be liable for damages to the borrower as a result of faulty inspections.\textsuperscript{147}

\textbf{§ 9.20 Construction Defects}
The lender will generally not be under a duty to disclose defects in the property to a buyer if the lender is just that, a mere lender. The lender may, however, be liable for construction defects when it is active in the construction of a home. The decision in Connor v. Great Western Savings & Loan Association caused a great deal of controversy, finding a duty to the borrower arising out of a voluntarily assumed relationship dictated by public policy. The court found the success of the lender's transaction with the developer depended upon inducing purchasers to finance their purchases through this lender. Further, the lender knew that the contractor was thinly capitalized, and this created a risk of cutting corners in construction. This decision has been widely criticized and limited by subsequent legislation and court decisions. Since Connor, decisions involving a normal lender-borrower relationship generally hold that the lender is not liable for construction defects. In this capacity, the lender has no duty to the borrower to supervise construction or development. Likewise, a lender may inspect for its own account without incurring liability as a participant in the project.

Lenders are liable to home buyers if they participate in the management of the project to the degree that a court may recharacterize the lender-borrower relationship as a joint venture. Likewise, when the lender assumes control of the contractor, it will be bound by the construction contract. If the borrower notes construction deficiencies and the lender refuses to withhold disbursements without investigation, the lender will also be liable.

A special situation is created when the lender forecloses or takes a deed in lieu of foreclosure. If it sells the project without completing construction or making any warranties, the lender will generally not be liable for construction defects. But if the lender becomes intertwined in the promotion and development of the property, it becomes the developer and incurs the resulting liability. Even so, courts do not always hold the construction lender liable to the home buyer. The court may refuse to impose liability for the developer's breach of warranties on a construction lender that had foreclosed on the property and finished the development. However, the lender is not always free from exposure. It will be liable to a purchaser for its representations to the purchaser, for patent construction defects in the project, and for breaching any applicable warranties resulting from defects in the parts of the project completed by the lender. Further, a construction lender that takes over a project after completion and then repairs defects has a common law duty to use due care in making the repairs and will be liable for its own negligence, but not for the negligence of the original developer.

§ 9.21 Disbursements

When the construction lender disburses construction loan proceeds, it exposes itself to a greater risk of lender liability. Although the satisfaction of the conditions of loan disbursement is governed by the standard of commercial reasonableness, if the lender convinces the borrower to rely on the lender's experience in disbursing construction funds and to deposit additional funds with the lender for disbursement as construction progresses, the lender will be liable for breach of its duty as agent of the borrower if the loan falls out of balance. A lesser standard may be applied when the lender controls the disbursement of loan proceeds and fails to obtain mechanics' lien releases. If liens are later filed against the property, the lender becomes the borrower's agent with a duty to use reasonable care to protect the borrower's interests.
If the lender disregards the borrower's instructions, the lender may be liable. In a recent case, the borrower noted defects in construction and requested that the lender withhold further disbursement until the defects were corrected. The bank did not stop disbursements and did not investigate the borrower's complaints. Although the court noted that a construction lender does not normally have a duty to safeguard against or even identify construction defects, the lender cannot disregard the interests of the borrower in the construction funds. The borrower would be placed in a position of having to repay the lender for a loan on an unsound building. The lender may continue disbursements only if it finds the complaints to be unfounded.

In Davis v. Nevada State Bank, the court announced a standard that places severe burdens on the construction lender who makes disbursements. Lender liability may arise under a construction loan when:

1. the lender assumes the responsibility or the right to distribute loan proceeds to parties other than its borrower during the course of construction
2. the lender is apprised by its borrower of substantial deficiencies in construction that affect the structural integrity of the building
3. the borrower requests that the lender withhold further disbursements of loan proceeds pending the satisfactory resolution of the construction deficiency
4. the lender continues to pay out loan proceeds in disregard of its borrower's complaints and without any bona fide attempt to ascertain the truth of these complaints
5. the borrower ultimately is damaged because the substance of the borrower's complaints was accurate and the borrower is unable to recover damages against the contractor or other party directly responsible for the construction deficiencies.

The lender must distinguish between substantial and insubstantial defects. To the borrower, all defects may be substantial. Borrowers may assert the substantial nature of the deficiencies as they urge the lender to withhold disbursements to put leverage on the contractor to correct the problems.

§ 9.22 Liability to Contractors

Generally, the construction lender does not have a duty to insure the financial stability of the venture for subcontractors not to protect subcontractors from nonpayment. Nor does the lender have an obligation to loan adequate funds for the completion of the project.

Liability may be premised on more than the mere status of the lender as a construction lender. Subcontractors often request confirmation from a construction lender that funds are available for the payment of the subcontractor's work. In one such case, the lender responded that a loan commitment was issued and that the amount of the subcontractor's contract had been reserved for payment of the subcontractor's work. The lender noted, however, that it would not be obligated to fund these monies if there was a substantial adverse change in the borrower's financial
condition. The lender subsequently stopped funding and the court held that a question of fact was presented as to whether the lender exercised its right to stop funding reasonably and in good faith.

In some cases the lender may agree with the contractor to pay the construction loan draws directly to the contractor instead of to the borrower. If, contrary to this agreement, the lender disburses draws to the borrower and the borrower diverts the funds before paying the contractor, the lender has breached its agreement and has negligently disbursed the loan proceeds. In one such case, the court upheld punitive damages against the lender and subordination of the lender's mortgage lien to the contractor's mechanic's lien.

§ 9.23 Minimizing Liability

Lenders should be wary of arrangements with borrowers that could constitute joint ventures. Loan documents should expressly negate any partnership, joint venture, agency, or relationship other than lender and borrower. If a joint venture is desired, insure that the loan analysts and engineers appreciate that their work may be subject to close scrutiny by the ultimate purchaser. Insure that loan agreements contain unambiguous exculpatory language making it clear that the lender's inspection and monitoring activities are for the lender's exclusive benefit. This language may also be recommended in recordable loan documents to put third parties and potential purchasers on notice of this limitation on the lender's obligation. The documents should provide that the lender, by making loan disbursements after inspections, does not make any warranty or owe any duty for the benefit of the borrower or third parties as to the quality of the construction inspected.

In a foreclosure, exercise extreme care when deciding whether and to what extent to complete a project. A lender that completes defective construction may be come liable for failing to cure the defect. Further, contracts of sale for foreclosed improved property should contain appropriate disclaimers or limitations of warranty to limit the lender's liability for unknown defects occurring prior to foreclosure.

5 Gries v. First Wis. Nat'l Bank, 82 Wis. 2d 774, 264 N.W.2d 254 (1978).


14 City Centre One Assocs. v. Teachers Ins. & Annuity Ass'n, 656 F. Supp. 658 (D. Utah 1987); Annotation, Specific Enforcement of an Agreement to Lend or Borrow Money, 82 A.L.R.3d 1116 (1978).


17 Wait v. First Midwest Bank, 142 Ill. App. 3d 703, 491 N.E.2d 795 (1986); See also Landes Constr. Co. v. Royal Bank of Canada, 833 F.2d 1365 (9th. Cir. 1987); But see In re Red Cedar Constr. Co., 63 Bankr. 228 (Bankr. W.D. Mich. 1987) (lender not liable for failing to make additional loans borrower alleged lender had orally promised to make).

18 See, e.g., Security Bank & Trust Co. v. Bogard, 494 N.E.2d 965 (Ind. Ct. App. 1986), in which the lender told the borrower that he would take the borrower's proposal to the loan committee and "we ought to have something here, ready for you to go with." The loan committee rejected the loan. The court held that the alleged contract lacked mutuality of obligation.


20 Palmer v. Production Credit Ass'n, 404 N.W.2d 293 (Minn. 1987). In Runnemede Owners, Inc. v. Crest Mortgage Corp., 861 F.2d 1053 (7th. Cir. 1988), the court refused to find a binding loan commitment even though the chairman of the lender had stated to the borrower, "Don't worry, I'm the committee. What I say goes. We have a deal." The court found no justifiable reliance by the borrower because the loan commitment and the borrower was sophisticated and experienced.


23 Becker v. First Am. State Bank, 420 N.W.2d 239 (Minn. Ct. App. 1988). The following states have enacted or are considering:

<table>
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<tr>
<th>Statute</th>
<th>Effective Date</th>
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<tr>
<td>Alaska Stat § 09.25.010(a) (13)</td>
<td>1989</td>
</tr>
<tr>
<td>Ind. Code § 32-2-1.5</td>
<td>July 1, 1989</td>
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In 1989, the ABA Section of Business Law formed a Joint Task Force of the Committees on Consumer and Commercial Financial Services to prepare a "model statute" barring the enforcement of oral lending agreements. In early 1990, a draft of this statute entitled "Model Lender Liability Statute of Frauds" was submitted to various industry groups for comment.


26 In Claire Assocs. v. Pontikes, 151 Ill. App. 3d 116, 502 N.E.2d 1186 (1986), the court held that a contingency in a loan commitment that the identity of the borrowing entity not change was enforceable by the lender, and a change in the borrowing entity entitled the lender to refuse to fund the loan. See also, Cambridgeport Sav. Bank v. Boersner, No. 88-5776-A (Mass. Aug. 17, 1990), in which the court held that because the borrower failed to meet the conditions precedent to funding set forth in the loan agreement, the bank had no obligation to disburse the loan proceeds; the borrower had breached the loan agreement and the lender was entitled to enforce strictly the terms of the loan agreement in spite of prior waivers.


Although the plaintiff signed loan documents at her husband's insistence while she was intoxicated, the bank was not liable for fraud because it was not aware that she was intoxicated; the lender was under no obligation to disclose the true financial position of the corporation whose debts she had personally guaranteed, because there was no evidence that the bank knew or should have known that she, as secretary of the borrower corporation, was unaware of the borrower's financial condition. Sinard v. Roach, 414 N.W.2d 100 (Iowa 1987). See also mid-America Nat'l Bank v. First Sav. & Loan Ass'n, 161 Ill App. 3d 531, 515 N.E.2d 176 (1987), in which the court held that the lender had no duty under the flood act to inform the borrower that the property was located in a flood-hazard area or that flood insurance was available. But see Small v. Norwalk Sav. Bank, 205 Conn. 751, 535 A.2d 1292 (1988).


In Crystal Springs Trout Co. v. First State Bank, 732 P.2d 819, on reh'g, 736 P.2d 95 (Mont. 1987), a bank president, who was also a lawyer and business advisor to an investor and officer of the borrower, repeatedly and knowingly misled a borrower as to the status and availability of interim financing and was held liable for actual and punitive damages.


Costa v. Neimon, 123 Wis. 2d 410, 366 N.W.2d 896 (Ct. App. 1985).


Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351 (7th. Cir. 1990).


U.C.C. § 1-208 (1989) is applicable if the lender is entitled to accelerate payment or require additional collateral at will or when it deems itself insecure. Reid v. Key Bank, 3 U.C.C. Rep. Serv. 2d (Callaghan) 1665 (1st Cir. 1987).


U.C.C. § 2-103(1) (b) (1989).


K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th. Cir. 1985). See also First Nat'l Bank v. Sylvester, 196 Ill. App. 3d 902, 554 N.E.2d 1063 (1990) (court held that borrower and guarantor were entitled to jury trial on issue of whether lender wrongfully terminated line of credit agreement that contained no expiration date; good faith requires party vested with contractual discretion to exercise it reasonably). But see Mirax Chem. Prods. Corp. v. First Interstate Commercial Corp., No. 89-1915 (E.D. Mo. Aug. 22, 1990), in which the court held that a revolving line of credit agreement, with payment-on-demand and termination-at-will features, may be terminated by the lender regardless of surrounding circumstances. The court rejected the borrower's claim that the issue of the lender's good faith in deciding to terminate the loan should be submitted to the jury.

When a lender terminates a line of credit, the obligation of good faith requires that it must do so reasonably and not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties. Carrico v. Delp, 141 Ill. App. 3d 684, 490 N.E.2d 972 (1986).


56 Id. See also Bartlett Bank & Trust Co. v. McJunkins, 147 Ill. App. 3d 52, 497 N.E.2d 398 (1986), which left to the jury the question of whether the lender acted in good faith and declined to decide whether a subjective or objective test was to be adopted when the loan documents provided that the lender had to be reasonably insecure to accelerate.


61 Wisconsin Fin. Corp. v. Beilke, 142 Wis. 2d 937, 417 N.W.2d 197 (Ct. App. 1987); Northwest Land & Inv., Inc. v. New W. Fed. Sav. & Loan Ass'n, 57 Wash App. 32, 786 P.2d 324 (1990); But see Firemen's Fund Mortgage Corp. v. Zollicoffer, 719 F. Supp. 650 (N.D. Ill. 1989) (borrower attempted to defeat foreclosure by arguing that lender breached mortgage and covenant of good faith and fair dealing when mortgagee took actions to secure premises as result of apparent abandonment by borrower; court held that conditions justified lender's actions and did not relieve borrower from obligation to make loan payments).


65 Westinghouse Credit Corp. v. Shelton, 645 F.2d 869 (10th. Cir. 1981). But see Schaller v. Marine Nat'l Bank, 131 Wis. 2d 389, 388 N.W.2d 645 (Ct. App. 1986), in which a lender was not obligated to continue honoring overdrafts as it had in the past. The court found that these past practices did not evidence an implied contract or require the lender to give advance notice of its intention not to continue honoring overdrafts.

66 In re Estate of Wernick, 151 Ill. App. 3d 234, 502 N.E.2d 1146 (1986). "[A] fiduciary relationship exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation." Restatement (Second) of Torts § 874 comment a (1979). A fiduciary is under a duty to act for the benefit of the other as to matters within the scope of the relationship. Restatement (Second) of Trusts § 2 comment (b) (1959). Literature discussing the concept of fiduciary duty is limited, and there is little guidance as to how the relationship exists in given context. See Curtis, The Fiduciary Controversy: Injection of Fiduciary Principles into the Bank-Depositor and Bank-Borrower Relationships, 70 Loy. L.A.L. Rev. 795 (1987); Fischel, The Economics of Lender Liability, 199
Yale L.J. 131 (1989); Hellmuth, Lender Liability and Fiduciary Obligation, in Probate and Property 21, ABA Section of Real Property, Probate & Trust Law (July/Aug. 1989).


71 Cameo W. Ltd. v. FDIC, No. 86-6573, D.C. No. CV-85-0911-E (9th. Cir. June 30, 1988) (case not approved for publication and not to be cited as precedent to or by any court in the Ninth Circuit, pursuant to Ninth Circuit Rule 36-3).


Hallmark Ins. Adm'rs. Inc. v. Colonial Penn Life Ins. Co., 697 F. Supp. 319 (N.D. Ill. 1988) (lender held liable when it owned one-half developer's stock and sought to joint venture development projects); Central Bank v. Baldwin, 94 Nev. 581, 583 P.2d 1087 (1987); Associated Piping & Eng'g Co. v. Jones, 17 Cal. App. 2d 107, 61 P.2d 536 (1936) (with regard to intent of parties, transaction may be recharacterized as partnership even though mortgage loan documents expressly disclaim any intention to form partnership or create any relationship other than debtor or creditor; courts will look beyond form of transaction to establish actual intent of partners).


NCNB Nat'l Bank v. Tiller, 814 F.2d 931 (4th. Cir. 1987). But see United States v. Fleet Factors Corp., 901 F.2d 1550 (11th. Cir. 1990), which held that a lender may be liable if its involvement in the financial management of the borrower is to such a degree that it has the capacity to influence the borrower's treatment of hazardous waste or could affect decisions regarding such treatment if it so chose.


Id § 9607(a).

Id § 9601(20) (A).

Id § 9607(b).

Id § 9601(35) (A).

Id.


United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990) (participation in the debtor's financial management, as opposed to its day-to-day operating management, can expose a lender to liability if the participation can affect hazardous waste disposal decisions).

National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability under CERCLA, 56 Fed. Reg. 29, 798 (1991) (to be codified at 40 C.F.R. pt. 300 (proposed June 24, 1991)).


United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990).

East Asiatic Co., Ltd. v. Port St. Helens, 910 F.2d 668 (9th Cir. 1990). See also Kempf v. City of Lansing, 115 Bankr. 559 (Bankr. W.D. Mich. 1990), which held that a property owner who was not engaged in active disposal of hazardous wastes during its short period of ownership was
not liable for response costs; CERCLA imposes liability only on those who owned the property at the time hazardous substances were introduced into the environment.


106 42 U.S.C. § 9607(e) (1988). See United States v. Northernaire Plating Co., 685 F. Supp. 1410 (W.D. Mich. 1988) (court applied equitable factors to apportion damages for environmental cleanup costs among the defendants, who had brought motions on crossclaims for contribution, and evaluated their relative degree of involvement in handling the hazardous waste, the degree of care exercised by each with respect to the hazardous waste, and their respective degrees of cooperation with federal, state, or local officials to prevent harm to the public health or environment); Rockwell Int'l Corp. v. IU Int'l Corp., 702 F. Supp. 1384 (N.D. Ill. 1988) (purchaser brought action against prior operator for declaratory judgment as to liability for future environmental cleanup costs; court held that seller could seek declaratory judgment that defendants were jointly and severally liable for such costs, and purchaser could also seek declaratory judgment on issue of contribution). Cf. A.M. Int'l, Inc. v. International Forging Equip. Corp., 743 F. Supp. 525 (N.D. Ohio 1990), (contractual release effective under Ohio law but not under § 107(e) of CERCLA, which "forbids giving effect to releases between tortfeasors" in contribution actions).

107 See Kelley v. Arco Indus. Corp., 739 F. Supp. 354 (W.D. Mich. 1990). The court attempted to define a standard for holding individual corporate officers and directors personally liable under CERCLA. Although CERCLA liability is essentially strict liability, the court held that because such a standard may be too harsh and sweeping to apply to all potentially liable individuals, it is appropriate to review evidence of an individual's authority and responsibility for health and safety practices, including hazardous-waste-handling practices, whether such responsibility was undertaken or neglected, and whether the individual make any affirmative attempts to prevent unlawful hazardous waste disposal. The court stated that the focus should be on whether the individual could have prevented the hazardous waste discharge at issue. See also Joslyn Mfg. Co. v. T.L. James Co., 893 F.2d 80 (5th Cir. 1990) (corporate veil could not be pierced to impose liability on parent corporation for cleanup costs of contaminated site unless the subsidiary corporation is used as a sham to perpetrate a fraud or avoid personal liability, because common law principles of corporate law principles of corporate law such as limited liability apply under CERCLA); cf. New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985) (officer of realty corporation that purchased real estate for development was personally responsible for environmental cleanup costs as "operator" of facility even though he did not own site at time of disposal or cause presence or release of hazardous wastes at site; because Congress intended that responsible parties be held strictly liable under CERCLA, court expressly rejected need to pierce corporate veil); United States v. Northeastern Pharmaceutical, 810 F.2d 726 (8th Cir. 1986), cert. denied, 484 U.S. 848 (1987) (court held that individual officers of dissolved company were liable
for response costs under CERCLA because as officers of company they had arranged with transporter for "midnight dumping" and burial of hazardous materials on property with owner's consent).

For a discussion of the factors to be analyzed to establish the degree of control necessary to hold corporate principals personally liable under CERCLA for the acts of the corporation, see United States v. Carolina Transformer Co., 739 F. Supp. 1030 (E.D.N.C. 1989).


114 Edwards v. First Nat'l Bank, 872 F.2d 347 (10th Cir. 1989).


116 See, e.g., Morosani v. First Nat'l Bank, 703 F.2d 1220 (11th Cir. 1983).


§ 870.


In re Teltronics Servs., Inc. 29 Bankr. 139 (Bankr. E.D.N.Y. 1983).


Cypress Oilfield Contractors, Inc. v. McGoldrick Oil Co., 525 So. 2d 1157 (La. Ct. App. 1988). Although under no obligation to do so, the lender sent another prospective lender a letter stating that the financial condition of its customer was "not in jeopardy," whereas in fact the customer was in dire financial straits and had assigned certain invoices and accounts to the bank lender. Although the first lender had no fiduciary duty to the third-party lender, when it wrote a letter regarding the financial condition of the customer, it assumed a duty to provide correct information. The court found that the first lender breached the duty by its negligent misrepresentation and was liable for encouraging the third-party lender to lend money.


Parnell v. First Sav. & Loan Ass'n, 336 So. 2d 764 (Miss. 1976).

Taylor v. Colonial Sav. & Loan Ass'n, 533 S.W.2d 61 (Tex. 1976).

Small v. Norwalk Sav. Bank, 205 Conn. 751, 535 A.2d 1292 (1988). See also Camp v. First Fed. Sav. & Loan Ass'n, 12 Ark App. 150, 671 S.W.2d 213 (1984) (existence of duty to borrower to disclose that property was in flood-prone area was fact issue for jury to determine when lender would have its construction loan repaid as result of sale and buyer placed considerable reliance on integrity of lender).


Howard v. Riggs Nat'l Bank, 432 A.2d 701 (D.C. 1981) (bank was not liable for its loan officer's recommendation of contractor who failed to complete construction).


Rudolph v. First S. Fed. Sav. & Loan Ass'n, 414 So. 2d 64 (Ala. 1982).


Id.


157 McKnight v. Board of Directors, 32 Ohio St. 3d 6, 512 N.E.2d 316 (1987).


160 In re Roth, 56 Bankr. 876 (Bankr. N.D. Ill. 1986).


168 Id.