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How to Aggressively Defend Against Lender Liability Lawsuits

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Introduction

Following an economic downturn, lenders are inundated with lender liability suits typically based on purported promises to extend the maturity dates of loans, alter the terms of loan agreements, or to forbear from foreclosing on real property collateral. Even if these suits lack merit, lenders are required to spend time and money defending these suits. As a result, it is imperative for lenders to aggressively defend lender liability suits to minimize the time and expense incurred.

As is true for any lawsuit, the most effective tactic is to avoid liability in the first instance. Therefore, lenders are well advised to require that a borrower sign a forbearance agreement before any negotiations occur, meticulously document correspondence with borrowers to avoid any confusion as to the parties' understandings, and provide borrowers with sufficient notice to consider and accept proposed loan extensions or amendments. If a lender liability lawsuit is ultimately filed, a lender has several litigation tools to help "aggressively" defend the lender liability lawsuit, including a rapidly developing tool called a special motion to strike a strategic lawsuit against public participation (or "anti- SLAPP" motion).

Typical Sources of Liability and Potential Defenses

The typical sources of liability in a lender liability complaint (or cross-complaint) are derived from contract or tort principles. Contract-based claims can include a purported breach of oral commitment to lend money or extend the maturity date of a loan, a breach of the terms of the written loan agreement, or a hybrid breach of contract claim based in part on oral representations and based in part on the terms of the written loan agreement.

A typical defense to an allegation of an oral representation is that the borrower is barred from introducing any evidence of an oral representation that preceded or was made in conjunction with the writing that contradicts the writing, which is called the parol evidence rule.[1] This doctrine has its limitations and in the recent case entitled *Riverisland Cold Storage v. Fresno-Madera Prod. Credit Ass'n* (2013) 55 Cal.4th 1169, the California Court of Appeal held that parol evidence can be introduced if a borrower alleges fraud at the inception of the parties' contractual relationship.

Non-contract tort claims typically asserted in a lender liability complaint include fraud, negligence, breach of fiduciary duty, fraudulent concealment or breach of the implied covenant of good faith and fair dealing. The typical crux of each of these tort claims arises from a lender's alleged misrepresentation of a fact to the borrower (i.e. the lender would extend the maturity date of the loan), reasonable reliance by the borrower and damages incurred by the borrower.

A typical defense to such tort-based claims is that such claims are barred under California law, which generally provides that that a lender does not owe its borrower a legal duty of care and that lenders are entitled to exercise their contractual rights under loan documents.[2] The recent decision in *Jolley v. Wells Fargo Bank* (2003) 112 Cal.App.4th 1527 somewhat eroded this general proposition by holding that lenders can be found to have a duty of care to a borrower if the lender steps out of its traditional role of a money lender. A second decision, in *Lueras v. BAC Home Loans Servicing, LP* (2013) 221 Cal.App.4th 49, somewhat narrowed the decision in Jolley and reaffirmed the general proposition that a lender does not typically owe a duty of care to a borrower. Nonetheless, if a lender steps out of its traditional role as a lender of money, it can be found to owe a duty of care to a borrower. At a minimum, if the borrower correctly pleads such a claim, the claim can survive through trial absent a lender's success with another litigation tool, as detailed below.

Other defenses to lender liability claims can include contributory negligence, wherein the lender proves that the borrower was at least partially at fault for any damage it incurred, third party superseding cause, in which the

lender proves that a third party such as an architect or contractor is at fault, or a statute of limitations defense, wherein the lender proves that the borrower waited too long to allege its claims.

Pre-Litigation Procedures

To help avoid liability in the first instance, lenders are well served to require that a borrower sign a forbearance agreement before any negotiations occur between the lender and borrower. The forbearance agreement should contain standard releases and waivers by the borrower and an alternative dispute resolution provision requiring that any dispute be first mediated and if not successfully mediated, arbitrated. That way, a borrower will be precluded from filing any action in a court of law and will be precluded from a jury trial. This point is especially important for loan agreements containing a jury trial waiver, which are no longer enforceable in California. Other requirements typically included in forbearance agreements are the production of updated financial statements by the borrower so the lender can effectively determine the borrower's credit worthiness.

Following execution of a forbearance agreement, lenders should document all correspondence with its borrower with the qualification that any correspondence is not binding on the lender until all conditions are met and approval is received by the lender's credit committee. Lenders should not make any verbal offers or assurances. If a lender is considering a note sale, it should do so carefully and analyze the potential for a lender liability suit to arise after the note sale and build that in to the terms of the note sale.

Post-Filing Analysis

Once a lender liability suit is filed, the lender should take immediate steps to help analyze the merits of the claims asserted against the lender. First, the lender should gather facts and documents to preserve evidence, and analyze the potential for an anti-SLAPP motion or cross-complaint. The lender should then issue an internal litigation hold letter to preserve all documents pertaining to the loan and borrower at issue. The lender and its counsel should then analyze whether an arbitration or reference provision exists to have the matter be transferred from a court to an arbitrator or whether there are grounds to remove the lawsuit from state to federal court. Finally, the lender should analyze whether mediation is a viable option and whether any potential bankruptcy issues exist.

Litigation Tactics

Aside from filing a demurrer (state court) or motion to dismiss (federal court), which are the most common responses to a lender liability action and which challenge the sufficiency of a borrower's allegations, a lender has additional litigation tools it can use to defend itself from a lender liability complaint. First, the lender should determine whether it has grounds to file a motion to compel arbitration, which would eliminate any potential for a jury trial. Second, a lender can evaluate whether it can remove the action to federal court. Third, and perhaps the most "aggressive" response to a lender liability complaint, a lender and its counsel should evaluate whether an anti-SLAPP motion is an appropriate response to the borrower's complaint.

Anti-SLAPP Summary

A "SLAPP" suit "seeks to chill or punish a party's exercise of constitutional rights to free speech and to petition the government for redress of grievances."[3] Thus, a lawsuit arising from constitutionally protected speech or petitioning activity is a SLAPP suit if it "lacks even minimal merit."[4] SLAPP suits may be disposed of by a special motion to strike under section 425.16, commonly known as an "anti-SLAPP motion," which is "a procedure where the trial court evaluates the merits of the lawsuit using a summary-judgment-like procedure at an early stage of the litigation."[5]

In analyzing an anti-SLAPP motion, the court engages in a two-step process. First, the court decides whether the defendant has made a threshold showing that the challenged cause of action is one arising from protected activity. If the court makes such a finding, it then determines the second prong -- whether the plaintiff has demonstrated a probability of prevailing on the merits of the claim under a standard similar to that used in determining a summary judgment motion.[6]

The anti-SLAPP procedure thus operates "like a … motion for summary judgment in 'reverse'"—the plaintiff bears the ultimate burden of stating and substantiating a legally

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sufficient claim in response to the special motion to strike.[7]

Anti-SLAPP Motions in Lender Liability Suits

In the context of a lender liability dispute, an anti-SLAPP motion is properly filed in response to a complaint if the borrower seeks to hold the lender liable for actions "arising from" the lender's litigation activity, which includes pre-litigation communications by the lender's lawyers and other communicative conduct such as the filing, funding, and prosecution of a civil action. This protection dovetails with the absolute litigation privilege codified in Section 47(b) of California's Civil Code.

The benefit of filing an anti-SLAPP motion is that, if successful, the Court will strike the improper causes of action without leave to amend and will order that the borrower pay the lender's attorneys' fees incurred in preparing the motion. If the lender is not successful, the order denying the anti-SLAPP motion is immediately appealable and if appealed, will stay the underlying causes of action until the appeal is resolved, which can be as long as 18 months.

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1 C.C.P. § 1856(a).
2 C.C.P. § 3434; *Jolley v. Chase Home Finance, LLC* (2013) 213 Cal.App.4th 872, 885; Jones v. Wells Fargo Bank (2003) 112 Cal. App. 4th 1527, 1540 at fn. 5 ("there is no fiduciary relationship between a debtor and creditor"); *Chazen v. Centennial Bank* (1998) 61 Cal. App. 4th 532, 537 ("A debt is not a trust and there is not a fiduciary relation between debtor and creditor as such."); *Nymark v. Heart Federal Sav. & Loan Assoc.* (1991) 231 Cal. App. 3d 1089, 1096 ("Under California law, a lender does not owe a borrower or third party any duties beyond those expressed in the loan agreement, excepting those imposed due to special circumstance or a finding that a joint venture exists.").
3 *Rusheen v. Cohen* (2006) 37 Cal.4th 1048, 1055.
4 *Navellier v. Sletten* (2002) 29 Cal.4th 82, 89.
5 *Varian Medical Systems, Inc. v. Delfino* (2005) 35 Cal.4th 180, 192; *Paiva v. Nichols* (2008) 168 Cal.App.4th 1007, 1015-1016; *Kibler v. No. Inyo County Local Hosp. Dist.* (2006) 39 Cal.4th 192, 197.
6 *Equilon Enterprises, LLC v. Consumer Cause, Inc.* (2002) 29 Cal.4th 53, 67.
7 *Briggs v. Eden Council for Hope & Opportunity* (1999) 19 Cal.4th 1106, 1123.