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LENDER LIABILITY:
SEVEN CRITICAL AREAS

John L. Hosack, Esq., Jason E. Goldstein, Esq., Michael Flynn, Esq., and Mr. Rick Rodriguez

12:00 Noon
November 6, 2019
Webinar
Buchalter
1000 Wilshire Boulevard, Suite 1500
Los Angeles, California 90017

I. INTRODUCTION

Taking steps to "avoid lender liability" now may prevent the filing of a lawsuit against you in the future or improve your case dramatically.

II. ALTERNATIVE DISPUTE RESOLUTION AGREEMENTS

1. **Jury Waiver**
   ***Grafton Partners, LP v. Superior Court* (2005) 36 Cal.4th 944, 964**
2. **Mandatory Mediation**
   - **A. Retired Judge**
   - **B. Paid for by the Lender**
   - **C. Predicate to most litigation**
3. **Judicial Reference**
   - **A. California Code of Civil Procedure §§ 638 *et seq*.**
   - **B. *Trend Homes, Inc. v. Superior Court* (2005) 1312 Cal.App.4th 950**
   - **C. Retired Judge**
4. **Arbitrations**
   - **A. Alternative to Judicial Reference**
   - **B. Retired Judge**
   - **C. Paid for by Lender**
   - **D. Limits on Discovery**
   - **E. Only admissible evidence**
   - **F. Follow California Law**
   - **G. Reasoned opinion**
   - **H. Fully appealable**
   - **I. Upheld by California Supreme Court: *Pinnacle Museum Tower Ass'n. v. Pinnacle Market Dev*. (2012) 55 Cal.4th 223**

III. LIMIT POTENTIAL LENDER LIABILITY CLAIMS BY REDUCING THE PERIOD OF TIME WITHIN WHICH A CLAIM MUST BE MADE

A. ***Cita Trust Co. AG v. Fifth Third Bank*** **(11th Cir. 2018) 879 F.3d. 1151**

"Customer shall bring no cause of action, regardless of form, more than one year after the cause of action arose."

B. **3 Witkin, California Procedure (5th Ed.) Actions, Section 469**

The lender may obtain special protection by incorporating provisions in the loan documents which require the commencement of an action within a shorter period than allowed by the applicable statute of limitations.

IV. A LENDER IN GENERAL IS *NOT* A FIDUCIARY OF THE BORROWER OR A GUARANTOR

A. *River Colony Estates Gen. Partnership v. Bayview Fin. Trading Group* (SD Cal 2003) 287 F. Supp. 2d 1213

B. *Rickel v. Schwinn Bicycle Co*. (1983) 144 Cal. App. 3d 648

C. Avoid use of terms such as “partner,” “advisor,” etc.

D. Remain a traditional lender of money

V. THE LENDER SHOULD AVOID THE APPEARANCE OF IMPROPER CONTROL OVER THE BORROWER

A. *Commercial loans*

A management consultant hired by the borrower at the lender's request gave the lender dominion and control.

B. *Construction loans*

Lender's due diligence activities (monitoring sales, etc.) did not make the lender liable.

VI. IS THE LENDER OBLIGATED TO NEGOTIATE A LOAN MODIFICATION WITH THE BORROWER?

A. California Homeowner Bill of Rights

Sheen v. Wells Fargo Bank, N.A. (2019) 38 Cal. App.5th 346, 358 ("… a lender does not owe a borrower a common law duty to offer, consider, or approve a loan modification.")

B. Commercial Loan

VII. THE LENDER'S LIABILITY TO THE BORROWER FOR PRECIPITOUS ACTION

KMC Co. v. Irving Trust Co. (6th Cir. 1985) 757 F.2d 752 (Lender's termination of credit without sufficient notice was a breach of implied covenant of good faith and fair dealing)

Menan v. U.S. Bank (E.D. Cal. 2013) 924 F. Supp. 2d 1151 (Lender's breach of forbearance agreement which contemplated further consideration of a loan modification was actionable)

VIII. A LENDER SHOULD BE CAREFUL BEFORE IT INVOKES A MATERIAL ADVERSE CHANGE AS A GROUND FOR A DEFAULT

A. The party which invokes the MAC clause has the burden to prove that a material adverse change occurred. *Capitol Justice LLC v. Wachovia Bank, N.A.* (D.D.C. 2009) 706 F. Supp. 23

B. Whether a change in circumstances constituted a MAC may be a question of fact. *Greenwood Place v. Huntington National Bank* (S.D. Ind. July 19, 2011) 2011 U.S. Dist. LEXIS 78736

IX. THE LENDER MAY BE LIABLE TO THE BORROWER BASED ON THE MISCONDUCT OF ITS LENDER'S AGENT

Daniels v. Select Portfolio Servicing, Inc. (2016) 246 Cal. App. 4th 1150

X. PRINCIPAL PLACES WHERE LENDER LIABILITY MAY ARISE (1 of 2)

1. Advertising
2. Standards of Conduct/Code of Ethics
3. Underwriting
   - A. Predatory Lending And Loan-To-Own
   - B. Conflicts of Interest
4. Loan Origination
   - A. Documentation
   - B. Payment Structure Practices
   - C. Know Your Customer (Is Your Customer Using You)?
5. Syndication/Participation
6. Loan Administration

X. PRINCIPAL PLACES WHERE LENDER LIABILITY MAY ARISE (2 of 2)

7. **Restructuring of defaulted loans**
8. **Foreclosure**
9. **Bankruptcy**

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Save The Date!

Avoiding And Resolving Loan Defaults: Loan Modifications, Forbearance Agreements, Workouts & Foreclosures

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XI. TRADITIONAL THEORIES OF LENDER LIABILITY

1. Breach of contract
2. Fraud, duress and misrepresentation
3. Negligence
4. Infliction of emotional distress (on an individual borrower)
5. Violation of Statutory duties
6. Breach of fiduciary duty
7. Improper control of the borrower
8. Breach of the covenant of good faith and fair dealing

XII. BREACH OF CONTRACT IS THE PRINCIPAL THEORY OF LENDER LIABILITY

1. ***Breach of the loan* commitment *(whether written or oral).***
2. ***Failure to make obligatory advances on the loan.***
3. ***Failure to make discretionary advances.***
4. ***Improper declaration of a default by the borrower.***
5. ***Failure of the Lender to provide adequate notice to the Borrower.***
6. ***Failure of the Lender to provide additional financing to the Borrower.***
7. ***Failure of the Lender to renegotiate the Borrower's loan.***

XIII. FRAUD AND MISREPRESENTATION ARE SECONDARY GROUNDS FOR LENDER LIABILITY

1. **Different perceptions of the same set of facts lead to Borrower claims of Fraud.**
2. **Statements made by the Lender, *without a reasonable good faith basis for believing it to be true*, even if unintentional, leads to Negligent Misrepresentation claims.**
3. **Documenting all verbal communications with a Borrower or Guarantor is critical to defeating Fraud and Misrepresentation claims.**

XIV. BREACH OF FIDUCIARY DUTY IS FREQUENTLY AND EASILY ALLEGED

1. **The "arms length" relationship between a Lender and its Borrower.**
2. **The Lender's "safe harbor" – when it stays within the role of the "conventional lender of money."**
3. **Do not be an "advisor" or "partner!"**

XV. THE LENDER'S IMPROPER CONTROL OVER THE BORROWER MAY LEAD TO LENDER LIABILITY

1. **The Lender's and Borrower's shared interest:**
   - A. **The success of the borrower's business.**
   - B. **The repayment of the loan.**
2. **The distinctions between the Lender and the Borrower which must be respected.**
   - A. **Borrower is trying to improve its financial condition.**
   - B. **Lender is trying to get repaid on money it believes was prudently lent.**
3. **The Lender should not give opinions on a decision which the Borrower is making, except in the rare case where it relates to a term in the loan documents.**

XVI. BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING MAY LEAD TO A FINDING OF LENDER LIABILITY

1. **Breach of the Implied Covenant of Good Faith and Fair Dealing exists in every contract.**
2. **The Lender's decisions must be reasonable because every juror is a borrower, but not all jurors are a lenders.**
3. **The reasonableness of the lender's decisions must be documented in writing, meaning the Lender's "intent" and the "meaning behind it."**
4. **The Lender must avoid the appearance that it is using its "superior bargaining position" to have the Borrower do things which are not in its best interests.**
5. **The Lender should avoid pressuring the Borrower to buy capital market swaps and/or cross-selling of products to the Borrower as conditions of obtaining the loan.**

XVII. THE LENDER'S SOFTWARE IS A FREQUENT FACTOR IN LENDER LIABILITY

1. **The benefit of standardized loan documents and loan software packages:**
   - A. **Cost savings;**
   - B. **Consistency.**
2. **The burden of standardized loan documents:**
   - A. **One size does not always fit all.**
   - B. **Standardized documents are not designed to resist lender liability claims.**

XVIII. POTENTIAL LOAN ORIGINATION ISSUES (1 OF 2)

1. **Borrowers who have not previously dealt with the Lender.**
2. **The loan officer's motivation to make a deal and "over promise" to "make a deal."**
3. **The Borrower "puffing up" its financial condition.**
4. **The loan officer's responses to the Borrower's questions about the Lender's future ability to increase the amount of the loan should be "measured" responses.**

XVIII. POTENTIAL LOAN ORIGINATION ISSUES AND BEST PRACTICES TO AVOID THEM (2 OF 2)

1. **The Borrower must confirm, in writing, its understanding of the specific loan terms and that it is not relying on any other representations of the Lender (express, oral or implied).**
2. **Document in writing the Borrower's time constraints.**
3. **Document in writing the limits to the loan officer's ability to make underwriting decisions, *e.g.*, if a loan committee makes the ultimate determination, disclose that in writing.**
4. **Explain, in writing, the requirements for the Lender's consideration of extending the loan term (labor and material bond, *etc.*) and time-frames for considering such requests. Confirm in writing that applying for an extension is not a guarantee that it will be granted.**

XIX. PRELIMINARY LOAN DOCUMENTATION ISSUES

1. **Circulate a "discussion draft" of the loan documents.**
2. **Inform the Borrower in writing that the "discussion draft" should be looked over carefully and require the Borrower to confirm, in writing, that it sent, or had the opportunity to send, the "discussion draft" to the Borrower's accountant, attorney, or other trusted advisor and to confirm that the documents are approved.**
3. **Document in writing the persons with whom the Borrower reviewed the "discussion draft."**
4. **Consider the Borrower's "initials" on critical provisions of the documents.**

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Avoiding And Resolving Loan Defaults: Loan Modifications, Forbearance Agreements, Workouts & Foreclosures

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XX. WAIVER BY BORROWER AND GUARANTOR OF LENDER'S KNOWLEDGE, INFORMATION AND OPINIONS

1. **Require that the Lender's knowledge, information and/or opinions only be provided upon written request.**
2. **Require the Borrowers and Guarantors to release all claims based on or arising out of the Lender's disclosure of any of its knowledge, information and opinions.**
3. **Require that the Borrowers and Guarantors indemnify and hold the Lender harmless from any and all claims based on the Lender's disclosure of its knowledge, information or opinions.**
4. **Have the initial loan documents acknowledge that the Lender has no obligation (express or implied) to disclose its knowledge, information and/or opinions, as well as provide the conditions for modification of this provision.**
5. **Be very careful, and consider the practical realities, of what the Lender knows and whether that information should be disclosed.**

XXI. WAIVER OF DISCLOSURE OF INFORMATION KNOWN TO THE LENDER TO THIRD PARTIES

1. **The loan documents should contain an express waiver by the Borrower and all Guarantors of any purported obligation by the Lender to provide any documents or information to a third party.**

2. **If the Borrower requests the Lender to disclose information to a third party, it should be on specific written terms and conditions.**

XXII. LENDER LIABILITY ISSUES WITH RESPECT TO LOAN ADMINISTRATION

1. **All communications (written or oral) with the Borrower and the Guarantors should be in "plain language" which is easy for a Borrower, Guarantor or Juror to understand. Technical terms should be defined.**
2. **Avoid compromising the "arms-length" relationship between the Lender and the Borrower/Guarantors. Keep all communications factual and formal.**
3. **If there is a change in administration of the loan (i.e., the loan officer is promoted and/or the loan is sold) provide advance notice, in writing, for a seamless transition, and provide an opportunity for the Borrowers and Guarantors to meet with the current and prospective loan officer.**

XXIII. DOES THE PAROL EVIDENCE RULE PROTECT LENDERS FROM BORROWER'S CLAIMS REGARDING ORAL AGREEMENTS THAT CONTRADICT THE LOAN DOCUMENTS?

1. **What is the parol evidence rule?**
2. **Does the parol evidence rule still exist?**
   - A. **Hope for the best.**
   - B. **Prepare for the worst.**
3. **Best practice: confirm all oral communications in writing!**

XXIV. "DEMAND" PROVISIONS IN LOAN DOCUMENTS SHOULD BE USED WITH CAUTION

1. **Types of "demand" provisions.**
2. **Viewing "demand" provisions through the eyes of a Borrower, Guarantor or Juror.**
3. **Document the basis for invoking the "demand" provision and take reasonable steps to avoid invoking the "demand" provision before doing so.**
4. **Loan officers should consult, in a privileged setting, with their credit committee, special assets group and/or lawyer before invoking a "demand" provision.**

XXV. ANY DEVIATION FROM THE EXPRESS TERMS OF THE LOAN DOCUMENTS SHOULD BE VIEWED WITH CAUTION

1. **Are deviations from the express terms of the loan documents normal?**
2. **Should the Borrower and Guarantors be informed in writing of each deviation from the express terms of the loan documents?**
3. **Beware of automatic notices/computer notices.**

XXVI. THE "BEST DEFENSE" AGAINST "LENDER LIABILITY" CLAIMS ARE LOAN DOCUMENTS DRAFTED IN ANTICIPATION OF LENDER LIABILITY CLAIMS

1. **Protocol Agreement (Pre-Negotiation Agreement)**
2. **Jury Waiver.**
3. **Mediation.**
4. **Judicial Reference.**
5. **Arbitration.**
6. **Standard of Proof.**
7. **Statute of limitations.**
8. **Limits on damages (waive right to punitive damages, incidental damages, consequential damages, and "amount").**
9. **Eliminate the right to recover attorneys' fees?**

XXVII. WELL TRAINED EMPLOYEES ARE ESSENTIAL TO AVOIDING LENDER LIABILITY CLAIMS

1. **The Lender's employees must recognize that they are not the Borrowers and Guarantors advisor, partner or confidant.**
2. **The Lender's employee's must deal with Borrowers and Guarantors in a very professional manner and not write, say or think anything which they would not want the Jury to consider.**
3. **All communications must be documented – a short confirmatory email may be the key to victory in a lawsuit!**

XXVIII. A WELL DOCUMENTED LOAN FILE IS ESSENTIAL TO AVOIDING LENDER LIABILITY CLAIMS

1. **The Lender's loan file should "tell the story" of the life of the loan – because years later memories fade and Borrowers' imaginations "run wild."**

2. **Not only should oral communications with the Borrower and/or the Guarantors be confirmed in writing by email or letter, a written memorandum should also be included in the Lender's loan file with a copy of the e-mail or letter which explains the context of the communication.**

XXIX. INSECURITY CLAUSES AND OTHER NON-MONETARY DEFAULTS SHOULD BE EXERCISED SPARINGLY

1. **What is an "insecurity" clause?**
2. **Upon what grounds should an "insecurity clause" be invoked?**
3. **How would an expert witness opine on the "reasonableness" or "unreasonableness" of the Lender's invocation of an "insecurity" clause?**

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XXX. AVOID BECOMING A "MORTGAGEE IN POSSESSION" BY HAVING A COURT APPOINT A RECEIVER

1. **Is it uncommon for Borrowers to get into situations which the Lender must "step in" to fix the problem?**
2. **What types of situations do Borrower's get into where the Lender must "step in" to fix the problem?**
3. **Why should a Lender utilize a Receiver to "fix" Borrower problems?**

XXXI. REVIEW THE BORROWERS AND GUARANTORS' CONDITIONS ON A REGULAR BASIS

1. **Require the Borrowers and Guarantors to regularly provide financial statements, state and federal tax returns, *etc*.**
2. **Regularly review the status of the collateral by conducting appraisals and field examinations.**
3. **Consider periodic Uniform Commercial Code, Litigation, Lien and Bankruptcy searches relative to the Borrowers and Guarantors.**

XXXII. DEALING WITH A DEFAULTED LOAN

1. **Only have restructure discussions after the Borrower and all Guarantors have executed a bilateral protocol agreement with the advice of counsel.**
2. **As partial consideration for a loan restructuring agreement (not before), have the Borrower and Guarantors release the Lender from all claims which may have existed before execution of the agreement.**
3. **Commence foreclosure actions (non-judicial or judicial) and any other actions which require time.**
4. **Consider ramifications of a potential Bankruptcy.**
5. **Partial payments – should you accept them?**

XXXIII. RECOMMENDATIONS FOR THE LENDER DURING THE BORROWER'S BANKRUPTCY

1. **"Strategic alliances" with the trustee, creditors' committee, or third party creditors.**
2. **Bankruptcy court is a court of "equity" which generally favors the debtor, but also has protections for secured lenders.**
3. **Preferential transfers, fraudulent transfers and equitable subordination.**
4. **The need for qualified Bankruptcy counsel.**

XXXIV. AVOIDING LENDER LIABILITY CLAIMS IN A FORECLOSURE

1. **Carefully review the file before commencing foreclosure proceedings and "clean up" the file if need be.**
2. **Do not provide information to third parties about the Borrower, Guarantor or the secured property.**
3. **The Borrower's application for a Temporary Restraining Order/Preliminary Injunction to stop the foreclosure sale.**
4. **Defending the Wrongful Foreclosure and Lender Liability lawsuit.**
5. **No "full credit bids" and obtaining an "Owner's Policy of Title Insurance."**
6. **Obtain a Receiver to collect the rents during the litigation.**

XXXV. AVOIDING LENDER LIABILITY CLAIMS BASED UPON A SALE OF THE LOAN (1 of 2)

1. The loan documents should provide that:

A. **Borrowers/Guarantors expressly agree that the Lender may sell, or participate, in whole or in part, in the sale of the loan.**

B. **The Lender has no obligation, whether express or implied, to notify the Borrower or Guarantors that it is considering a sale of the loan.**

C. **The Lender has no obligation, express or implied, to sell the loan to them or to a nominee which they have selected.**

D. **The Borrowers and Guarantors agree to indemnify and hold the Lender harmless, including paying for a lawyer selected by the Lender, in the event that there are any claims that the Lender inappropriately sold the loan.**

XXXV. AVOIDING LENDER LIABILITY CLAIMS BASED UPON A SALE OF THE LOAN (2 of 2)

2. If the loan is to be sold:

A. It should be sold without "representation or warranty whether express or implied."

B. The Buyer should represent and warrant that it is not relying, whether expressly or impliedly, upon anything that the Lender and/or its representatives may have communicated about the Loan, but it is solely relying upon its own independent investigation and the advice of its own counsel in making its decision.

C. The Lender should consider the liability associated with participant or syndicate banks.

XXXVI. CONCLUSION

Presenters

John L. Hosack—*Presenter*

John L. Hosack is a Shareholder in the firm's Litigation Practice Group in Los Angeles and a member of the firm's Mortgage Banking Group. Mr. Hosack represents mortgage brokers, secured lenders and property owners at trial and on appeal in real property disputes including, broker liability, lender liability, fraud, breaches of contract, mechanic's liens, stop notices, judicial foreclosures, receiverships, escrow claims and title insurance claims. His transactional practice includes commercial real property loan documentation, loan workouts, REO sales and foreclosures. He is an Affiliate Member of the California Mortgage Association and a member of the Los Angeles Mortgage Association, a Fellow of the American College of Real Estate Lawyers and a Fellow of the American College of Mortgage Attorneys. He is the author of "California Title Insurance Practice (First Ed., Calif. Cont. Ed. Bar), the first book on title insurance, and is a past Chair of the ABA's Title Insurance Litigation Committee.

John L. Hosack
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Jason E. Goldstein—*Presenter*

Jason E. Goldstein is a Shareholder and Co-Chair of Buchalter's Mortgage Banking Group. Mr. Goldstein specializes in "private money," real property related litigation, title, escrow and trade secrets. Mr. Goldstein has an extensive legal background which includes defending lenders, brokers and servicers in court (negligence, fraud, TILA, RESPA, HBOR, wrongful foreclosure, lender/servicer liability defense, etc.), prosecuting escrow and title insurance litigation (on behalf of the insured), insurance coverage (Title, CGL, E&O, etc.), litigating misappropriation of trade secret claims, defending and prosecuting claims on behalf of general contractors and prosecuting receiverships. Mr. Goldstein is a fellow of the American College of Mortgage Attorneys ("ACMA") and a member of the ACMA Title Insurance Committee.

Jason E. Goldstein
Shareholder
Buchalter Irvine Office

Presenters

Michael Flynn—*Presenter*

Michael Flynn is a member of the Firm's Corporate Practice Group and Co-Chair of Buchalter's Mortgage Banking Group in the Los Angeles office. Mr. Flynn applies his unique background as the former Acting General Counsel of HUD, and the former General Counsel of PNC Mortgage and Flagstar Bank, to counsel clients on a variety of regulatory, mortgage, consumer financial services, FinTech and real estate matters.

Michael Flynn
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Rick Rodriguez—*Presenter*

Mr. Rodriguez is the founder and principal of Rodriguez and Associates Advisory Group ("R&A"), a Los Angeles based consultancy firm that has provided a unique array of services to its clients since 1992. For the past 24 years, R&A has successfully formulated creative workout and loan restructure resolutions to complex multi-party debtor-creditor transactions in judicial and non-judicial settings.

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