

Will Lender Liability Make A Comeback In New York?

By Thomas J. McNamara

Following the stock market crash of October, 1987 and the savings and loan crisis of the late 1980's, the courts experienced a spike in lender liability litigation. While a few well publicized verdicts against lenders elsewhere caught the public's attention, the spectre of lender liability never really took hold in New York. Will lender liability make a comeback and fare any better in the aftermath of the current financial crisis?

Before answering that question, it may be helpful to review exactly what "lender liability" is, and is not. Generally, there is no cause of action for "lender liability" *per se*. Rather, lender liability is a term utilized to describe various circumstances and causes of action under which lenders may be held liable for their conduct, or lack thereof. The common law theories under which lenders have been held liable under the "lender liability" umbrella include causes of action for misrepresentation, negligent misrepresentation and non-disclosure, economic duress, breach of contract, participation in a breach of fiduciary duty, excessive control of the borrower, breach of the obligation of good faith and fair dealing, fraud, and other similar causes of action. Sometimes the basis for lender liability is statutory, such as the Racketeer Influenced Corrupt Organizations Act ("RICO"), the Truth in Lending Act, the Fair Debt Collection Practices Act, the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), the Equal Credit Opportunity Act, the Home

Ownership and Equity Protection Act ("HOEPA"), and other anti-predatory lending statutes.

New York courts, with limited exceptions,¹ have generally not been receptive to claims of lender liability. For example, in *Gillman v. Chase Manhattan Bank, N.A.*, 73 N.Y.2d 1 (1988), the New York Court of Appeals affirmed the reversal of the trial court which had held that a lender's security agreement was unconscionable and therefore unenforceable and that the bank had acted in bad faith in enforcing its rights. Similarly, in *Citibank, N.A. v. Plapinger*, 66 N.Y.2d 90 (1985), the Court of Appeals rejected a guarantor's claims of fraud in the inducement, negligent misrepresentation, and the like in allegedly being fraudulently induced to sign guaranties upon oral representations concerning the extension of additional lines of credit. In upholding summary judgment for the banks, the Court of Appeals pointed out that the guaranties contained specific language disclaiming any reliance by the guarantors on any oral representations.

There is one type of lender liability claim which New York courts appear to be more receptive to consider and give the borrower its day in court. Where there is evidence that the lender has exercised undue control over a borrower for an improper purpose New York courts are not quick to dismiss the borrower's or guarantor's claims. In *Bestolife Corp. v.*



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American Amicable Life, 5 A.D.3d 211 (1st Dep't 2004), plaintiffs borrowers and guarantors alleged that the defendant lender pressured them to close a particular transaction so that its affiliated investment banking unit could earn certain fees. In order to accomplish this ulterior purpose, plaintiff alleged that, contrary to prior oral assur-

ances, the lender threatened to freeze plaintiff's lines of credit, putting it in default, and forcing it to renegotiate the debt at a higher interest rate. Reversing the trial court which had dismissed plaintiff's complaint on a pre-answer motion, the Appellate Division reinstated plaintiffs' claims for breach of contract, breach of fiduciary duty, professional negligence, tortious interference and unjust enrichment.

In *Nisselson v. Ford Motor Co.*, 340 BR 1 (Bankr. E.D.N.Y. 2006), the bankruptcy trustee of an automobile dealer alleged that the defendant pressured the dealership's owner to sell a controlling interest in its dealership to another dealer, or else risk termination of its franchise. The plaintiff bankruptcy trustee alleged that this was done so that the defendant could exercise control over the dealer and dump excess automobile inventory at the dealership to make its sales figures appear better. The Bankruptcy Court denied a motion, by Ford Motor Co. and its lending unit, Ford Motor Credit, to dismiss causes of action against them for fraud, aiding and abetting fraud, conspir-

acy to commit fraud, breach of fiduciary, aiding and abetting breach of fiduciary and deepening insolvency claims. In a similar and related action brought on behalf of the dealership's owner/guarantor in state court, the state court denied a motion to dismiss claims against the lender for fraudulent inducement and aiding and abetting fraud, while dismissing various other claims.²

While the courts are likely to see more lender liability claims and defenses as lenders decide not to extend further credit, and to call or take action to collect loans, it is unlikely that New York law concerning lender liability will see substantive changes merely due to a financial crisis. That does not mean, however, that the courts will not closely scrutinize colorable claims where lenders are alleged to have exercised undue control over their borrower or enforced their rights as creditors for ulterior purposes to the detriment of the borrower.

Time will tell.

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FOOTNOTES

1. See, e.g., *Whitney v. Citibank, N.A.*, 782 F.2d 1106 (2d Cir. 1986) (upholding punitive damages award against lender for participating in a breach of fiduciary duty owed by two partners of the borrower with respect to taking a deed in lieu of foreclosure of partnership property without the knowledge and consent of the third partner).

2. *Monaghan v. Ford Motor Co.*, Index No. 13148/2006 (Sup. Ct. Nassau Co. October 15, 2008) (Warszawsky, J.).