

Baker Donelson Training

Recent Trends in Lender Liability Litigation 2013

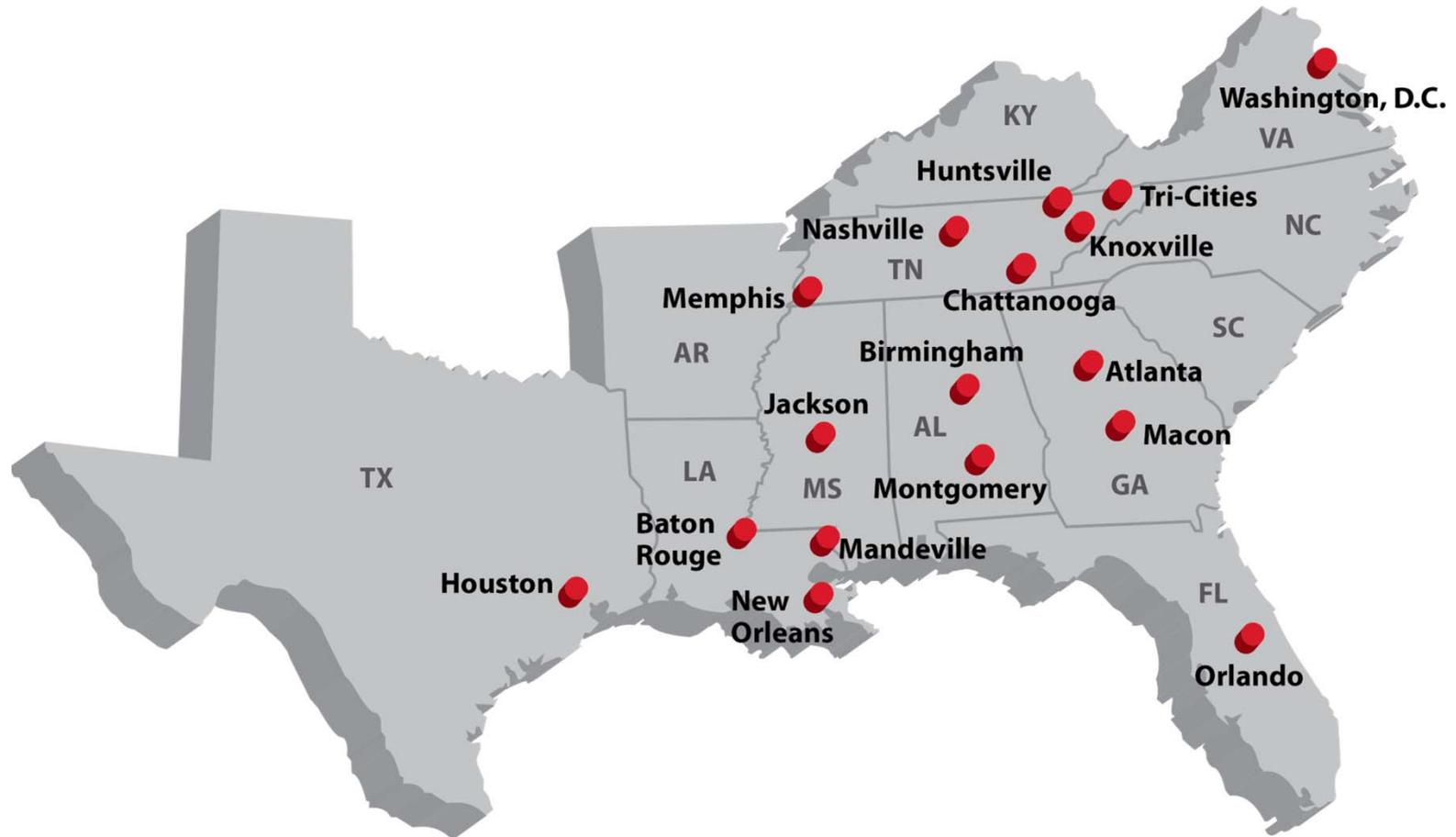
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Recent Trends in Lender Liability Litigation

I. Introduction

- A. Breach of Contract
- B. Breach of Implied Covenant of Good Faith and Fair Dealing
- C. Tort Claim
 - a) Negligent servicing
 - b) Deepening insolvency
- D. Breach of Fiduciary Duties
- E. Interference with, or control of, Borrower's business

Poll Question

Recent Trends in Lender Liability Litigation (cont.)

II. Recent Trends from the Trenches

- A. Lender Liability claims generally arise in one of the following contexts:
 - a) Claims seeking recovery of damage or “leverage” to accept DPOs (e.g. Breakwater letters)
 - b) Counterclaims to foreclosure/receivership/guarantor actions
 - c) “First strike” lawsuits in anticipation of collection/foreclosure actions

Poll Question

Recent Trends in Lender Liability Litigation (cont.)

- B.** Obligors typically go after lenders on one of the following grounds:
- a)** Breach of Contract/Violation of obligation of good faith and fair dealing
 - b)** Tort claims (e.g., negligent servicing; deepening insolvency)
 - c)** Breach of fiduciary duties
 - Traditionally no duty in commercial transaction
 - Will legislative action in consumer lending (e.g., Dodd Frank requirement to steer consumer away from mortgage loan if no reasonable ability to repay) spill over to commercial legal decisions?
- C.** Lender liability allegations are typically about leverage

Poll Question

Alleged Interference with or Control of Borrower's Business

III. Alleged Interference with or Control of Borrower's Business

Required lender approvals of material leases or renewals

- A. Allowing or refusing use of escrows and reserves (tenant improvement/leasing commissions, replacements reserves, etc.)
- B. Cash water falls with hard lock box – disbursement of funds for operations
- C. Conduct of due diligence by lender prior to exercise of remedies or by possible note purchaser (presence of third parties at property)
 - a) Appraisal and environmental access
 - b) Broker contact with tenants

Declaring Default for other than Payment Default

IV. Concerns about Declaring Default for other than Payment Default

- A. SPE violations due to insolvency or commingling
- B. Material adverse change provisions

Alleged Oral Modification of Loan Documents

V. Alleged Oral Modification of Loan Documents

- A. Course of conduct – waiver of defaults due to lack of action or objection
- B. Oral or informal written communications interpreted as modification/extension
- C. Importance of written non-waiver statements including need for lender approvals and written docs signed by all parties
- D. Dealing with allegations of master servicer approvals or other representations as binding on lender

Application of Funds Received After Default

VI. Application of Funds Received After Default

- A. Make sure to use reservation of rights letter
- B. There is good Florida case law providing that lenders exercising rights under the loan documents does not create a lender liability claim (e.g., lock box for rents does not equal tortious interference).

Mediation and Loan Modifications

VII. Mediation and Loan Modifications

A. Mediation

- a. Authority to act in mediation/pre-approval of Committee
- b. Recent amendments to Florida Rule of Civil Procedure 1.720 requires that the attending party must have full authority to settle without further consultation and file a “certification of authority” with the court
- c. Consistency in course of conduct during settlement discussions

B. Loan Modifications

- a) Opportunity to reset relationship and fix problems
- b) Revisit loan documents
- c) Time to obtain
 - Waiver of (existing) claims and defenses
 - Acknowledgement of debt and guaranties

Poll Question

Mediation and Loan Modifications (cont.)

- C. Virtually all commercial loan documents contain merger clauses, integration clauses, and “no oral modification” clauses.
- D. Florida case law provides a promise to modify loan documents must be supported by consideration.
- E. “In those limited circumstances where parol changes are admissible to alter the terms of a previous and unambiguous written contract, the rule is clear that the proffered evidence must support a new contract, and not merely a gratuitous assertion by the alleged promisor, unsupported by consideration or detrimental reliance by the promisee.” *F.M.W. Properties, Inc. v. Peoples First Financial Sav. and Loan Ass’n*, 606 So. 2d 372 (Fla. 4th DCA 1992).
- F. In *F.M.W.*, court went so far as to state that testimony such as “don’t worry, we’ll work with you,” hardly constitutes an agreement supported by consideration.”

Best Practices

VIII. Best Practices

- A. Develop a strategy
- B. Focus on big picture and end game
- C. Do not "run" the borrower's business
- D. Do not become the borrower's advisor
- E. Do not act suddenly or erratically
- F. Honor agreements/act honorably
- G. Follow internal policies and procedures
- H. Know your opposition
- I. Determine whether any carve-out liability and whether a deficiency is worth pursuing.
- J. Golden Rule