Special Project: LENDER LIABILITY

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Introduction

In recent years banks and other commercial lending institutions have faced a rapid increase in problem loans.¹ At the same time, the relatively new phenomenon in United States law known as “lender liability” has signaled an expansion of the legal theories under which courts may find lenders liable for damages incurred by borrowers.² Perhaps most significantly, many courts now allow borrowers to recover against lenders based on various tort theories.³ Because of the broader remedies afforded under tort theories as compared to those remedies previously available in contract, some lenders recently have experienced large adverse verdicts.⁴ If courts continue to base findings of liability on new theories,⁵ lenders must choose between suffering a potentially severe economic loss by refusing to aid a financially troubled borrower or

risking being made party to a lender liability suit by providing such help. Conversely, any significant judicial curtailment of the theories under which borrowers may proceed against lenders undermines the effectiveness of these actions to ensure fair dealing and to prevent lenders from exploiting borrowers with respect to credit terms and conditions.

This Special Project addresses the dilemma currently facing courts by examining critically the leading theories of lender liability and discussing three potential solutions to various aspects of the problem. Initially, this Special Project surveys today's most prevalent theories of lender liability, as well as the impact that increasing liability has had on lenders. This Special Project then examines three potential solutions to the uncertainty currently plaguing the lender-borrower relationship. First, this Special Project explores the possibility of lenders using Uniform Commercial Code sections 2-609 and 2-610 as a guide to conduct so as to avoid tort liability for breach of the implied covenant of good faith and fair dealing which some courts now find in loan agreements. Second, this Special Project analyzes several state legislatures' attempts to use the Statute of Frauds to deal with the underlying tension between protecting the integrity of written agreements, thereby promoting banking stability, while still allowing for a recourse by the borrower if the writing does not express the actual agreement. Finally, this Special Project considers the merits of using arbitration as a means of coping with the liability explosion in lender-borrower disputes.