

LEGAL
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Understanding Borrowers' Claims Against Lenders

BY JEFFREY WURST

Losing its business and having to repay its debts can compel a bitter borrower to retaliate against a lender, blaming the lender for its default. Jeffrey Wurst notes the courts do not always favor borrowers, as a recent suit filed against MB Financial Bank demonstrates.



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It should come as no surprise that when asked to pay on a defaulted debt, borrowers and guarantors often look for ways to escape liability by alleging the lending bank acted improperly and committed egregious acts that caused the borrowers' defaults. Typically, in these situations, defaulting borrowers make claims such as breach of fiduciary duty, breach of contract, breach of the implied covenant of good faith and fair dealing, consumer fraud, tortious interference, conversion and disposition of collateral in a commercially unreasonable manner.

In a recent decision, the Appellate Court of Illinois addressed these claims brought against MB Financial Bank and its senior vice president in her individual capacity. The court clearly addressed the standards for each of these claims. This article will summarize the legal standards for these claims to assist lenders in avoiding the traps demonstrated in the rare cases when borrowers' claims prevailed.

First, a brief factual background that led up to the action against MB.

In 2011, Booklet Binding entered into a typical ABL facility with MB's predecessor bank with additional collateral provided by Booklet's affiliate, KP Industrial

Properties (KP). Several months after closing its loan, Booklet experienced financial difficulties, fell into a significant overadvance position and overdrew its checking accounts. Subsequently, the bank and borrowers entered into a series of amendments to the loan documents in an attempt to provide an opportunity for the borrowers to rehabilitate and get back on track financially, including retaining a turnaround consultant and bringing in an investor. The overadvances continued, and the borrowers' financial condition worsened.

By August 2013, the bank's workout group was involved and advised the borrowers that the bank would not extend any further financing or clear any checks (including payroll checks) unless there were sufficient funds in the bank accounts. When the principals of the company offered to use personal funds to cover payroll, the workout officer told them any funds they personally deposited into the payroll account would be used to setoff obligations owed to the bank. She then froze all accounts and denied the bank online access to the borrowers' accounts. Even then, the bank offered to extend additional financing to the borrowers if the owners agreed to guarantee the proposed new overadvances and have the guaranties secured.

Booklet ultimately effected an assignment for the benefit of creditors and the assignee assigned "any and all claims [and] causes of action" Booklet and KP might have against the bank to the former owners. After liquidating the collateral and collecting the accounts receivable, the bank was paid in full.

A year later, the former owners brought an action against the bank and its workout officer, claiming the bank prematurely declared a default under the loan agreement and mishandled the collateral Booklet and KP had pledged to secure the loan. Two years later, the bank moved for summary judgment, which was granted, and the former owners appealed. The appellate court, in a reasoned decision, addressed each of the former owners' claims and affirmed the court below, ruling in favor of the bank. In its decision favoring MB, the appellate court clearly described each of the claims brought against the bank, which are summarized below.

A fiduciary relationship exists where one party reposes trust and confidence in another, who thereby gains a resulting influence and superiority over the subservient party. As a general rule, a fiduciary relationship does not exist between a debtor and creditor.

Breach of Fiduciary Duty

To prevail on a claim of breach of fiduciary duty, a plaintiff must show:

1. The existence of a fiduciary duty on the part of the defendants
2. The defendant's breach of that duty
3. Damages proximately resulting from that breach

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Breach of Contract

To prevail on a breach of contract action, a plaintiff must establish the following:

1. The existence of a valid and enforceable contract
2. Performance by the plaintiff
3. Breach of the contract by the defendant
4. Damages or injury to the plaintiff as a result of the breach

In this case, the court noted the parties' dispute centered on whether the bank breached its contracts with Booklet by prematurely declaring a default under the loan agreement. The court concluded there was no issue of fact that the bank had not breached the agreement when it declared a default after the borrowers failed to cure the overadvances.

Good Faith and Fair Dealing

Every contract has an implied covenant of good faith and fair dealing. Breach of the duty of good faith and fair dealing arises only when one party is "vested with contractual discretion" and exercises that discretion "arbitrarily, capriciously or in a manner inconsistent with the reasonable expectation of the parties." However, the duty of good faith and fair dealing is an implied covenant, and it cannot be used to overrule or modify the express terms of a contract. Nor may the implied covenants of good faith and fair dealing be used to read into a contract an obligation that does not exist. The principals claimed the bank breached its covenant of good faith and fair dealing when it declined to complete work-in process. However, the court held that no provision, express or implied, in the loan agreement required the bank to do Booklet's work, and the covenant of good faith and fair dealing could not be used to read into a contract an obligation that does not exist.

Consumer Fraud

In order to establish a violation of the Consumer Fraud Act, a plaintiff must demonstrate:

1. A deceptive act or practice by the defendant
2. The defendant's intent that the plaintiff relies on the deception
3. Occurrence of the deception in the course of conduct involving trade or commerce
4. Actual damage to the plaintiff proximately caused by the deception

The court summarily dismissed the principals' claim that the bank acted improperly in denying the borrowers online access.

Tortious Interference

To recover for tortious interference with prospective economic advantage, a plaintiff must establish the following elements:

1. A reasonable expectancy of entering into a valid business relationship
2. The defendant's knowledge of the expectancy
3. An intentional and unjustified interference by the defendant that induced or caused a breach or termination of the expectancy

4. Damage to the plaintiff resulting from the defendant's interference

A plaintiff states a cause of action only if he alleges a business expectancy with a specific third party as well as action by the defendant directed towards that third party.

Conversion

To prevail on a claim for conversion, a plaintiff must demonstrate:

1. Unauthorized and wrongful control, dominion or ownership by the defendant over the plaintiff's property
2. The plaintiff's right in the property
3. The plaintiff's absolute and unconditional right to the immediate possession of the property
4. A demand for possession of the property

Commercial Reasonableness

UCC Article 9 provides, "[a]fter default, a secured party may sell... or otherwise dispose of any or all of the collateral. Every aspect of a disposition of collateral, including the method, manner, time, place and

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other terms, must be commercially reasonable." Commercial reasonableness is determined on a case-by-case basis unless the manner of the sale falls under one of the "safe harbor" exceptions in §9-627 of the UCC. Relevant here, §9-627(c) provides as follows:

Approval by court or on behalf of creditors. A collection, enforcement, disposition or acceptance is commercially reasonable if it has been approved in a judicial proceeding, by a bona fide creditors' committee, by a representative of creditors or by an assignee for the benefit of creditors.

Where collateral is disposed of pursuant to the safe-harbor provisions §9-627(c), the transaction is commercially reasonable as a matter of law.

This case is a good example of what a borrower may toss at a lender when the relationship breaks down. The undisputed facts demonstrated that the bank had acted within its rights and had not abused its position to the disadvantage of the borrowers.

Keep in mind that bad facts engender bad results and that each of these claims have been successful in actions against lenders who crossed the line of proper conduct, at least in the eyes of the court that ruled against them.

Finally, this action was brought as a retaliatory measure after the bank was paid in full. Although the claims were not successful, the record is unclear whether the bank was able to recover what must have been significant legal costs in defending itself. [abfj](#)

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