Wisconsin Lenders Beware: Borrowers Are Striking Back With Lender Liability

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I. INTRODUCTION

The Metropolitan Bank is a profitable bank which specializes in commercial lending. One of its longstanding customers is Plastic Plus, Inc., a Wisconsin corporation. It is owned and operated by Danny Ongais. Plastic Plus' main business is the manufacture and sale of high tech plastic automotive products. Prior to buying Plastic Plus with the help of Metropolitan Bank, Danny Ongais graduated from high school and worked at a local gas station.

Since Danny is an auto mechanic, and not a financial wizard, he has relied heavily on Metropolitan Bank's financial advice. Danny readily acknowledges that this reliance has contributed tremendously to Plastic Plus' success. Recently, Metropolitan Bank recommended that Danny develop new plastic components for cars and trucks which could be sold to manufacturers and mechanics worldwide. To offset the cost of developing and marketing a new product, Metropolitan Bank volunteered to increase Plastic Plus' line of credit from $200,000 to $3 million, at a very favorable interest rate, and the parties executed a new security agreement which contained the following default provision:

12.3. Default in Current Ratio: In the event the Borrowers shall fail to maintain a current ratio of at least 2.0 and such default shall continue uncured for a period of thirty days after the Bank gives the Borrowers written notice of such deficiency, then the obligation of the Bank to make loans and issue letters of credit shall terminate and the Bank, at its option, may declare all amounts to be, and all amounts shall become, immediately due and payable, together with accrued interest. Presentment, demand, protest, notice of acceleration, nonpayment and dishonor are expressly waived.

Under the new security agreement, Danny borrowed approximately $2,800,000 on his line of credit. He used $2,600,000 to develop a new product, the Plastic Plus Fully Plastic Exhaust System. While Plastic Plus projects that initial sales for the new product will be approximately $15 million
annually, Metropolitan Bank is convinced that the product will not sell. The outlays necessary to develop the product have decreased Plastic Plus' current ratio to 1.8. As soon as this occurred, Metropolitan Bank gave Plastic Plus written notice that thirty days had now passed without any change in the current ratio; Plastic Plus is technically in default under the security agreement. Metropolitan Bank would like to use this opportunity to call the loan because, due to "changes in the financial market," it may earn substantially more on its money elsewhere. However, before doing so, it turns to its legal counsel for advice.

This hypothetical situation is typical of many lending relationships nationwide. Recently, courts have found that while lenders may have been trying to protect legitimate legal rights and business interests, their conduct has failed to meet standards of fair play. Lenders have been held liable for such things as: negligently processing loan applications; negligently administering loans; failing to disclose accurate and complete financial information to the borrower and his creditors; failing to advance money under discretionary lines of credit; threatening to call loans or commence foreclosure actions based on technical non-compliance with the security agreement; and exercising too much control over the borrower's business.

Wisconsin courts have not had the opportunity to address many of these issues. First, this Comment gives an overview of the common law lender liability theories of: agency;¹ fraudulent misrepresentation;² duress;³ tortious interference with business relations;⁴ good faith and fair dealing;⁵ fiduciary duty of disclosure;⁶ and negligent misrepresentation.⁷ Second, it suggests, where applicable, how Wisconsin courts may decide lender liability issues using the appropriate underlying common law theory. Finally, this Comment suggests several de-

1. See infra notes 15-17 and accompanying text.
2. See infra notes 45-48 and accompanying text.
3. See infra notes 60-66 and accompanying text.
4. See infra notes 72-79 and accompanying text.
5. See infra notes 93-103 and 114-17 and accompanying text.
6. See infra notes 121-33 and accompanying text.
7. See infra notes 137-40 and accompanying text.
fensive lending tactics which a Wisconsin lender and its legal
counsel may use to minimize lending risk.

II. AGENCY

Under the common law theory of agency, lender liability is
premised upon the existence of a principal/agent relationship
between the lender and borrower. While few courts have
adopted agency principles as a means of finding lender liability,
the Minnesota Supreme Court in A. Gay Jenson Farms Co. v. Cargill,
held that the lender, by its exercise of control
and influence over the borrower, became a principal with lia-
ability for the transactions entered into by its agent, the
borrower.

*Jenson* arose out of the financial collapse of a grain eleva-
tor operation, Warren Grain & Seed Co. (Warren). Warren’s entire operation had been financed by Cargill, Inc.
(Cargill) for over fourteen years. In return for financing
Warren, Cargill received a right of first refusal to purchase
grain from Warren, access to Warren’s financial records and
the right to approve any capital improvements made by War-
ren in excess of $5,000. Further, Warren was prohibited
from guaranteeing debts, encumbering its assets, declaring a
dividend, and buying or selling stock without Cargill’s con-
sent. As Warren’s debt grew, Cargill monitored Warren on a
daily basis and initially promised several of Warren’s creditors
that it would assure payment of their accounts.

The *Jenson* court defined agency as “the fiduciary relation-
ship that results from the manifestation of consent by one per-
son to another that the other shall act on his behalf and

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8. See, e.g., Wasilowski v. Park Bridge Corp., 156 F.2d 612 (2d Cir. 1946); *In re Prima Co.*, 98 F.2d 952 (7th Cir. 1938), cert. denied, 305 U.S. 658 (1939); Buck v. Nash-
Finch Co., 78 S.D. 334, 102 N.W.2d 84 (1960).
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.* at 289.
subject to his control, and consent by the other so to act."15 The court also required that an agreement, but not necessarily a contract, must exist between the parties before an agency relationship would be implied.16 Furthermore, in cases where the existence of an agency relationship is not clear-cut, Jenson held that circumstantial evidence may be used to establish the requisite course of dealings between the parties.17 Thus, the court concluded that an agency relationship resulted due to the following facts: (1) Cargill’s continuous directions and recommendations to Warren constituted a manifestation of its consent that Warren should be its agent; (2) Warren acted on Cargill’s behalf in procuring grain for Cargill as part of its normal operations which Cargill totally financed; and (3) Cargill’s continuous interference with the internal affairs of Warren constituted de facto control.18

Once an agency relationship has been established, a lender, as a principal, may incur liability for the acts of the borrower, as agent, when the lender assumes control of the borrower’s business.19 However, Buck v. Nash-Finch Co.20 makes it evi-

15. Jenson, 309 N.W.2d at 290 (citing Jurek v. Thompson, 308 Minn. 191, 194, 241 N.W.2d 788, 791 (1976); RESTATEMENT (SECOND) OF AGENCY § 1 (1958)). Note that the fiduciary relationship used in an agency context differs from the fiduciary duty of disclosure discussed in the text accompanying notes 121-25.


17. Jenson, 309 N.W.2d at 290 (citing Rausch v. Aronson, 211 Minn. 272, 273, 1 N.W.2d 371, 372 (1941)). Factors of circumstantial evidence in Jenson which indicate the lender’s control and influence over the borrower include:

   (1) Cargill’s constant recommendations to Warren by telephone;
   (2) Cargill’s right of first refusal on grain;
   (3) Warren’s inability to enter into mortgages, to purchase stock or to pay dividends without Cargill’s approval;
   (4) Cargill’s right of entry onto Warren’s premises to carry on periodic checks and audits;
   (5) Cargill’s correspondence and criticism regarding Warren’s finances, officers’ salaries and inventory;
   (6) Cargill’s determination that Warren needed “strong paternal guidance”;
   (7) Provision of drafts and forms to Warren upon which Cargill’s name was imprinted;
   (8) Financing of all Warren’s purchases of grain and operating expenses; and
   (9) Cargill’s power to discontinue the financing of Warren’s operations.

Jenson, 309 N.W.2d at 291.

18. Id.

19. Id. (quoting RESTATEMENT (SECOND) OF AGENCY § 14 O (1958)). The Restatement (Second) of Agency notes that:
dent that a lender must take absolute and total control of the borrower’s business to incur liability.

In Buck, the borrower, a grocery store owner, bought merchandise from the lender, a wholesaler. After a period of time, and at the lender’s insistence, one of its accountants became the bookkeeper for the borrower. Also at the lender’s suggestion, the borrower hired a manager who had been handpicked by the lender. The Supreme Court of South Dakota held that while the lender exercised such control over the borrower’s operations that neither cash nor merchandise could be withdrawn from the business, the fact that the borrower controlled the store’s buying operations at all times indicated that the lender did not exercise such substantial control over the borrower as to warrant imposing liability on the lender.

In two earlier decisions, In re Prima Co. and Wasilowski v. Park Bridge Corp., which are factually similar to Jenson and Buck, the Seventh and Second Circuit Courts of Appeals also held that the respective lenders had not exerted undue influence and control over the businesses of the borrowers. It is very difficult to reconcile the Buck, Prima, and Wasilowski decisions with the Jenson decision. The lenders exercised similar degrees of control in all the cases and both Buck and

A security holder who merely exercises a veto power over the business acts of his debtor by preventing purchases or sales above specified amounts does not thereby become a principal. However, if he takes over the management of the debtor’s business either in person or through an agent, and directs what contracts may or may not be made, he becomes a principal, liable as any principal for the obligations incurred thereafter in the normal course of business by the debtor who has now become his agent. The point at which the creditor becomes a principal is that at which he assumes de facto control over the conduct of his general debtor, whatever the terms of the formal contract with his debtor may be.

RESTATEMENT (SECOND) OF AGENCY § 14 O comment a (1958).
20. 78 S.D. 334, 102 N.W.2d 84 (1960).
21. Id. at __, 102 N.W.2d at 85.
22. Id.
23. Id. at __, 102 N.W.2d at 86-88. Despite the management change, the store still continued to lose money. Id.
24. Id. at __, 102 N.W.2d at 91.
25. 98 F.2d 952 (7th Cir. 1938), cert. denied, 305 U.S. 658 (1939). For a detailed analysis of Prima, see Lundgren, supra note 9, at 525-27.
26. 156 F.2d 612 (2d Cir. 1946).
27. Wasilowski, 156 F.2d at 615; Prima, 98 F.2d at 966.
28. In Prima, one of the lending banks suggested that the borrower hire an outside manager who had total control over the borrower’s business, subject only to the control
Jenson based the imposition of liability on section 140 of the Restatement (Second) of Agency.\(^\text{29}\) Perhaps the decisions' differing results can only be explained by the fact that the Jenson decision was handed down more than twenty years after Buck, Prima, and Wasilowski, in an age when courts were more receptive to finding lender liability.

While the Wisconsin Supreme Court defines the agency relationship in accord with the Jenson court,\(^\text{30}\) it never has applied it in the lending context. Since past cases in this area indicate that a finding of liability is dependent upon the existence of factual elements of control which result in an agency relationship, absent such factors, it is unlikely that the Wisconsin borrower would prevail under this theory. Thus, a borrower would need to consider pursuing alternative theories of liability.

III. COMMON LAW THEORIES OF LENDER LIABILITY

A. Traditional Tort Theories Applied to Lender Liability

When lenders become dissatisfied with the financial performance of the borrower, they are quick to blame the decisions and policies of the borrower's management team for the financial downfall. To rectify the borrower's loss in earning potential, lenders often attempt to influence the decisions or make-up of the borrower's board of directors or management team by threatening to put the borrower in default under the terms of the loan agreement and call the loan. The relatively recent holding of the Texas Court of Appeals in State National Bank v. Farah Manufacturing Co.,\(^\text{31}\) illustrates how lender liability may arise under the traditional tort theories of fraudulent misrepresentation, duress and tortious interference.

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of the two lending banks. Prima, 98 F.2d at 962-63. For a synopsis of the elements of control in Buck, see supra text accompanying notes 21-24. For the elements of control in Jenson, see supra notes 17-18 and accompanying text.

29. For the courts' analyses of section 140 of the Restatement (Second) of Agency, see Jenson, 309 N.W.2d at 291; Buck, 78 S.D. at __, 102 N.W.2d at 89-90.


Farah Manufacturing Co. (FMC), an apparel manufacturer owned by the Farah family and run by William F. Farah, became a public corporation in 1967. From 1972 to 1976, FMC suffered pre-tax losses of nearly $44 million, partially as a result of an extended strike. In July of 1976, the FMC Board of Directors removed Farah as Chief Executive Officer (CEO) and named Leone as CEO. On February 14, 1977, FMC and State National Bank of El Paso, Continental Illinois National Bank and Trust Company of Chicago and Republic National Bank Dallas N.A. (the "lenders") amended a loan agreement to include a management change clause. This clause provided that any change in management of FMC considered adverse to the lenders' interests would constitute an event of default and allow the lenders to accelerate the loan. FMC continued to suffer losses. At the March 7, 1977, annual directors' meeting, Farah attempted to regain his position as president and CEO. Fearing that Farah's election would violate the terms of the management change clause, the board sought the advice of the lenders. The lenders considered all possible alternatives and advised the Board of Directors that if Farah was elected president of the company, the lenders automatically would bankrupt FMC and padlock it.

32. Id. at 667.
33. Id.
34. Id.
35. Id. The management change clause set forth in section 6.1(g) of the February 14, 1977 loan agreement made it an event of default if there occurred: "Any change in the office of President and Chief Executive Officer of Farah [Manufacturing Company, Inc.] or any other change in the executive management of Farah [Manufacturing Company, Inc.] which any two Banks shall consider, for any reason whatsoever, to be adverse to the interests of the Banks." Id.
36. Id.
37. Id.
38. Id. at 673. The lenders met over a period of approximately ten days and considered the following alternatives before rendering a final decision:
1) stop the board meeting if the lenders do not want Farah in [office];
2) get a new board with probable lender indemnification if the lenders want other management;
3) allow Farah to have the position for 30-60 days after which the loan will be called;
4) make a public statement;
5) shrinking the board; and
6) go to New York to sell the company.
Evidence introduced at trial indicated that the lenders blocked the election of two directors they believed Farah would be able to control. Subsequently, the lenders succeeded in having three individuals, two of whom had some association with at least one of the lenders, elected to the Board of Directors. There was no evidence that the board members breached any fiduciary duty or that the lenders dominated the board members. On May 27, 1977, FMC hired Galef as a financial consultant at the insistence of the lenders. Two months later, the lenders waived the management change clause to permit Galef to replace Conroy as CEO of FMC. Under Galef, FMC sold valuable assets at auctions and used the proceeds to make prepayments on FMC's loans. There was also evidence that the lenders pursued several potential merger candidates for FMC, without FMC's knowledge.

Eventually, the parties restructured the loan agreement, Farah was re-elected CEO, and the company returned to profitability. However, by this time the lenders had committed several tortious acts which resulted in a jury verdict of nearly $19 million against the lenders. The Texas Court of Appeals affirmed the award based on a finding that the lenders committed acts of fraudulent misrepresentation, duress and tortious interference.

1. Fraudulent Misrepresentation

While the specific elements of the tort of fraudulent misrepresentation are governed by controlling state law, action-

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39. *Id.* at 674.
40. *Id.* at 675-76. The new Board members were Pulley, a long-time employee of Republic who agreed to serve as a Board member if Republic indemnified him; Williams, a member of the Board of Directors of State National; and Jaynes, the only member considered to be independent of the lenders. *Id.*
41. *Id.* at 668. Galef was hired to consult for the fee of $1,000 per day. State National opposed Galef's suggestion that Farah also be hired as a consultant. *Id.* at 677.
42. *Id.* at 678. The evidence indicated that the auction sales stripped FMC of many valuable assets, a number of which were purchased by competitors and financed by State National. *Id.*
43. *Id.*
44. *Id.* at 680.
45. State law governs whether a suit may be maintained when a lender's misrepresentations are not in writing. See, e.g., Emery Corp. v. Century Bancorp., 588 F. Supp.
able fraud generally consists of the following traditional elements:

(1) [t]hat a material representation was made; (2) that it was false; (3) that, when the speaker made it, he knew it was false or made it recklessly without any knowledge of its truth and as a positive assertion; (4) that he made it with the intention that it should be acted upon by the party; (5) that the party acted in reliance upon it; and (6) that he thereby suffered injury. The gist of an action based upon fraud is found in the fraud of defendant and damage to plaintiff.46

Additionally, some states require borrowers to prove that they justifiably relied on the lender's fraudulent misrepresentation, and thus, acted with due diligence.47 The borrower is required to prove every element of fraudulent misrepresentation before the borrower will be entitled to damages.48

In Farah, the court focused on the meaning of the word "representation" in order to determine when failure to fully inform a borrower constitutes a fraudulent misrepresentation: “A representation consists of words or other conduct manifesting to another the existence of a fact, including a state of mind . . . . A misrepresentation is a representation which, under the circumstances, amounts to an assertion not in ac-

15 (D. Mass. 1984). In Emery, the defendant made false statements concerning its customer’s creditworthiness during a telephone conference call between Massachusetts and Pennsylvania. While Pennsylvania law allowed for suit based on oral fraudulent misrepresentations, a Massachusetts’ statute of frauds specifically prohibited actions based on oral misrepresentations. Id. at 17.

46. Farah, 678 S.W.2d at 681 (citing Custom Leasing, Inc. v. Texas Bank & Trust, 516 S.W.2d 138, 143 (Tex. 1974)). See also Brayton Chem., Inc. v. First Farmers State Bank, 671 F.2d 1047, 1050 (7th Cir. 1982); Rigby Corp. v. Boatmen’s Bank & Trust, 713 S.W.2d 517, 539 (Mo. Ct. App. 1986); State ex rel. Southwestern Bell Tel. Co. v. Brown, 519 P.2d 491, 495 (Okla. 1974).

47. See, e.g., General Motors Acceptance Corp. v. Central Nat’l Bank, 773 F.2d 771, 782 (7th Cir. 1985) (in which the court rejected defendant’s argument that GMAC’s business practices were imprudent and caused GMAC’s losses stating: “[Defendant] Bank’s misrepresentations were deliberate, and GMAC’s contributory negligence is not a defense to liability for an intentional tort.”); Mallis v. Bankers Trust Co., 615 F.2d 68, 80 (2d Cir. 1980) (in which the court defined due diligence as “incidental to proof of justifiable reliance” rather than as a separate element of fraud, since fraud is an intentional tort to which contributory negligence is not a defense).

48. See Rigby, 713 S.W.2d at 539 (requires the pleader to establish every element by substantial evidence); In re Belco, Inc., 38 Bankr. 525, 528 (Bankr. W.D. Okla. 1984) (requires the pleader to prove fraud by clear and convincing evidence).
cordonance with the facts.” While a representation may literally be true, it is actionable if it is used to create an impression which is substantially false. Section 527 of the Restatement (Second) of Torts states:

A representation that a maker knows to be capable of two interpretations, one of which he knows to be false and the other true is fraudulent if it is made:

(a) with the intention that it be understood in the sense in which it is false, or
(b) without any belief or expectation as to how it will be understood, or
(c) with reckless indifference as to how it will be understood.

In Farah, the lenders, through a letter written by their counsel, made a fraudulent misrepresentation by voluntarily conveying false or misleading information which was capable of two interpretations and which was wrongfully designed to influence Farah and the other members of the Board of Directors. Where lenders convey false information to borrowers or deliberately suppress material facts, their failure to disclose the falsity constitutes fraud.

In a situation where the lender argues that it had no knowledge of falsity at the time it made the questionable representations to the borrower, courts will infer the requisite knowledge of falsity from the surrounding circumstances.

49. Farah, 678 S.W.2d at 680-81 (quoting Custom Leasing, Inc. v. Texas Bank & Trust, 516 S.W.2d 138, 142 (Tex. 1974)).
50. Farah, 678 S.W.2d at 681 (citing Blanton v. Sherman Compress Co., 256 S.W.2d 884 (Tex. Ct. App. 1953)).
51. Farah, 678 S.W.2d at 681 (quoting RESTATEMENT (SECOND) OF TORTS § 527 (1977)).
52. Farah, 678 S.W.2d at 681.
53. Id. See Aaron Ferer & Sons, Ltd. v. Chase Manhattan Bank, 731 F.2d 112, 123 (2d Cir. 1984) (where the court stated: “a duty to disclose may arise in two situations: first where the parties enjoy a fiduciary relationship, and second, where one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge.”) (citations omitted); Chrysler Credit Corp. v. First Nat'l Bank & Trust, 582 F. Supp. 1436, 1442-43 (W.D. Pa. 1984). See generally Nicewander, Financial Record Privacy — What Are and What Should Be the Rights of the Customer of a Depository Institution, 16 ST. MARY'S L.J. 601, 621-23 (1985).
54. See, e.g., Brayton Chem., Inc. v. First Farmers State Bank, 671 F.2d 1047, 1048-49 (7th Cir. 1982) (knowledge inferred based on the fact that the bank continually transacted business with the subject of the inquiry); Commercial Nat'l Bank v. Federal Deposit Ins. Corp., 131 Ill. App. 3d 977, 981, 476 N.E.2d 809, 813 (1985).
In *Farah*, for example, State National Bank argued that fraud does not arise from a misrepresentation of future action unless the future act would have been beneficial to the promisee and the promisor's nonperformance injured the promisee. However, the court used the surrounding circumstances of the March 22, 1977 letter to FMC, the oral representations of State National Bank and its attorney, and Farah's justifiable reliance on their representations to establish the lender's fraudulent intent. Hence, actionable fraud may result from a present misrepresentation even though the lender has actual control over its occurrence or existence in the future.

While Wisconsin courts have yet to address the issue of fraudulent misrepresentation in the lending context, the Wisconsin fraudulent misrepresentation standard appears to be similar to that set forth in *Farah*. Currently, the party alleging fraud must prove by clear and convincing evidence that: (1) the fraudulent misrepresentation contained an untrue statement of fact or that the party accused of fraud made the statement with reckless disregard as to its truth or falsity; (2) the party accused of fraud made the fraudulent misrepresentation with the intent to defraud and for the purpose of inducing the other party to act upon it; and (3) that the party alleging fraud detrimentally relied upon the fraudulent misrepresentation. Although the Wisconsin court is mute as to whether the misrepresentation in question must be material, one might assume that materiality will be required since the court requires the plaintiff to show damages or injuries.

55. *Farah*, 678 S.W.2d at 682.
56. *Id.* at 681-82. The court further stated that "[w]here a promise regarding future action is made with the intent that it will not be performed and is made to deceive a person, then it is actionable as a fraudulent misrepresentation." *Id.* at 682 (citations omitted).
59. *First Nat'l Bank*, 25 Wis. 2d at 573, 131 N.W.2d at 310 (quoting *Household Fin.*, 8 Wis. 2d at 55-56, 98 N.W.2d at 392); W.H. Hobbs Supply Co. v. Ernst, 270 Wis. 166, 169, 70 N.W.2d 615, 617 (1955); *Larson*, 267 Wis. at 475, 66 N.W.2d at 182.
2. Duress

Duress is the second common law theory of liability relied upon by the Texas Court of Appeals in *Farah*. The elements of common law duress generally include:

(1) a threat to do some act which the threatening party has no legal right to do;

(2) a threat which is of such a character as to cause the threatened party to do that which he would not otherwise do and which he is not legally bound to do;

(3) the restraint caused by such threat must be imminent; and

(4) the person at whom the threat is directed has no present means of protection.  

A plaintiff must establish all of the aforementioned elements to recover for duress. Thus, there is no basis for a claim of duress when the threatening party has a legal right to do that which he threatens.  

In other words, common law duress is dependent upon the threatening party's use of either extortive measures or improper demands which demonstrate a lack of good faith by the threatening party.  

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60. See *Farah*, 678 S.W.2d at 684. Further elements which are available to the threatening party in the enforcement of its legal rights include:

[5] Where a demand made is wrongful or unlawful, and it is necessary for the party making such demand to resort to the courts to enforce same, there is no duress, for the one upon whom demand is made has adequate means of protection, and there is no imminent restraint. . . .

[6] But where the party making such demand has, or is supposed to have, the power to injure the business or property interests of the one upon whom such demand is made, without resort to the courts to enforce the demand, and threatens to do an act which would cause such injury, and which he has no right to do, and thereby induces a compliance with his demand,

[7] against the will of such party through fear of injury to his business or property interests, such threats amount to duress,

[8] if it appears that the party making such demand and threat ought not in good conscience to retain the benefit received by reason thereof.

*Id.*


(1) A threat is improper if . . .

(d) the threat is a breach of the duty of good faith and fair dealing under a contract with the recipient.
Economic duress, sometimes referred to as business compulsion, differs somewhat from common law duress. It arises when the threatening party "forces its victim to choose between distasteful and costly situations," such as undergoing bankruptcy, losing one's credit rating or suffering a loss of profits because of loan restrictions. In determining whether the lender acted with a proper motive and purpose in subjecting the borrower to choose between such adverse alternatives, courts consider all the facts and circumstances in order to make a reasonable inference of the lender's intent. When duress is exerted under circumstances sufficient to influence the apprehensions and conduct of a prudent businessman, the borrower is not bound by the resulting agreement.

The economic duress claim in Farah focused on the lenders' threats to bankrupt FMC and padlock its doors if Farah became involved in the management of the company. These threats gave Farah and others the impression that the only way to save FMC was to accede to the lenders' demand that Farah not be reelected as CEO. The court concluded that, as a matter of law, FMC established a cause of action for economic duress.

3. Tortious Interference

The third theory of common law lender liability relied on by the Texas Court of Appeals in Farah is that of tortious

(2) A threat is improper if the resulting exchange is not on fair terms, and
(a) the threatened act would harm the recipient and would not significantly benefit the party making the threat . . . or
(c) what is threatened is otherwise a use of power for illegitimate ends.

Id.
interference with business relations.\textsuperscript{68} This claim centered around the lenders' willful and intentional interference with FMC's right to lawful management through the selection of a handpicked CEO and board members and the forcing of Farah's resignation.\textsuperscript{69} Additionally, the fact that the lenders encouraged and financially supported costly litigation and a proxy fight against Farah when he sought to restore lawful management to the company indicated interference.\textsuperscript{70} The court found that the lenders interfered with FMC's business relationships through the election of incompetent, inexperienced directors and officers with divided loyalty.\textsuperscript{71}

In order to maintain a cause of action for interference with another's business relations, the plaintiff must establish that:

1. there was a contract subject to interference;
2. the act of interference was willful and intentional;
3. such intentional act was a proximate cause of plaintiff's damage; and
4. actual damage or loss occurred.\textsuperscript{72}

Proof of these elements will establish a prima facie case of interference; the burden of proof then shifts to the defendant who is required to show the justification or privilege for the acts.\textsuperscript{73}

Usually, once interference with another's business relations has been established, it "is actionable only if the interference is motivated by malice and no useful purpose of the inducing party is subserved."\textsuperscript{74} \textit{Davis v. Lewis}\textsuperscript{75} defines malice in a legal sense, not in its proper sense of ill will against a person, as characterizing an unlawful act done intentionally without just cause or excuse.\textsuperscript{76} Therefore, since malice constitutes an intentional and unlawful interference, a plaintiff need not prove the defendant acted with ill will to establish a cause

\textsuperscript{68} Id. at 688.
\textsuperscript{69} Id.
\textsuperscript{70} Id.
\textsuperscript{71} Id. at 690.
\textsuperscript{73} Farah, 678 S.W.2d at 689.
\textsuperscript{74} Pace, 631 F. Supp. at 1419-20 (citing Farah, 678 S.W.2d at 688).
\textsuperscript{75} 487 S.W.2d 411 (Tex. Ct. App. 1972).
\textsuperscript{76} Farah, 678 S.W.2d at 688 (citing Davis, 487 S.W.2d at 414). See generally Light v. Transport Ins. Co., 469 S.W.2d 433 (Tex. Ct. App. 1971).
of action to recover actual damages based on the tort of interference.\textsuperscript{77}

A defendant may lawfully interfere with another's business relations if it has an economic interest, uses only fair means (accompanied by honest intent) and acts only to better its own business and not principally to harm the other.\textsuperscript{78} Interference is wrongful only "[i]f [the] acts complained of do not rest on some legitimate interest or if there is sharp dealing or overreaching or other conduct below the behavior of fair [business persons] similarly situated . . . ."\textsuperscript{79} While the courts often allow interference with another's business relations,\textsuperscript{80} the \textit{Farah} court held that a "justifiable business interest does not grant [an] absolute privilege to interfere with a contractual relationship between others."\textsuperscript{81}

In \textit{Frank Coulson, Inc.—Buick v. General Motors},\textsuperscript{82} the Fifth Circuit Court of Appeals held that various factors which relate to the private interests of the parties involved, as well as to the social utility of these interests, must be weighed.\textsuperscript{83} It stated: "The principal issue thus becomes whether the social benefits derived in permitting acts of intervention outweigh the harm to be expected therefrom."\textsuperscript{84} For instance, the Oklahoma Supreme Court in \textit{Del State Bank v. Salmon},\textsuperscript{85} despite evidence that the bank intentionally interfered in terminating the borrower's employment, held that the bank had the privilege to interfere in the affairs of the borrower because of the bank's status as a substantial creditor of the borrower's employer and because the bank intended its actions to benefit its financial position, and not wrongfully harm the borrower.\textsuperscript{86}

\textsuperscript{77} \textit{Farah}, 678 S.W.2d at 689. Actual malice which may be defined as ill will, spite, evil motive, or purposing the injury of another, need not exist. \textit{Id.} See \textit{Del State Bank v. Salmon}, 548 P.2d 1024, 1026 (Okla. 1976); \textit{Clements v. Withers}, 437 S.W.2d 818, 822 (Tex. 1969); \textit{Herider Farms-El Paso, Inc. v. Criswell}, 519 S.W.2d 473, 476 (Tex. Ct. App. 1975).

\textsuperscript{78} \textit{Del State Bank}, 548 P.2d at 1027.

\textsuperscript{79} \textit{Farah}, 678 S.W.2d at 689 (citing \textit{Light}, 469 S.W.2d at 439). See Leonard Duckworth, Inc. v. Michael L. Field & Co., 516 F.2d 952, 956 (5th Cir. 1975).

\textsuperscript{80} \textit{See supra} notes 78-79 and accompanying text.

\textsuperscript{81} \textit{Farah}, 578 S.W.2d at 689.

\textsuperscript{82} 488 F.2d 202 (5th Cir. 1974).

\textsuperscript{83} \textit{Id.} at 206.

\textsuperscript{84} \textit{Id.}

\textsuperscript{85} 548 P.2d 1024.

\textsuperscript{86} \textit{Id.} at 1027.
B. Good Faith and Fair Dealing

Despite the application of traditional tort theories in the lending context, the leading common law theory of lender liability is that of good faith and fair dealing.\(^8\) In the usual loan process, the bank and the borrower enter into an agreement stating that the bank will lend a certain amount, at a certain rate, for a certain period of time. The Uniform Commercial Code protects the parties by imposing an obligation of good faith in the performance and enforcement of the security agreement.\(^8\) Recently, courts have applied the good faith obligation to all stages of the lender/borrower relationship.\(^8\)

1. Refusal to Advance Funds

In *K.M.C. Co. v. Irving Trust*,\(^9\) a jury awarded the plaintiff $7.5 million in damages caused by the lender’s failure to act in good faith in refusing to make further advances under a discretionary line of credit.\(^9\) K.M.C., a wholesale and retail grocery business, entered into a financing agreement with Irving Trust Company (Irving) whereby Irving held a security interest in all of K.M.C.’s accounts receivable and inventory.\(^9\) In return, Irving extended K.M.C. a $3 million line of credit in 1979 which was increased to $3.5 million one year later.\(^9\) Then, on March 1, 1982, K.M.C. requested $800,000 from the bank and Irving refused, notwithstanding the fact that the new funding would still have left the company’s total borrowing below the $3.5 million approved line of credit.\(^9\) K.M.C. collapsed and sued Irving, arguing that Irving’s refusal without prior notice to advance the requested funds breached its

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\(^8\) The terms “good faith” and “fair dealing” are actually interchangeable. See Swartz, *Lender Liability*, U.S. BANKER, May 1986, at 10, 14.

\(^8\) See generally U.C.C. § 1-201(19) (1977).

\(^8\) See infra notes 90-119. See, e.g., Sterling Faucet Co. v. First Mun. Leasing, 716 F.2d 543 (8th Cir. 1983) (the court found a letter between a lender and borrower to be a binding commitment to lend which required the parties to negotiate the terms of the loan in good faith); Cohen v. Ratinoff, 147 Cal. App. 3d 321, 195 Cal. Rptr. 84 (1983) (the court implied the covenant of good faith to a lender exercising its rights under a commercial lease). See infra note 102 and accompanying text.

\(^9\) 757 F.2d 752 (6th Cir. 1985).

\(^9\) Id. at 755.

\(^9\) Id. at 754.

\(^9\) Id.

\(^9\) Id.
duty of good faith performance implied in the security agreement between the two parties.\textsuperscript{95} Irving argued that it had full discretion to decide whether or not to make advances under the loan agreement; it also argued that the loan, as a demand loan, could have been called at any time.\textsuperscript{96} The court found that Irving had a duty to exercise good faith in deciding whether to demand repayment of the loan or in refusing to make further advances.\textsuperscript{97}

"'Good faith' means honesty in fact in the conduct or transaction concerned."\textsuperscript{98} In determining whether a lender’s discretion not to advance additional funds falls within the good faith limitation, "the Uniform Commercial Code and the courts have imposed limitations of reasonableness and fairness."\textsuperscript{99} Hence, the court in \textit{K.M.C.} concluded that "there must at least be \textit{some} objective basis upon which a reasonable loan officer in the exercise of his discretion" would have acted in making the decision not to advance funds.\textsuperscript{100}

Notice is a key element in determining whether the lender made the refusal to advance funds in good faith and in the reasonable exercise of the lender’s discretion.\textsuperscript{101} To impose a good faith duty of notification, a security agreement must ex-

\textsuperscript{95} Id.
\textsuperscript{96} Id. at 759.
\textsuperscript{97} Id. at 754-60.

A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

\textit{Id.}

\textsuperscript{100} \textit{K.M.C.}, 757 F.2d at 761 (emphasis in original). \textit{See infra} text accompanying note 117.

\textsuperscript{101} \textit{Id.}, at 759. \textit{See} Wells v. Alexandre, 130 N.Y. 642, 645, 29 N.E. 142, 143 (1891): "[I]f a notice was requisite to its proper execution, a covenant to give such notice will be inferred, for any other construction would make the contract unreasonable, and place one of the parties entirely at the mercy of the other." \textit{Id.} (citations omitted).
Lender Liability

The Uniform Commercial Code states that "the application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement." Thus, the fact that Irving refused to advance funds without prior notice to K.M.C. constitutes an act of bad faith, as well as an abuse of discretion which gives rise to liability.

In *In re Red Cedar Construction Co.*, the court makes it evident that the lender does not have a good faith duty to notify the borrower when an agreement between the parties is revocable. Furthermore, the lender does not have a good faith duty to notify the borrower that it will not advance funds when the lender reasonably believes that the borrower is either not capable of making payment or performing or otherwise falls outside the lender's eligibility guidelines. Thus, whether a lender must act on a good faith basis in refusing to advance funds depends on the type of security agreement that governs the lending relationship of the parties.

Recently, the Wisconsin Court of Appeals defined good faith to mean "an honest intention to abstain from taking unfair advantage of another, through technicalities of law, by failure to provide information or to give notice, or by other activities which render the transaction unfair." The court qualified the definition by stating that the failure of a lender to give notice is not determinative; the "touchstone of good faith is honesty in fact and reasonableness." If upheld, this decision appears to give the Wisconsin lender the latitude to refuse

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102. *Red Cedar*, 63 Bankr. at 237. See supra note 89.
103. *K.M.C.*, 757 F.2d at 759 (citing U.C.C. § 2-309 comment 8 (1977)).
104. *K.M.C.*, 757 F.2d at 759. The court stated in dicta that "if Irving had given K.M.C. 30 days, 7 days, even 48 hours notice," it would have been a different case. *Id.* at 763.
106. *Id.* at 237-38 & n.7.
107. *Id.* at 238. The court based this conclusion on the Sixth Circuit Court of Appeals holding in *K.M.C.* that an "obligation to act in good faith would require a period of notice to K.M.C. to allow a reasonable opportunity to seek alternative financing, absent valid business reason precluding Irving from doing so." *Id.* at 236 (citing *K.M.C.*, 757 F.2d at 760-63) (emphasis added).
109. *Id.* at 403, 388 N.W.2d at 651.
to advance additional funds without prior notice. Thus, the key to avoiding liability in Wisconsin under the good faith standard is to act honestly and reasonably.

2. Acceleration of Maturity

In *Brown v. AVEMCO Investment Corp.*,\(^{110}\) the security agreement between the lender and borrower gave the lender the right to accelerate, at its option, full payment of the loan.\(^{111}\) Because the borrower violated a provision in the security agreement which prohibited it from leasing an airplane used as collateral to a third party, the lender attempted to use this violation of the security agreement to put the borrower in default two years after the lease between the borrower and the lessee was entered into.\(^{112}\) The *Brown* court found that the lender's act of taking advantage of a technical default constituted bad faith.\(^{113}\)

Acceleration clauses, while designed to protect the lender from actions of the borrower which jeopardize or impair the lender's security, are not to be used for the commercial advantage of the creditor.\(^{114}\) Courts and the Uniform Commercial Code utilize the reasonableness and fairness test in determining whether questionable acceleration resulted from a good faith belief of security impairment.\(^{115}\) In *Blaine v. G.M.A.C.*,\(^{116}\) the court held that acceleration is permissible when the lender falls within the "dual elements of whether (1) a reasonable [person] would have accelerated the debt under the circumstances, and (2) whether the creditor acted in good faith."\(^{117}\) For example, when the course of dealing between the parties reveals that the borrower historically pays late and the lender continually accepts payments without complaint, it would be unreasonable for the lender to accelerate payment of the debt the next time the borrower misses a specified pay-

\(^{110}\) 603 F.2d 1367 (9th Cir. 1979).

\(^{111}\) *Id.* at 1375.

\(^{112}\) *Id.* at 1369.

\(^{113}\) *Id.* at 1379-80.

\(^{114}\) *Id.* at 1376.

\(^{115}\) *See supra* note 99.

\(^{116}\) 82 Misc. 2d 653, 370 N.Y.S.2d 323 (1975).

\(^{117}\) *Id.* at 655, 370 N.Y.S.2d at 327.
ment date.\textsuperscript{118} Thus, the good faith standard used for permissible acceleration is very similar to the good faith standard to which a lender must adhere in refusing to advance additional funds.\textsuperscript{119}

C. Additional Common Law Theories of Lender Liability

1. Fiduciary Duty of Disclosure

The facts of a California Circuit Court case, \textit{Kruse/Jewell v. Bank of America},\textsuperscript{120} demonstrate the theory of fiduciary duty of disclosure. The borrower, Jewell, an unsophisticated apple farmer, had a longstanding business relationship with the Bank of America. One of Jewell’s processors, the O'Connell Company, had serious financial problems. Jewell borrowed money from the Bank of America, lent it to the O'Connell Company (also a customer of the Bank of America), who in turn paid off a default judgment obtained by Taylor-Doyle, Inc. Taylor-Doyle, also controlled by the Bank of America, used the money which the O'Connell Company borrowed from Jewell to repay its delinquent loans to the Bank. The jury found the Bank of America committed a breach of fiduciary duty by failing to disclose its interest in the transaction to Jewell and awarded Jewell nearly $46 million in compensatory and punitive damages which the trial judge reduced to $27 million.

A fiduciary relationship is a "confidential trust relationship [which] arises when one party justifiably reposes confidence in another."\textsuperscript{121} There are two types of fiduciary

\begin{itemize}
\item \textsuperscript{118} See, e.g., Alaska Statebank v. Fairco, 674 P.2d 288 (Alaska 1983), where the court found that the lender’s action in taking possession of the collateral resulted in a breach of the lender’s obligation of good faith where the bank’s course of conduct in accepting late payments resulted in a waiver of its right to accelerate the loan without notice to the borrower.
\item \textsuperscript{119} See supra notes 98-100 and accompanying text.
\item \textsuperscript{120} No. 112438, slip op. (Superior Ct. Sonoma County, CA 1985).
\item \textsuperscript{121} Williams v. Burns, 540 F. Supp. 1243, 1252 (D. Colo. 1982) (citing Page v. Clark, 197 Colo. 306, 316, 592 P.2d 792, 798 (1979)). See Liebergesell v. Evans, 93 Wash. 2d 881, __, 613 P.2d 1170, 1175 (1980); Moon v. Phipps, 67 Wash. 2d 948, 954, 411 P.2d 157, 160-61 (1966). The Restatement of Contracts describes a fiduciary relationship as one in which one party "occupies such a relation to the other party as to justify the latter in expecting that his interests will be cared for . . . ." \textsc{Restatement of Contracts} § 472(1)(c) (1932).
\end{itemize}
relationships. A fiduciary relationship in law exists between two parties by the simple fact that the nature of the relationship is one which historically has been considered to be fiduciary in character. In law relationships include relationships between a trustee and beneficiary, a principal and agent, a husband and wife, a physician and patient, and an attorney and client. A fiduciary relationship in fact exists where one party justifiably expects the other party to care for the party's welfare.

Historically, courts have failed to find the existence of a fiduciary relationship in fact between a lender and borrower. However, when special circumstances do result in the development of a confidential or fiduciary relationship between a lender and its borrower, the lender has a duty to disclose material facts when dealing with the borrower. Circumstances which indicate the existence of a fiduciary relationship in fact—and thus impose a duty of disclosure upon the lender—include: the nature and length of the relationship of the parties; the relative sophistication of the borrower with regard to financial and business matters; and the lender's awareness that the borrower relied upon it to look after the borrower's interests.

124. *Liebergesell*, 93 Wash. 2d at __, 613 P.2d at 1176.
125. Id. (citing RESTATEMENT OF CONTRACTS § 472 comment c (1932)).
126. See *Aaron Ferer & Sons, Ltd. v. Chase Manhattan Bank*, 731 F.2d 112, 123 (1984) (no fiduciary duty arose despite the finding that the lender concealed material facts from the borrower); *Klatt v. First State Bank*, 206 Iowa 252, 220 N.W. 318 (1928) (a claim of a confidential relationship between the bank and the customer is not sufficient to impose a fiduciary duty); *Klein v. First Edina Nat'l Bank*, 293 Minn. 418, 196 N.W.2d 619 (1972) (a bank ordinarily has no special duty to counsel and inform the customer of every material fact relating to the transaction).
127. *Aaron Ferer*, 731 F.2d at 123. See generally *Brasher v. First Nat'l Bank*, 232 Ala. 340, 168 So. 42 (1936); *Stewart v. Phoenix Nat'l Bank*, 49 Ariz. 34, 64 P.2d 101 (1937) (where the bank acted as the customer's financial advisor for 23 years and induced him to give a mortgage by use of fraudulent means, the bank incurred a fiduciary duty of disclosure); *First Nat'l Bank v. Brown*, 181 N.W.2d 178 (Iowa 1970); *Burien Motors, Inc. v. Balch*, 9 Wash. App. 573, 513 P.2d 582 (1973) (an independent contractor, such as a bank, business advisor or broker, may assume a duty to disclose material facts when involved in a relationship of trust and confidence with another).
128. See supra text accompanying note 120. In *Kruse/Jewell* the jury was instructed:
The *Kruse/Jewell* court found an *in fact* relationship. For instance, the fact that George M. Jewell had only a high school education, lacked sophistication in financial matters, and readily relied on his friend and banker, William Sullivan, led the jury to conclude that Bank of America had a fiduciary relationship with Jewell.

A lender has a duty to disclose known facts when it is involved in a fiduciary or confidential relationship with the borrower. Failure to make such disclosure constitutes a breach of fiduciary duty. In *Everman National Bank v. United States*, the United States Court of Appeals for the Federal Circuit held that the rule of materiality limits a lender’s duty to disclose knowledge which may be of interest to the borrower. The court defined materiality as whether the prudent and reasonable banker would have reason to know that the borrower would regard as important the information possessed by the lender. Therefore, when the lender and borrower develop a fiduciary relationship, the prudent and reasonable banker has a duty of disclosure, unless such information is either irrelevant or trivial.

2. Negligent Misrepresentation

While all courts generally impose liability on lenders who make fraudulent misrepresentations to borrowers, only a few courts have imposed lender liability using a theory of negligent misrepresentation. The apparent reason courts use a

Under ordinary circumstances the relationship between a bank and its customer is not a fiduciary one. Before a bank can be charged with a fiduciary obligation to its customer, the bank must act on behalf of, and for the benefit of its customer, or the parties must enter into a relationship which imposes that understanding as a matter of law.

Considerations for the establishment of a fiduciary duty are:

1. the nature and length of the relationship
2. discussions between the parties, and
3. the relative sophistication of the parties with regard to financial and business affairs.


130. *Id.*
131. 756 F.2d 865 (Fed. Cir. 1985).
132. *Id.* at 869.
133. *Id.*
134. See supra notes 33-36 and accompanying text.
narrower standard of liability in negligent misrepresentation actions is that the fault of the maker of a misrepresentation is sufficiently less where it does not intentionally deceive the borrower, but only fails to exercise reasonable care in making the good faith representation.\footnote{135}{RESTATEMENT (SECOND) OF TORTS § 552 comment a (1977).}

In \textit{First National Bank v. Collins},\footnote{136}{616 P.2d 154 (Colo. Ct. App. 1980).} the Colorado Court of Appeals adopted the rationale of section 552 of the Restatement (Second) of Torts, which sets forth the following elements necessary to state a claim for relief in negligent misrepresentation:

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) \ldots [T]he liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.\footnote{137}{Id. at 155 (citing RESTATEMENT (SECOND) OF TORTS § 552 (1977)).}

This section of the Restatement clearly limits the liability which may be incurred by a lender to a "‘fixed, definable and contemplated’ class of plaintiffs who the defendant has special reason to anticipate will rely on the statement."\footnote{138}{Note, \textit{Confirming Bank Liability in Letter of Credit Transactions: Whose Bank is it Anyway?}, 51 FORDHAM L. REV. 1219, 1247 (1983) (citations omitted).} Once a borrower has established the prima facie elements of negligent misrepresentation, the borrower has a cause of action only if it can establish both that it justifiably relied on the negligently
supplied information and that the lender's negligent misrepresentations proximately caused its injuries.\textsuperscript{139}

To incur liability in Wisconsin using the theory of negligent misrepresentation, the maker of the representation must honestly believe in the truth of its statement, but fail to exercise reasonable care in ascertaining the facts, or lack the skill and competence required by a particular business or profession.\textsuperscript{140} Given this standard of liability, it would be entirely reasonable for Wisconsin courts to extend this theory to the lending context in the future. In determining whether the lender either failed to exercise reasonable care or lacked the requisite skill and competence, courts probably will consider what a reasonable and prudent lender would have done, given a like situation.

IV. DEFENSIVE LENDING TACTICS FOR WISCONSIN LENDERS

Unless the Wisconsin lender strictly adheres to the laws governing lending practices, juries probably will be asked to decide cases in which Wisconsin business managers and their employees have had their livelihoods destroyed by the unrelenting foreclosure actions of insensitive, arrogant lenders. Because juries nationwide will most likely continue to side with the borrower\textsuperscript{141} and continue to impose large punitive damage awards,\textsuperscript{142} what may the Wisconsin lender do to help minimize its lending risks? Quite simply, lenders should treat borrowers fairly and reasonably in all stages of the lending


\textsuperscript{140} Stevenson v. Barwineck, 8 Wis. 2d 557, 564, 99 N.W.2d 690, 694 (1959).


\textsuperscript{142} See, e.g., K.M.C. Co. v. Irving Trust, 757 F.2d 752 (6th Cir. 1985) (a $7.5 million jury award that included punitive damages was upheld); Alaska Statebank v. Fairco, 674 P.2d 288 (Alaska 1983) (jury award of $35,000 in punitive damages was upheld in this case involving a $50,000 promissory note); Kruse/Jewell v. Bank of America, No. 112438, slip op. (Superior Ct. Sonoma County, CA 1986) (jury awarded $27 million in punitive damages which the trial judge reduced to $6 million).
relationship. The following factors should be taken into consideration in making efforts to curb lender liability.

A. Documentation

When a borrower's business falters, lenders immediately look to the default provisions of the security agreement. More often than not, the default provision of a security agreement contains an insecurity clause similar to that found in Brown v. AVEMCO Investment Corp., which states: "[I]f for any reason Secured Party may deem itself insecure, then the whole principal sum unpaid upon said promissory note . . . shall immediately become due and payable at the option of Secured Party." Brown indicates that a lender should not accelerate a demand note upon a technical default of a security agreement's provision unless the lender, acting in good faith, believes that the prospects for payment or performance are impaired. At the same time, other courts have held that demand instruments do not by their nature impose a good faith standard.

Since courts are undecided as to whether a lender must use a good faith standard in accelerating payment on a demand note, lenders are well advised to act conservatively by accelerating payment only in good faith. To avoid the issue raised by Brown, the lender could specify at the time the security agreement is negotiated which events of default are to be considered material enough to constitute default. However, this creates another problem in that anything not specifically listed in the security agreement as material is not considered materially sufficient to put the borrower in default.

143. See Cappello, supra note 141, at 7.
144. 603 F.2d 1367, 1369 (9th Cir. 1979). See Alaska Statebank, 674 P.2d at 289.
145. Brown, 603 F.2d at 1369 (emphasis added).
146. Id. at 1378. See supra notes 110-13 and accompanying text. See also K.M.C., 757 F.2d at 759; In re Red Cedar Constr. Co., 63 Bankr. 228, 237-38 (Bankr. W.D. Mich. 1986).
149. Id.
Where a technical default, such as late payment, occurs and the good faith lender decides not to put the borrower in default, the lender may have waived its right under the terms of the security agreement to receive timely payments in the future. In such a situation, courts are divided as to whether repossession of the collateral or acceleration of payment without first giving notice to the borrower constitutes a violation of good faith and fair dealing by the lender. The lender may minimize the risk of incurring liability by doing two things. First, the security agreement should contain a waiver clause which ensures that the acceptance of late payments does not constitute a modification or waiver of either the borrower's duty to make timely payments or the lender's right to repossession the collateral or accelerate payment without giving notice. Secondly, upon accepting a late payment from the borrower, the lender should send notices to the borrower informing it that late payments constitute an event of default under the terms of the security agreement and that the lender's acceptance of such payment does not result in a waiver of its right to call the loan.

 makes it evident that a lender should never accelerate a demand instrument without first giving the borrower written notice of default, unless it is able to show that such a delay in acceleration will result in a material deterioration of the lender's position. While the period of notice which the lender must give the borrower depends on the terms of the given security agreement clause, suggests that even after expiration of the specified notice period, acceleration of the loan may still be improper if the borrower has not been given sufficient time to either complete a contemplated sale of assets or to arrange for alternative financing. Therefore, despite the explicit right

150. See, e.g., Alaska Statebank v. Fairco, 674 P.2d 288, 293 (the course of dealings between the parties and the lender's continued acceptance of the delayed payments resulted in a modification of the express terms of the loan agreement).
153. Flick & Replansky, supra note 148, at 429.
154. 757 F.2d 752 (6th Cir. 1985). See supra notes 90-104 and accompanying text.
155. , 757 F.2d at 759; In re Red Cedar Constr. Co., 63 Bankr. 228 at 238.
156. , 757 F.2d at 763 n.13. See Flick & Replansky, supra note 148, at 426.
to accelerate set forth in the security agreement, the cautious lender will allow the borrower a reasonable amount of time after the notice of acceleration has been given.

Another common security agreement provision which tends to give lenders headaches is a “Change in Management” clause. While State National Bank v. Farah Manufacturing Co.\textsuperscript{157} does not prohibit a lender from including a “Change in Management” clause in the security agreement,\textsuperscript{158} it makes it evident that improper use of such a clause could result in substantial damages.\textsuperscript{159} A “Change in Management” clause should only be included where the lender reasonably believes that certain individual directors and officers of the borrower are important enough to the borrower’s financial condition that it would not lend the money absent their managerial ability.\textsuperscript{160} In these cases, the “Change in Management” clause should specifically name the individual directors and officers involved. Even though the borrower consents to the inclusion of this clause, lenders should not use it to influence the election of individuals to the Board of Directors who are likely to serve the interests of the lender, rather than those of the shareholders.\textsuperscript{161} Additionally, lenders should not threaten to call the borrower’s line of credit for the purpose of either compelling a change in management or forcing the borrower to act otherwise for the lender’s benefit.\textsuperscript{162}

Finally, because most of the cases in which borrowers are successful against lenders have been tried before sympathetic juries, the lender should consider including a clause in the security agreement which waives each party’s right to a jury trial in the event of litigation.\textsuperscript{163} When including such a

\textsuperscript{157} 678 S.W.2d 661 (Tex. Ct. App. 1984). \textit{See supra} text accompanying notes 31-44.

\textsuperscript{158} \textit{Id.} at 667. \textit{See} Parsons Steel, Inc. v. First Alabama Bank, N.A., 679 F.2d 242, 246 (11th Cir. 1982) (conditioning the extension of additional credit on the appointment by the bank of a business manager did not violate the Bank Holding Company Act Amendments).

\textsuperscript{159} \textit{Farah}, 678 S.W.2d at 667.

\textsuperscript{160} Flick & Replansky, \textit{supra} note 148, at 417.

\textsuperscript{161} \textit{Farah}, 678 S.W.2d at 668. \textit{See supra} text accompanying notes 27-28. A bank should avoid having its employees, officers or directors serve on a borrower’s Board of Directors. Flick & Replansky, \textit{supra} note 148, at 421.

\textsuperscript{162} \textit{Farah}, 678 S.W.2d at 673-74.

\textsuperscript{163} Flick & Replansky, \textit{supra} note 148, at 448.
clause in a security agreement, lenders must be sure that the borrower is knowingly and voluntarily waiving this right.  

B. Counseling

When the profitability of a borrower begins to deteriorate, lenders should not impose conditions or requirements on the borrower which are not contained in the security agreement. While courts usually allow lenders to give the borrower advice if it is requested, the lender should never threaten default on the borrower due to the borrower's failure to follow the lender's advice. If the lender desires some control over the borrower's destiny it may reserve a veto power over select financial activities of the borrower in the security agreement, but it should not obtain a veto power over all proposed business activity of the borrower.

The lending relationship becomes particularly precarious when the lender suggests that the borrower hire an outside consultant. Courts will allow lenders to recommend that a consultant be hired, but the lender is not to choose the consultant. Furthermore, the lender should not interfere with the employment contracts of its borrower, even if it does so with the honest intent of protecting its own business while not harming that of its borrower. In short, the lender should avoid taking action which could lead to a finding that it is in control of the borrower.

164. Cases in which the validity of a contractual waiver of a jury trial has been in issue have overwhelmingly applied the knowing and voluntary standard. See, e.g., K.M.C., 757 F.2d at 756; National Equip. Rental, Ltd. v. Hendrix, 565 F.2d 255, 258 (2d Cir. 1977); Dreiling v. Peugeot Motors of Am., Inc., 539 F. Supp. 402, 403 (D. Colo. 1982); Feldman & Son, Ltd. v. Checker Motors Corp., 572 F. Supp. 310, 313 (S.D.N.Y. 1983).

165. Moss, Defensive Lending, 73 A.B.A. J. 72 (March 1987). See A. Gay Jenson Farms Co. v. Cargill, 309 N.W.2d 285, 290-91 (Minn. 1981); Buck v. Nash-Finch Co. 78 S.D. 334, 102 N.W.2d 84, 86 (1960); Farah, 678 S.W.2d at 688.


167. Parsons Steel, Inc. v. First Ala. Bank, 679 F.2d 242, 244 (11th Cir. 1982); In re Prima Co., 98 F.2d 952, 956 (7th Cir. 1938); Buck, 78 S.D. at ___, 102 N.W.2d at 86; Farah, 678 S.W.2d at 676.


169. Flick & Replansky, supra note 149, at 435.
C. Disclosure by the Lender

While there are circumstances which limit the disclosure of material facts, the lender generally has a duty to disclose any fact which a prudent and reasonable banker would consider material. Once the lender determines that disclosure is required, it must provide truthful and accurate information. Such disclosure also minimizes the possibility that the borrower will misinterpret the lender’s disclosure.

Because many borrowers place a great deal of trust and confidence in their lender, it is very important that the lender continually counsel the borrower throughout the duration of the lending relationship. While courts have recognized oral modifications to a written agreement between

170. See Nicewander, supra note 53, at 621-22.

171. See, e.g., Everman Nat’l v. United States, 756 F.2d 865, 869 (Fed. Cir. 1985) (applied the standard of whether a prudent and reasonable banker would have reason to know that FMHA would regard as important the fact that House’s refusal to disclose constituted a bar to his selling Grade A milk); Central States Stamping Co. v. Terminal Equip. Co., 727 F.2d 1405, 1408-09 (6th Cir. 1984) (in which a bank officer undertook to provide information to purchaser regarding creditworthiness of a bank customer knowing that the purchaser had confidence in officer’s knowledge about the customer, the officer had a duty to disclose facts about its customer’s financial instability); Camp v. First Fed. Sav. & Loan, 12 Ark. App. 150, 671 S.W.2d 213, 216 (1984) (a residential lender had a duty to disclose to home buyer, where buyer was unknowledgeable as to flood prone areas and reasonably relied on the lender’s representations).

172. See, e.g., Central States Stamping, 727 F.2d at 1409; Catalina Yachts v. Old Colony Bank & Trust Co., 497 F. Supp. 1227, 1236 (D. Mass. 1980); Rigby Corp. v. Boatmen’s Bank & Trust Co., 713 S.W.2d 517, 540 (Mo. Ct. App. 1986). See also ROBERT MORRIS ASSOCIATES, CODE OF ETHICS (1980), Articles 1 & 3, which state in part:

Article 1:
There are two cardinal principles in the exchange of credit information: confidentiality and accuracy of inquiries and replies.

Article 3:
Responses should . . . disclose sufficient material facts commensurate with the purpose and amount of the inquiry. Specific questions should be given careful and frank replies.

Id.

173. See, e.g., Central States Stamping, 727 F.2d at 1409; Catalina Yachts, 497 F. Supp. at 1236; Rigby, 713 S.W.2d at 540.

174. See supra text accompanying notes 121-25.

LENDER LIABILITY

parties, it is always best to have the entire agreement between the parties in writing. In addition, lenders should maintain complete and accurate files of every material event that occurs during the course of the lending relationship. Since any document, memo, or letter written by the lender may ultimately be seen by a jury, only the facts, and not subjective comments about the borrower, should be recorded.

This is one of the best ways for the lender to avoid claims by the borrower that it acted with malice, insensitivity or arrogance toward the borrower.

V. CONCLUSION

Given the adoption in Wisconsin of any of the previously analyzed common law lender liability theories, could Metropolitan Bank be found liable for putting Plastic Plus in default and accelerating payment? This analysis reveals that Plastic Plus and Danny Ongais would most likely have a cause of action based on the lender liability theory of good faith and fair dealing. Such facts as an understandably slight decrease in the current ratio which does not jeopardize Metropolitan Bank's position, and the calling of the loan solely for the commercial advantage of Metropolitan Bank may be sufficient to indicate that Metropolitan Bank failed to act in good faith. While counsel probably is safe in informing Metropolitan Bank that it has not exercised control sufficient for courts to imply agency, nor made the threats or repre-


177. Sterling Faucet Co., 716 F.2d at 543-44 (the detailed content of a commitment letter enabled the court to discern the intent of the parties); Alaska Statebank v. Fairco, 674 P.2d 288, 292 (Alaska 1983) (the written security agreement allowed the court to distinguish between what were "mere negotiations" and what was actually included in the contract).


180. See generally the Introduction to this Comment, which contains a factual description for this hypothetical situation.

181. See supra notes 98-103 and accompanying text.

182. See supra notes 15-17 and accompanying text.
sentations needed to bring about the application of the theories of fraudulent misrepresentation,\textsuperscript{183} duress,\textsuperscript{184} tortious interference with business relations\textsuperscript{185} or negligent misrepresentation,\textsuperscript{186} it can be argued that Metropolitan Bank committed a breach of fiduciary duty.\textsuperscript{187} The fact that Danny is unsophisticated in financial matters, has had a longstanding relationship with Metropolitan Bank and has acted to expand its business because of Metropolitan Bank’s advice, indicates that a fiduciary relationship exists. Therefore, a court could hold that Metropolitan Bank had a duty to inform Plastic Plus that the act of borrowing $800,000 or more without increasing its current asset base would result in a less than acceptable current ratio and constitute an event of default.

Whether Wisconsin courts will adopt any of the common law lender liability theories is yet to be seen. What is readily apparent, though, is that juries willingly side with the borrower.\textsuperscript{188} Perhaps the best advice to the lender is: beware, the advent of lender liability has given borrowers the wherewithal to demand that they be treated fairly throughout the course of the lending relationship.

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\textbf{TIMOTHY P. REARDON}
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\begin{itemize}
\item \textsuperscript{183} See supra notes 45-51 and accompanying text.
\item \textsuperscript{184} See supra notes 60-66 and accompanying text.
\item \textsuperscript{185} See supra notes 72-77 and accompanying text.
\item \textsuperscript{186} See supra notes 134-39 and accompanying text.
\item \textsuperscript{187} See supra notes 121-28 and accompanying text.
\item \textsuperscript{188} See supra notes 141-42 and accompanying text.
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