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Lender Liability Under Iowa Law

by

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LENDER LIABILITY UNDER IOWA LAW

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I. BACKGROUND

Lender liability. The thought of it, states one banking publication, is
“sending chills down many a banker’s spine.”

1 Indeed, the size of some of the recent verdicts against financial institutions
   in lender liability suits is staggering.2 There is a growing perception among
   lenders that they have become the guarantors of their borrower’s business
   success. As one bank lawyer commented, banks have become “the insurance

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practices with the firm of Nyemaster, Goode, McLaughlin, Voigts, West, Hansell, & O’Brien,
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2. Five of the largest lender liability verdicts nationally in the past two years include:
Penthouse v. Dominion Federal Savings & Loan ($129 million) (New York); Scharenberg v.
Continental Bank & Trust ($105 million); Conlan v. Wells Fargo Bank ($60 million) (California);
Robinson v. Texas Commerce Bank-McAllen ($59.3 million) (Texas); and Stranghellini
companies of the ‘80’s.’"3 While some have suggested that the crest of lender liability may have already been reached,4 particularly as some of the larger verdicts against lenders have been overturned by appellate courts,5 it seems likely that lender liability claims will continue to be asserted as long as juries continue to return large verdicts against banks and other financial institutions.

Much like “environmental law” or “RICO,” few attorneys ten years ago had given “lender liability” much thought, at least in such specific terms. Today, however, lender liability is an important topic at legal seminars and has spawned a new group of legal specialists. Is lender liability really something new? Certainly banks have never been exempt from lawsuits. To a certain extent it is the same old wine in a new bottle—familiar causes of action based on contract and tort law packaged under an evocative new heading.6 But it should not be dismissed so lightly. The frequency with which borrowers are suing their lenders has multiplied and new applications of old causes of actions have developed.7 From the point of view of a judge or legal scholar, many of the claims that have become associated with “lender liability” are analytically unrelated and have as their only common thread a bank or other lending institution as defendant. From the point of view of an Iowa lawyer representing either borrowers or lenders, it may be useful to consider these various cases and theories collectively, either as an arsenal of potential claims and defenses that may be asserted, or as a guideline for counseling financial institutions as to how to avoid the many pitfalls in the lender liability area.

While most of the attention in the lender liability area has focused on multimillion dollar verdicts against financial institutions in California or on


5. Two of the more significant verdicts against lenders that were overturned in 1988 include a $128 million judgment against a Virginia savings and loan association for breach of an agreement to loan money to a hotel-casino project, and a $26 million verdict against a California bank for fraud and bad faith breach of an agreement to provide long-term financing to an apple farm. Penthouse Int'l, Ltd. v. Dominion Fed. Sav. & Loan Ass'n, 855 F.2d 963 (2d Cir. 1988), cert. denied, 109 S. Ct. 1639 (1989); Kruse v. Bank of Am., 202 Cal. App. 3d 38, 248 Cal. Rptr. 217 (1988), cert. denied, 109 S. Ct. 870 (1989).

6. See Flick & Replansky, Liability of Banks to Their Borrowers: Pitfalls and Protections, 103 BANKING L.J. 220, 257 (1986) (“The various theories of liability outlined in this article are for the most part, not new or novel theories of law.”); Granoff, Emerging Theories of Lender Liability: Flawed Applications of Old Concepts, 104 BANKING L.J. 492, 493 (1987) (“Although it has become fashionable to refer to ‘emerging theories’ of lender liability, it is the opinion of this commentator that established legal concepts both in contract and in tort remain essentially unchanged.”).

7. See, e.g., Granoff, supra note 6; American Bar Association, EMERGING THEORIES OF LENDER LIABILITY (H. Chaitman ed. 1985 & 1987) [hereinafter ABA-Lender Liability].
the east coast, Iowa has also played a role in the development of the law in the lender liability area. In particular, banks and other financial institutions became attractive, and usually unsympathetic, targets for Iowa farmers caught in the squeeze between the lax credit policies of the 1970s and the declining farm values and "farm crisis" of the 1980s. This Article will focus on Iowa cases involving claims against lenders under the various common law theories associated with lender liability. Except for a brief discussion of the requirement of good faith under the Uniform Commercial Code ("U.C.C.")) and of a recently adopted Iowa statute designed to limit the liability of lenders under contract law, this Article will not examine the extensive body of law involving the liability of lenders under various state or federal statutes. While cases decided in Iowa will be emphasized, this Article will also comment briefly on certain major common law theories of lender liability that have developed in other jurisdictions which Iowa courts have not yet faced.

II. TORT THEORIES OF LIABILITY

A. Fraud/Breach of Fiduciary Duty

The most significant developments in the area of lender liability in Iowa have come in a series of cases relating to nondisclosures by a lender allegedly constituting either fraud or a breach of fiduciary duty. Indeed, Iowa has among the most well-developed case law of any state concerning a bank's fiduciary obligations and its consequent duty of disclosure to a borrower. Technically, fraud and breach of fiduciary duty are separate causes of actions, but in practice, the distinction has generally been blurred in lender liability cases.

Some authors have suggested that proving the existence of a fiduciary duty is the single most important factor in a lender liability lawsuit. "The lender who acts as a fiduciary to the borrower is liable for almost anything; the lender who does not is liable for almost nothing." What is the significance of a finding that a lender owes a borrower a fiduciary duty? The most important consequence is that it imposes upon the lender a duty to speak, transforming mere silence into constructive fraud. Silence, in view of a duty to speak, may also result in liability for "aiding and abetting" a fraud.

8. Some of the more prevalent statutory sources of liability include the federal and state securities law, RICO, federal and state environmental laws, and federal and state commercial credit laws. See generally ABA-Lender Liability, supra note 7. One of the more significant cases relating to a lender's liability under the securities laws as an "aider and abettor" and "control person" arose in federal court in the Southern District of Iowa, but dealt primarily with federal securities law and will not be discussed here. See Metge v. Baehler, 762 F.2d 621 (8th Cir. 1985), cert. denied, 444 U.S. 1057 (1986).


under federal securities laws.\textsuperscript{11}

A typical fraud/breach of fiduciary duty case might arise where a borrower intends to become financially involved in a transaction in which the bank has a financial interest or of which it has knowledge. After the borrower's investment proves unsuccessful, the borrower claims the bank should have disclosed its interest in, or knowledge about, the transaction. Although there has been some attempt by the Iowa courts to distinguish nondisclosures arising in breach of fiduciary duty cases from those in fraud cases,\textsuperscript{12} in general the cases are usually analyzed together.\textsuperscript{13} The fundamental question in both types, at least in the context of an alleged failure to disclose, is the same—whether the lender has a duty to reveal certain information to its borrower.

While as a general rule one party to a business transaction has no duty to disclose material facts to the other,\textsuperscript{14} there are significant exceptions to this rule. For example, one who speaks must say enough to prevent his words from misleading the other party, one who has special knowledge of material facts to which the other party does not have access may have a duty to disclose these facts, and one who stands in a fiduciary or confidential relation to the other party must disclose material facts.\textsuperscript{15} In addition, some courts have indicated that where a lender acts in such a way that it is deemed to control or dominate the borrower, the court may impute to the lender a fiduciary obligation to the borrower.\textsuperscript{16}

The \textit{Restatement (Second) of Torts} states that a fiduciary relationship exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relationship.\textsuperscript{17} The Iowa Supreme Court has recognized that certain relationships necessarily give rise to a fiduciary or confidential relationship,\textsuperscript{18}
such as the relationship between attorney and client, guardian and ward, principal and agent, and executor and heir. Courts have generally held that the relationship between a bank and a borrower or a depositor is that of debtor-creditor. This relationship does not ordinarily impose a fiduciary duty upon the bank. Recently, however, some courts have been more willing to apply fiduciary principles to the bank-borrower and the bank-depositor relationships, particularly if the bank has been giving financial advice to the customer for a number of years, if the bank stands to benefit from the transaction, or if the bank has reason to know that the customer is relying on the bank to counsel, advise, or inform the customer.

At least three Iowa appellate decisions have found that a lender breached a duty to disclose material information to its customer under certain circumstances. The pioneer Iowa case in the area of breach of fiduciary duty/fraudulent nondisclosure by a lender is First National Bank in Lenox v. Brown. In Brown, the bank had loaned money to a filling station operator and had taken mortgages and security interests as security for the loan. The borrower began to encounter business difficulties and the bank president suggested to the business owner that it might be wise to sell the business. Mr. Brown agreed to purchase a one-half interest in the business and the seller suggested that Brown contact the bank about obtaining a loan. The bank loaned the money to Brown and a cosigner but failed to mention

as convertible terms and have reference to any relationship of blood, business, friendship, or association in which the parties repose special trust and confidence in each other and are in a position to have and exercise, or do have and exercise, influence over each other.


19. Kurth v. Van Horn, 380 N.W.2d 693, 696 (Iowa 1986); see also Restatement (Second) of Torts § 551 comment f (1977).


23. Id. at 180.
24. Id.
25. Id.
to Brown that the business was heavily indebted to the bank, that the bank held both a mortgage on the property and a blanket security interest on the business assets, and that the bank intended to apply a portion of the loan proceeds to the present owner's indebtedness.\textsuperscript{26} After Brown failed to pay, the bank brought an action on the note and Brown defended on the basis of fraud in the inducement of the transaction.\textsuperscript{27}

The Iowa Supreme Court, affirming the trial court, held that the existence of bank liens on the business assets was material to the transaction and should have been disclosed by the bank.\textsuperscript{28} In its opinion, the court established the foundation for future breach of fiduciary cases by stating:

Ordinarily mere silence on the part of one party, in an arms length transaction, as to material facts discoverable by the other does not serve to create actionable fraud. This is not the case, however, where there exists a relationship of trust or confidence, and the trusted party has superior knowledge of the facts. In the latter situation the superior party has a duty to disclose all material facts of which he is aware, or at least those favorable to his own position and adverse to the other.\textsuperscript{29}

Although the bank had no prior relationship with Brown, the court observed that the bank officer should have known that Brown "trusted him implicitly."\textsuperscript{30} The court rejected the bank's argument that it should not be held liable because the undisclosed information was a matter of public record that could have been discovered by Brown.\textsuperscript{31} The key factors appeared to be the bank's superior knowledge and its self-interest in the transaction. The court observed that in this case the bank "dealt with defendants as tools with which to alleviate the result of its own prior poor loan judgment."\textsuperscript{32}

Another Iowa case in which a bank was held liable for failing to disclose material information is \textit{Nie v. Galena State Bank & Trust Co.}\textsuperscript{33} In \textit{Nie}, the plaintiff, an inexperienced investor, was asked to invest in a feeder pig business.\textsuperscript{34} The current owner of the feeder pig business suggested that the plaintiff talk to representatives of the company's bank concerning the finan-

\begin{footnotesize}
27. \textit{Id.} at 181.
28. \textit{Id.} at 184.
29. \textit{Id.} at 182 (citations omitted).
30. \textit{Id.}
31. \textit{Id.} at 183-84. \textit{Compare First Nat'l Bank v. Brown, 181 N.W.2d 178 (Iowa 1970) with Denison State Bank v. Madeira, 230 Kan. 684, 640 P.2d 1235 (1982) (no duty of disclosure by bank where undisclosed facts "were either a matter of public record or were otherwise readily available if some reasonable effort had been made to ascertain them," stating that "[t]o adopt such a standard would put an intolerable obligation upon banking institutions and convert ordinary day-to-day business transactions into fiduciary relationships where none were intended or anticipated").}
32. \textit{First Nat'l Bank v. Brown, 181 N.W.2d at 184.}
34. \textit{Id. at 374.}
\end{footnotesize}
cial status of the company. The bank officer said he thought the company was a good business and that certain financial statements accurately reflected the condition of the business. No mention was made of the fact that the bank officer had an investment in the business and that some of the pigs in the operation were owned by the bank officer. After the business went sour plaintiff brought an action against the bank for fraud due to its failure to disclose material information. The Iowa Court of Appeals determined that the bank had an interest in seeing new capital infused into the operation in which it had already invested. The court further determined the bank officer's failure to disclose the fact that he owned hogs which were part of the business could constitute actionable nondisclosure. 

The court stated:

A customer who seeks impartial investment advice from a bank officer justifiably expects to speak to a disinterested party and would have no reason to think that the officer to whom he is speaking would have personal investments in the business the customer's inquiries are directed to. We think a bank officer should disclose personal investments in a business which happens to be the same business a customer seeks advice about. [The bank officers] were not disinterested parties and this should have been disclosed.

Nie contains certain similarities to the facts of Brown and the result in the two cases are consistent. The key facts in both were the bank's superiority of knowledge and its self-interest in the transaction. These facts gave rise to a legal duty to communicate material information to the other party.

A third Iowa case which discussed a confidential or fiduciary relationship regarding a duty of disclosure is Peoples Bank & Trust Co. v. Lala. Over the course of several years, the bank had extended substantial loans to the borrowers individually and to various corporations controlled by the borrowers. These loans were undersecured and the bank sought additional security by having the borrowers execute various mortgages and personal guaranties. No new consideration was given to support the additional security. Subsequently, the bank attempted to collect on the notes and foreclose on the mortgages. The borrowers defended on various grounds, including the fact that the notes and mortgage which they signed were invalid.

35. Id.
36. Id.
37. Id.
38. Id.
39. Id. at 376-77.
40. Id. at 376.
41. Peoples Bank & Trust Co. v. Lala, 392 N.W.2d 179 (Iowa Ct. App. 1986).
42. Id. at 181.
43. Id.
44. Id.
45. Id.
because they were obtained by undue influence and overreaching by the bank officer, who breached his fiduciary duty to the borrowers.\textsuperscript{46}

The Iowa Court of Appeals recited the general rule that a confidential relationship does not arise solely from a bank-depositor or bank-borrower relationship, rather, any such relationship must be evaluated on the facts and circumstances in each individual case.\textsuperscript{47} In \textit{Lala}, the court found that more than merely a bank-depositor relationship between the borrowers and the bank officer existed.\textsuperscript{48} For over twenty years the borrowers, a husband and wife, had obtained all of their business and personal financing through the bank officer, and in addition, the bank officer and the borrowers were close and trusted personal friends.\textsuperscript{49} The court found that, during the previous twenty years, the borrowers and the bank officer placed special trust and confidence in each other, the bank officer was in a position to exercise influence over the borrowers, and accordingly, he had the duty to act in good faith.\textsuperscript{50} The court further held that, because a confidential relationship existed between the bank and the borrowers, the bank should have disclosed material information on homestead exemption rights to the borrowers when the bank sought the wife’s signature on a $100,000 note and mortgage on their homestead.\textsuperscript{51}

The court reiterated the general rule that “where a relationship of trust or confidence exists between two parties to a transaction the superior party has a duty to disclose all material facts of which he is aware, or at least those favorable to his own position and adverse to the other.”\textsuperscript{52} In this case, the borrower’s homestead rights were a material fact that the bank had a duty to disclose before the bank sought to have the borrower waive those rights. The court surmised that the bank was motivated to cover substantial unsecured loans, which were then in default.\textsuperscript{53} “As such, [the bank] had conflicting interests and was not a disinterested party when it gave [the borrower] advice and obtained her signature on the note and mortgage of her homestead. We believe the bank’s conflict of interest and [the borrower’s] homestead rights should have been fully disclosed.”\textsuperscript{54}

\textit{Brown, Nie,} and \textit{Lala} demonstrate that under certain circumstances a duty may exist for a lender to disclose material information to its customer, whether the duty arises from a fiduciary or confidential relationship, inequality of knowledge, or other attendant circumstances. There are three Iowa Supreme Court decisions, however, in which the court found that a
duty of disclosure did not arise between a bank and its customer. The first of these cases is *Manson State Bank v. Tripp.* In *Tripp*, Dr. Tripp was asked to invest in a company by another local physician, who arranged for Dr. Tripp to meet with a bank officer to finance the investment. The bank officer said something to the effect that the bank had faith in the company and may have indicated that he thought it was a good investment. The company in which Dr. Tripp was investing was indebted to the bank in the amount of $37,558. The money loaned to Dr. Tripp for the investment, however, was not used to pay down the bank loan except insofar as the new capital may have been used for routine installment payments. Dr. Tripp had received and signed a copy of a subscription agreement which acknowledged receipt of information revealing the difficult financial condition of the company in which Dr. Tripp was investing.

After the company in which he was investing went bankrupt, Dr. Tripp failed to pay on the note and the bank brought an action to collect on the note. Dr. Tripp defended on the grounds that the bank committed fraud by failing to disclose either the indebtedness of the corporation to the bank or the fact that the bank had cut off further credit to the corporation. The court distinguished the *Brown* case, saying it "does not hold ... that a confidential relationship arises out of every bank-borrower relationship. Such a relationship is ordinarily non-existent in such a situation, as other jurisdictions have squarely held. ..." The Iowa Supreme Court affirmed the trial court's finding that no relationship of trust and confidence arose between the bank and Dr. Tripp.

Tripp had never done business with [the bank officer] or plaintiff bank before. He had received financial statements showing the companies to be "bailed out" were in serious financial trouble. ... He was obviously an educated man and, according to his own financial statement furnished the bank, had invested in stocks and bonds to the extent of $100,000 before making this loan. He had talked with other persons concerning the advisability of this investment. While he testified those persons considered the proposed corporation a "good investment" he never claimed he did not know the two corporations to be taken over were in bad shape.

56. *Id.* at 106.
57. *Id.* at 106-07.
58. *Id.* at 106.
59. *Id.* at 107.
60. *Id.* at 106.
61. *Id.*
62. *Id.*
63. *Id.* at 108 (citing Klien v. First Edina Nat'l Bank, 293 Minn. 418, 422, 196 N.W.2d 619, 622 (1972)).
64. *Id.*
Because no relationship of trust and confidence existed between the bank and Dr. Tripp, the bank had no duty to disclose the information it possessed concerning the company in which he was investing.86

Tripp has many similarities to Brown and Nie, in both of which the court found a duty of disclosure. Tripp may be distinguished, however, because the plaintiff was a sophisticated investor who was less likely to be relying on the bank in the investment decision, and who knew the company in which he was investing was in financial trouble. In other words, the plaintiff had greater general knowledge about investments and greater specific knowledge about the transaction at issue than the plaintiff in either Brown or Nie. The bank's duty of disclosure, then, may vary based on the sophistication and knowledge of the transaction possessed by the borrower. As one court has observed, "[a] fiduciary duty must be defined with reference to the experience and intelligence of the person to whom the duty is owed."87

In Kurth v. Van Horn,88 a farmer in financial trouble asked his landlord, Gerdes, for assistance in obtaining a loan from the defendant bank.89 Gerdes cosigned the note for the farmer and granted the bank a mortgage on his farm to secure the note.90 The bank did not disclose to Gerdes that it would use part of his money to pay off loans to the farmer previously written off, or that there were certain other financial advantages to the bank in this arrangement.91 Shortly thereafter, Gerdes died. Gerdes' trustee sued the bank and its president alleging fraud and breach of fiduciary duty for failing to disclose the bank's financial interest in having the farmer obtain the loan.92 The jury found no fraud, but did find a breach of fiduciary duty by the bank, granted actual and punitive damages, and cancelled the mortgage.93 The Iowa Supreme Court reversed, holding that there was insufficient evidence to support a finding of a fiduciary duty.94 The court observed that as a general rule, a fiduciary duty or confidential relationship does not arise solely from a bank-depositor relationship.95 The plaintiffs in Kurth asserted, however, that the rule should be different when the customer becomes a borrower.96 The court disagreed and quoted approvingly the following definition of a fiduciary relationship:

65. Id.
66. Id.
69. Id. at 694.
70. Id.
71. Id.
72. Id.
73. Id. at 695.
74. Id. at 698.
75. Id. at 696.
76. Id.
[A] very broad term embracing both technical fiduciary relations and those informal relations which exist wherever one man trusts in or relies upon another. One founded on trust or confidence reposed by one person in the integrity and fidelity of another. A "fiduciary relation" arises whenever confidence is reposed on one side, and domination and influence result on the other; the relation can be legal, social, domestic, or merely personal. Such relationship exists when there is a reposing of faith, confidence and trust, and the placing of reliance by one upon the judgment and advice of the other.⁷⁷

The court determined in this case that nowhere is there evidence that Gerdes relied upon the bank to render its advice in connection with this loan. Nor, do we believe, there was any showing that the bank misled Gerdes in any way . . . .

. . . .

The bank should not be held liable for merely permitting Gerdes and Hall to implement their plan by interceding and preventing the consummation of these loan documents.⁷⁸

The plaintiffs had suggested that the banker should have refused to conclude this loan until the borrower had secured legal counsel.⁷⁹ The court stated that this form of protectionism goes far beyond the exercise of the banker's responsibility in this case and its failure to do so does not amount to a breach of fiduciary duty. The bank had no affirmative duty to prevent Gerdes from doing what the evidence clearly shows he wanted to do.⁸⁰

There was no evidence in this case that the bank had ever acted as an investment advisor for Gerdes, and in fact, Gerdes hardly knew the banker at all.⁸¹ Gerdes had only been a depositor at the bank and, prior to the loan, had never borrowed money from the bank.⁸² The court concluded that the banker owed no fiduciary duty to Gerdes that would have required the bank to disclose its interest in the transaction.⁸³

The most recent case finding no duty of disclosure by a bank to its customer is Sinnard v. Roach.⁸⁴ In Sinnard, a widow, Linda Sinnard, was

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⁷⁷. Id. at 695-96 (quoting BLACK'S LAW DICTIONARY 564 (5th ed. 1979)). The court also noted that a fiduciary relationship has been defined in this way: "A fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation." Id. at 696 (quoting RESTATEMENT (SECOND) OF TORTS § 874 comment a (1979)).

⁷⁸. Id. at 697.

⁷⁹. Id.

⁸⁰. Id.

⁸¹. Id. at 698.

⁸². Id.

⁸³. Id.

left a $250,000 home and $300,000 by her deceased husband.\textsuperscript{85} She remarried the defendant, Walsh, who induced Linda to invest in his business.\textsuperscript{86} The defendant bank was the lender to Walsh's business.\textsuperscript{87} As the financial condition of Walsh's business deteriorated, Walsh asked his wife to sign various documents assigning mortgages on her home and security interests in certificates of deposit to the bank as security for the loans to the business.\textsuperscript{88} The evidence suggested that Linda did not read the documents or understand what she was signing and that some of the documents were signed while she was intoxicated.\textsuperscript{89} The documents were signed outside the bank and were prompted by Walsh's request.\textsuperscript{90} When Walsh's business defaulted on its loans, the bank began to foreclose upon the certificates of deposit and on the mortgage on Linda's house.\textsuperscript{91}

Linda then brought an action against Walsh and the bank for fraud and breach of fiduciary duty. The jury returned a verdict finding Walsh, the bank, and a bank officer liable for fraud and assessed significant compensatory and punitive damages against all the defendants.\textsuperscript{92} The Iowa Supreme Court reversed, holding that the transactions between Linda Sinnard and the bank never reached the point where a legal duty arose on the part of the bank to protect Linda from assigning her assets as security for the loans.\textsuperscript{93}

The court observed that the subject matter of the documents was not withheld from Linda and was stated on the face of the documents, which she chose not to read.\textsuperscript{94} Linda had met the bank officer only briefly and the court concluded that her brief contact was not sufficient to alert the bank officer to the possibility that she was placing the sort of trust in him that could legally bind him to deal with her as a fiduciary.\textsuperscript{95} Moreover, the information that allegedly should have been disclosed by the bank was not peculiarly within the bank's knowledge.\textsuperscript{96} This information was known equally by Linda's husband, Walsh, and there was no reason for the bank to assume that Walsh was not advising Linda as to the status of the business.\textsuperscript{97} The court concluded that the bank had no duty "to protect Linda from either her husband's or her own folly."\textsuperscript{98}

\begin{enumerate}
\item Id. at 102.
\item Id. at 102-03.
\item Id.
\item Id. at 102.
\item Id. at 104.
\item Id.
\item Id.
\item Id. at 104-05.
\item Id. at 105.
\item Id. at 105-06.
\item Id. at 106.
\item Id. at 107.
\item Id.
\item Id. at 105.
\end{enumerate}
The outcome of the various Iowa cases in the fraud or breach of fiduciary duty area depends heavily on the facts of each case and the broad rules of law that will apply to a lender’s conduct are difficult to infer. Nonetheless, a few generalizations may be appropriate. First, a fiduciary duty may arise based on the length and quality of the relationship between the bank and borrower. Where the bank has acted as a trusted advisor to the borrower over a number of years, such as in Lala, it is likely that a fiduciary relationship will be found. In this regard, the existence of a fiduciary duty or duty of disclosure will be affected by the general sophistication of the borrower as well as the lender’s knowledge that the borrower is relying upon the lender. Second, even where there is no prior relationship between the bank and borrower, a fiduciary relationship, or at least a duty of disclosure, may arise out of the nature of the transaction, such as in Brown or Nie. In particular, when the lender has a self-interest in the transaction, or possesses material information not otherwise available to the borrower, disclosure will likely be required. Finally, lenders may take some small comfort in knowing that, as long as full disclosure has been made, the lender is not generally required to go beyond mere disclosure to protect the borrower from doing something ill-advised. In neither Kurth nor Sinnard was the lender required to protect the borrowers from their own schemes, actions, or folly.

Unlike the situation several years ago, the trend nationally now appears to be moving in favor of the lenders on the fiduciary duty issue. A California appellate court decision, Price v. Wells Fargo Bank, is perhaps the most significant recent ruling on this issue. The California courts had earlier pioneered the concept that the relationship between a bank and its depositors and loan customers is at least “quasi-fiduciary.” In Price, the borrower-ranchers fell behind in their loan payments. After the bank demand of

99. See Peoples Bank & Trust Co. v. Lala, 392 N.W.2d 179, 186 (Iowa Ct. App. 1986).
100. See McCracken v. Edward D. Jones & Co., 445 N.W.2d 375, 381 (Iowa Ct. App. 1989) (stockbroker stood in fiduciary relationship to customer where customer had no prior investment experience and broker knew customer was relying upon his judgment and advice); Kurth v. Van Horn, 380 N.W.2d 693, 698 (Iowa 1986); see also Bank of Red Bay v. King, 482 So. 2d 274, 285 (Ala. 1985) (“When both parties are intelligent and fully capable of taking care of themselves and dealing at arm’s length, with no confidential relations, no duty to disclose exists when information is not requested, and mere silence is then not a fraud.”).
payment, the plaintiffs sold cattle, trucks, beehives, and certain land at allegedly distressed prices in order to meet their obligation. The Prices claimed, among other things, that the bank had orally assured them that the debt could be restructured over a longer term. The Prices' claims included breach of fiduciary duty, breach of good faith, fraud, and infliction of emotional distress. The court in Price stated that the earlier California decisions finding a relationship of "trust and confidence" between a bank and its depositors and loan customers were "inconsistent with both past authority and current trends in the law." The court held that a bank and its depositor have a debtor-creditor relationship, not a fiduciary one. The court relied in part on the decision of the California Supreme Court in Foley v. Interactive Data Corp., which "surely preclude[d] the sort of loose extension of tort recovery, based on 'quasi-fiduciary' relationship, sanction[ed]" in another California decision.

The Iowa courts, too, have demonstrated a subtle yet perceptible shift toward restricting the circumstances under which fiduciary obligations will be imposed upon a lender. The stated tests and legal standards for determining a fiduciary relationship have not changed, nor will they likely change in the near future. Nonetheless, in Sinnard, the court's most recent pronouncement on the fiduciary duty of a lender, the court's decision is undergirded by a recognition of the vastly different interests of borrower and lender. As other courts around the country decide breach of fiduciary cases, the Iowa courts will likely restrict the circumstances which create a fiduciary duty for banks and other lenders, particularly in the commercial context.

B. Negligent Misrepresentation

Another claim that may be asserted against lenders, particularly where fraud or bad faith is lacking, is negligent misrepresentation. Not every negligent misrepresentation made by a lender is actionable; if that were the case, the tort of fraudulent misrepresentation might become unnecessary. Negligent misrepresentation exists only when a lender supplies false information for the guidance of others in their business transactions. The Restatement (Second) of Torts section 552 sets forth the standard for negli-
gent misrepresentation as follows:

(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. 116

In general, the Iowa courts have adopted the Restatement rule. 117

One area where negligent misrepresentation is likely to apply is in a lender's response to a credit inquiry. 118 While lenders generally are under no obligation to supply credit information, once they agree to supply it they must do so accurately and with reasonable care and diligence. 119 While the Iowa courts have not yet faced this issue, one may reasonably assume that lenders may be liable for providing false, incomplete or misleading information about a borrower in response to a credit inquiry.

There is at least one reported Iowa decision involving a negligent misrepresentation claim by a borrower against a lender. In Larsen v. United Federal Savings & Loan Association, 120 two homebuyers who were borrowing money from United Federal Savings ("UFS"), sued UFS alleging that they paid an excessive price for their home in reliance upon a negligent appraisal made by a UFS employee. 121 The court determined that UFS owed the homebuyers a duty of care, because UFS should have foreseen that the homebuyers, who paid for the appraisal and to whom the results were reported, would rely on the appraisal to reaffirm their belief as to the value of the home. 122 Thus, UFS was held liable to plaintiffs for negligently appraising the home. 123

A federal court decision in Iowa also concerned a negligent misrepresentation made by a lender. Phenix Federal Savings & Loan Association v. Shearson Loeb Rhoades, Inc. 124 involved a complex series of financing deals for the construction of three ethanol plants in Iowa. 125 The jury found that Shearson Loeb Rhoades negligently misrepresented to the owner/borrower "that it would secure permanent financing of the plants by underwriting

116. Id.
121. Id. at 283.
122. Id. at 287-88.
123. Id.
125. Id. at 1126.
industrial development bonds.”\textsuperscript{126} In addition, the jury found that “Shearson had negligently misrepresented to [a savings and loan association] which had provided interim construction financing for the plants, that it would ‘take out’ [the savings and loan] by providing permanent financing.”\textsuperscript{127} The Eighth Circuit Court of Appeals affirmed the jury’s verdicts.\textsuperscript{126}

Although there is a good argument in Larsen that the appraisal was intended solely for the bank’s use and not for the guidance of others, the conduct made actionable in Larsen appears generally to be the type of negligent misrepresentation to which the Restatement refers. The Phenix decision, however, while seemingly unremarkable, is disturbing. The court appears to have allowed an ordinary breach of contract action to become a negligent misrepresentation (or tort) action. The “negligent misrepresentation” that was made to the borrower in Phenix was Shearson’s promise that it would provide permanent financing.\textsuperscript{128} While this promise may have constituted a legally binding commitment, the breach of which was actionable under contract principles, it does not appear to justify liability in tort. A few courts from other jurisdictions have noted the expanding use of the tort of negligent misrepresentation to incorporate statements concerning a party’s intention to perform a contract, which logically should be actionable only as a breach of contract.\textsuperscript{130}

C. Negligence

In addition to claims for negligent misrepresentation, a lender may be liable to a borrower for negligence if it undertakes to perform certain responsibilities. Negligence is the breach of legal duty or obligation recognized by the law, requiring the actor to conform to a certain standard of conduct for the protection of others against unreasonable risks.\textsuperscript{131} It has been defined by the Iowa courts as “conduct which falls below the standard established by law for the protection of others against unreasonable risk of harm.”\textsuperscript{132}

\textsuperscript{126} Id.
\textsuperscript{127} Id.
\textsuperscript{128} Id. at 1127, 1131.
\textsuperscript{129} Id. at 1129.
\textsuperscript{130} See, e.g., MSA Tubular Prod., Inc. v. First Bank & Trust Co., 869 F.2d 1422, 1425 (10th Cir. 1989) (liability for overstating the average deposits of a customer in response to a credit inquiry); Central States Stamping Co. v. Terminal Equip. Co., 727 F.2d 1405 (6th Cir. 1984); Hi-Grade Cleaners, Inc. v. American Permac, Inc., 561 F. Supp. 643, 644 (N.D. Ill. 1982) (“We have found no cases supporting an action for negligent misrepresentation where a party to a contract stated that it would perform under the contract and then did not . . . . Basically, we believe that when a defendant is already contractually bound to the plaintiff, his assurance that he will perform in accordance with the contract is simply a reiteration of his original promise. It creates no additional liability in contract, let alone in tort.”); see also Black, Jackson & Simmons Ins. Brokerage, Inc. v. I.B.M. Corp., 109 Ill. App. 3d 132, 440 N.E.2d 282 (1982).
\textsuperscript{131} Lewis v. State, 256 N.W.2d 181 (Iowa 1977).
\textsuperscript{132} Id. (citing Restatement (Second) of Torts §§ 281, 286 (1977)).
For example, courts have held that where a lender undertakes to process a loan application, it has a duty to do so with reasonable care, and the breach of this duty will subject the lender to liability in tort for negligence.\footnote{Jacques v. First Nat'l Bank, 307 Md. 527, 515 A.2d 756 (1986) (negligence in denying loan); First Fed. Sav. & Loan Ass'n v. Caudle, 425 So. 2d 1050 (Ala. 1982).} In an Alabama case, First Federal Savings & Loan Association v. Caudle,\footnote{First Fed. Sav. & Loan Ass'n v. Caudle, 425 So. 2d 1050 (Ala. 1982).} a lender was held liable for failing to process a loan application with due care, which resulted in the lender negligently telling the plaintiff-borrowers that they had been approved for an FHA loan when in fact they had not been approved.\footnote{Id. at 1051-52.} The plaintiffs did not learn of their failure to obtain FHA financing until after they completed construction of their home, and thus were forced to obtain another loan at a higher interest rate.\footnote{Id.}

D. Intentional Interference with Contract or Prospective Business Advantage

A common law tort claim that is frequently asserted by borrowers against lenders in varying situations is intentional interference with either existing contractual relations or prospective business relationships.\footnote{See generally ABA-Lender Liability, supra note 7, Vol. IV at 21-26.} This cause of action may arise, for example, where the lender refuses to honor an oral commitment to lend, accelerates loan payments pursuant to a default provision, or otherwise cuts off credit to a borrower. Another situation in which this tort might arise is when the lender has failed to conduct a proper investigation of a borrower on a loan, or fails to take appropriate action as a result of an investigation that uncovers existing contracts of the borrower that may be at odds with the bank's loan agreements with the borrower.\footnote{See, e.g., First Wyoming Bank v. Mudge, 748 P.2d 713 (Wyo. 1988).}

In Iowa, the elements of the tort of intentional interference with either an existing contract or a business expectancy are: (1) an existing valid contractual relationship or business expectancy; (2) knowledge of the contractual relationship or business expectancy by the interferer; (3) intentional interference inducing or causing a breach or termination of the relationship; and (4) resulting damage.\footnote{Westway Trading Corp. v. River Terminal Corp., 314 N.W.2d 398, 402-03 (Iowa 1982); Stoller Fisheries, Inc. v. Am. Title Ins. Co., 258 N.W.2d 336, 340 (Iowa 1977); see also Restatement (Second) of Torts §§ 766, 766A (1977).} Although Iowa courts recognize that justification is a defense, and therefore that the genuine assertion of a legally protected interest is not tortious, the burden of proving justification appears to be on the party against whom the claim is asserted. This is in contrast to some other jurisdictions in which the lack of justification must be asserted as a part of the prima facie case of intentional interference.
As a practical matter, most intentional interference claims will hinge upon whether the lender's actions were "justified," and therefore not improper. The Restatement lists the following factors to be considered in determining whether an interference is improper or unjustified:

(a) the nature of the actor's conduct,
(b) the actor's motive,
(c) the interests of the other with which the actor's conduct interferes,
(d) the interests sought to be advanced by the actor,
(e) the social interests in protecting the freedom of action of the actor and the contractual interests of the other,
(f) the proximity or remoteness of the actor's conduct to the interference, and
(g) the relationship between the parties.140

The justification defense turns upon a determination of the defendant's primary intent, purpose, or motive in engaging in the interfering conduct.141

In several Iowa decisions, borrowers have claimed that their lenders intentionally interfered with existing contracts or prospective business advantage.142 Two Iowa cases, Harsha v. State Savings Bank143 and Farmers Cooperative Elevator v. State Bank,144 exemplify the most typical claim that may arise against a lender in this area. In each case, the bank refused to extend further credit to a borrower, either because of perceived financial difficulty of the borrower or the bank's dissatisfaction with the borrower's business operations. The borrowers alleged in each case that the refusal to extend credit caused the borrower's business to suffer, foregoing future profits or prospective business advantage.145 In each case, recovery was denied because the borrower failed to prove that the lender acted with the necessary intent to injure or destroy the borrower.146 Instead, in each case the bank was acting primarily to protect its own financial interest and not to

141. Knickerbocker v. First Nat'l Bank, 827 F.2d 281, 287 (8th Cir. 1987); see also Restatement (Second) of Torts § 769 (1977) (acting to protect financial interest is a defense to intentional interference claim).
142. See infra notes 61-66 and accompanying text; see also Klooster v. North Iowa State Bank, 404 N.W.2d 564 (Iowa 1987). In Klooster, the Iowa Supreme Court held that tortious interference did not apply to a transaction between a bank and a borrower inter se. In other words, the court indicated that it was not possible to interfere with a contract to which one was a party. Id. at 570.
ruin the borrower.\textsuperscript{147}

The borrower was more successful in another Iowa decision involving a
bank's interference with existing contracts and prospective business advan-
tage. In Peterson v. First National Bank,\textsuperscript{148} a farmer deeply in debt to his
bank borrowed funds from the Commodity Credit Corporation ("CCC"), al-
legedly in order to pay his farm rent.\textsuperscript{149} There was a dispute as to whether
the banker agreed to allow the farm rent to be paid out of the CCC pro-
cceeds.\textsuperscript{150} In any event, when the CCC proceeds were deposited in the bor-
rower's account at the bank, the bank applied the funds toward reducing
existing bank debt and refused to loan the borrower funds to cover a check
written by the borrower for the past-due farm rent.\textsuperscript{151}

The jury determined that the bank intentionally interfered with the
farm lease by refusing to advance the rent money to the borrower from the
CCC proceeds.\textsuperscript{152} Although this verdict was set aside by the trial judge, it
was reinstated by the Iowa Court of Appeals.\textsuperscript{153} The bank had apparently
argued that any interference was "justified" because the bank acted with the
intent of protecting its own interest and did not use improper means.\textsuperscript{154} The
court summarily rejected this defense stating that the jury reasonably could
have determined the bank did not employ proper means.\textsuperscript{155} Although the
court did not define what "improper means" were used by the bank, the
bank's apparent protection of its own interest, deemed satisfactory in Har-
sha and Farmers State Bank, was insufficient to justify its conduct here. We
must assume that there was evidence presented that the bank acted ma-
liously or in bad faith in setting off the deposits, although the court did not
discuss any improper motive by the bank.

The plaintiffs were also successful in their intentional interference claim
in Knickerbocker v. First National Bank,\textsuperscript{156} an Iowa case tried in federal
court and subsequently appealed to the Eighth Circuit. In that case, the
Knickerbockers were severely in debt to the First National Bank and several
other creditors as a result of their grain and hog operations.\textsuperscript{157} The Knicker-
bockers alleged that in the course of several meetings with the First Na-
tional Bank, the bank agreed to apply certain proceeds received from a grain

\textsuperscript{147} Farmers Coop. Elevator v. State Bank, 236 N.W.2d at 682; Harsha v. State Sav.
Bank, 346 N.W.2d at 800.

\textsuperscript{148} Peterson v. First Nat'l Bank, 392 N.W.2d 158 (Iowa Ct. App. 1986).

\textsuperscript{149} Id. at 160.

\textsuperscript{150} Id.

\textsuperscript{151} Id.

\textsuperscript{152} Id. at 160-61.

\textsuperscript{153} Id. at 168.

\textsuperscript{154} Id. at 167-68.

\textsuperscript{155} Id.

\textsuperscript{156} Knickerbocker v. First Nat'l Bank, 827 F.2d 281 (8th Cir. 1987).

\textsuperscript{157} Id. at 284.
elevator to satisfy the Knickerbockers' lease obligations to their landlords. The bank disputed the nature of this alleged agreement, and did not release the proceeds to the landlords, allegedly because of the bank's concern that it was uncertain as to which creditor had priority, and it did not want to have to pay twice. The failure to pay the landlords resulted in the cancellation of the leases, and allegedly resulted in the downfall of the Knickerbockers' business.

The jury found that the bank both breached its oral agreement to pay the landlords and interfered with the Knickerbockers' contractual relations with their landlords, and awarded more than three million dollars in damages to the Knickerbockers. The trial court, however, granted the bank's request for judgment notwithstanding the verdict, and with respect to the intentional interference claim, adopted the bank's argument that it failed to pay the landlords not because it intended to interfere with the leases, but because it was concerned about the priority of the creditors with respect to the proceeds. Subsequently, the Eighth Circuit reversed, reinstating the jury's verdict and indicating there was evidence against the bank that the jury could have viewed as "calculated steps designed to put the Knickerbockers out of business."

Interestingly, one of the crucial pieces of evidence used against the bank in Knickerbocker was an internal analysis by the bank indicating that it would reduce its loss by over $70,000 by foreclosing immediately on the Knickerbocker loan rather than by continuing to finance the Knickerbockers. This evidence was used to demonstrate the incentive and intent of the bank to destroy the Knickerbockers. It is certainly arguable, however, that given the bank's internal analysis, it was entirely permissible for the bank to openly acknowledge a course of action to foreclose upon the Knickerbockers rather than to continue financing. However, the court deferred to the jury's finding of fact.

The difficult issues in interference cases involve the situation in which a bank is pursuing a course of action in its own economic self-interest that it knows will result in the breach of certain contracts of the borrower. The cases all cite the same legal standards, but appear to come down on different sides of this question. In Knickerbocker, the bank's economic self-interest was viewed insufficient to justify conduct the bank knew would result in the breach of several of the borrower's contracts. This is a dangerous precedent.

158. Id. at 285.
159. Id. at 287.
160. Id. at 286.
161. Id. at 284.
162. Id. at 287.
163. Id. at 291.
164. Id. at 287.
165. Id. at 286.
166. Id.
for lenders. In sum, the crucial issue in most intentional interference cases, at least in the lender liability context, is whether the lender’s action is “justified.” The cases are not clear at this point regarding what constitutes justification, and in particular, whether actions taken in the lender’s economic self-interest will be “justified.”

E. Economic Duress/Undue Influence

A less frequent claim that may arise against a lender is economic duress against a borrower. Duress may be a concern where the lender exercises significant control over the business operations of the borrower. Economic duress or business compulsion exists where one party, with no legal right to do so, causes another to take a particular course of action through improper threats concerning economic or business interests. Duress is most often used defensively as a basis for invalidating a contract. In some states, however, it has been used affirmatively as the basis for a restitutionary remedy.

A good example of economic duress in the lender liability context arose in the Texas case of State National Bank v. Farah Manufacturing Co. In that case, the lender of Farah Manufacturing Company had a “management change clause” in the loan agreement whereby the lender had the right to declare the loan in default if the borrowing company elected a new chief executive officer. Shortly after the loan was funded, William Farah sought to become elected chief executive officer of the company. The lender threatened to declare a default that would bankrupt the company if Farah were elected and thereby prevented Farah’s election. The lenders installed their own choice of officers and directors, and the company subsequently suffered large financial losses under this management. The company then filed suit against the lender, and was successful in its claim that the lender exercised economic duress in having management elected, enti-

167. See generally 25 AM. JUR. 2d Duress and Undue Influence §§ 6-7 (1966); see also Restatement (Second) of Contracts §§ 175, 176 (1981).


171. Id. at 667.

172. Id.

173. Id. at 668.

174. Id.
tling the borrower to restitution.175 While the actions of the lender were cer-
tainly heavy-handed, it had only threatened to do something (declare a de-
fault upon a change in management) that it had a right to do under the loan
agreement.176 The court acknowledged this fact, but nonetheless held that
the threatened use of the management change clause was coercive.177

While Iowa law recognizes the doctrine of economic duress/business
compulsion,178 there do not appear to be any reported lender liability cases
involving the offensive use of this theory as a tort. Lenders should not take
too much comfort in this absence of precedent, and would be well advised to
avoid threats or other "heavy-handed" acts that may lay the foundation for
a borrower's claim of economic duress. Nonetheless, the offensive use of du-
ress seems to be an aberration, and it is likely that Iowa will continue to use
duress solely as a defense to a contract claim.

A lender may also face problems if it exercises undue influence over a
borrower.179 In Peoples Bank & Trust Co. v. Lala180 the Iowa Court of Ap-
peals considered the doctrine of undue influence as a defense to a contract.
The borrowers in that case alleged that the notes and mortgage that they
signed were invalid because they were obtained by undue influence and
overreaching by the bank officer.181 The court observed that generally, to
constitute undue influence, there must be such persuasion that results in
overpowering the will of a person or prevents him from acting voluntarily.182
Significantly, however, the court observed that this standard is much differ-
ent where a fiduciary or confidential relationship exists between the lender
and the borrower.183 In this case, the transaction will presumptively be
deemed invalid:

Where a confidential relationship exists between the parties, however,
the burden of proof shifts to the party seeking to uphold the validity of
the transaction to establish by clear and convincing evidence the transac-
tion was entered into voluntarily. The party seeking to uphold the trans-
action is required to prove entire good faith on its part and free, volun-

175. Id. at 686.
176. Id.
177. Id.
179. Undue influence involves unfair persuasion, a milder form of pressure than du-
ress. Such persuasion nevertheless makes the contract voidable if it is exercised on a
party who is under the domination of the person exercising it or is, by virtue of his
relation with that person, justified in assuming that this person will not act in a man-
ner inconsistent with his welfare.

181. Id. at 184-85.
182. Id. at 185 (quoting Harrison v. City Nat'l Bank, 210 F. Supp. 362, 373 (S.D. Iowa
1962)).
183. Id.
tary and intelligent action by the other party to the transaction. The $100,000 note and mortgage were invalidated in Lala for failure to satisfy this high standard. Accordingly, lenders should be aware of the concern that undue influence not be exercised over borrowers, particularly where there is a fiduciary or confidential relationship between the lender and borrower.

III. Good Faith: A Bridge Between Contract and Tort?

A. Good Faith Under the Uniform Commercial Code

Perhaps one of the most publicized aspects of the developing law of lender liability is the emerging concept of the lack of good faith as a basis for liability either in contract or tort. The concept of good faith, itself, is hardly a radical idea. Most jurisdictions, including Iowa, have recognized under common law principles an implied obligation of good faith in every contract. The Restatement (Second) of Contracts has also embraced the notion of an implied good faith obligation. The Uniform Commercial Code imposes a general obligation of good faith, stating that “every contract or duty within this chapter imposes an obligation of good faith in its performance or enforcement.” Good faith is defined in the Uniform Commercial Code as “honesty in fact,” a subjective standard. The Restatement (Second) of Contracts fails to define good faith, but does define, or at least categorize, bad faith:

A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to spec-

184. Id. (citations omitted).
185. As previously discussed, the note and mortgage were also invalidated due to the banker’s failure to make adequate disclosure concerning the homestead exemption. See supra notes 48-54 and accompanying text.
188. See Restatement (Second) of Contracts § 205 (1979).
190. U.C.C. § 1-201 (1987); see also IOWA CODE § 554.1-201 (1989).
ify terms and interference with or failure to cooperate in the other party's performance.191

While the concept of good faith is not new, what is new is the degree to which it is being applied to the lender-borrower relationship.

A frequent battleground in lender liability cases has been the application of good faith principles to the lender's decision whether to fund a borrower's requested advance pursuant to a line of credit. It had previously been held that a line of credit did not obligate the lender to fund each request made by the borrower within the credit limit unless the lender was specifically obligated to do so in the agreement.192 In a seminal lender liability decision from the Sixth Circuit Court of Appeals, K.M.C. v. Irving Trust Co.,193 a grocery wholesaler, K.M.C., and a commercial lender, Irving Trust, entered into a financing agreement in which Irving Trust had the discretion to advance K.M.C. up to $3,500,000 pursuant to a line of credit.194 The money loaned was payable on demand and was secured by K.M.C.'s inventory and accounts receivable.195 About three years after the loan was funded, Irving Trust suddenly refused to advance $800,000 to K.M.C. despite the fact that this loan would not have exceeded the line of credit.196 As a result, K.M.C.'s business collapsed. The jury found that Irving Trust had breached its contract by engaging in bad faith conduct and awarded K.M.C. $7.5 million in damages.197 The Sixth Circuit affirmed, noting that while the financing agreement gave Irving Trust the discretion to advance funds, the arrangement left "K.M.C.'s continued existence entirely at the whim or mercy of Irving, absent an obligation of good faith performance."198 The court determined that the bank's refusal to advance funds without prior notice was arbitrary and capricious and was not made in good faith.199 Several other courts have followed K.M.C.'s lead in applying a good faith obligation to a lender's decision whether to advance funds under a line of credit.200 No re-

192. See, e.g., Midatlantic Nat'l Bank v. Commonwealth Gen., 386 So. 2d 31, 33 (Fla. Dist. Ct. App. 1980) (a line of credit "does not impart upon the bank the legal responsibility to loan up to the limit . . . but merely facilitates the easier extension of credit.").
194. Id. at 754.
195. Id.
196. Id.
197. Id. at 755.
198. Id. at 759. In reaching this conclusion, the court was further influenced by the fact that all of K.M.C.'s receipts were placed in a "blocked account" to which Irving Trust had sole access. Thus, as a practical matter, if Irving Trust refused to advance funds and K.M.C. could not obtain alternative financing, K.M.C. would be left without operating capital until it paid down its loan. Id.
199. Id. at 763.
ported Iowa decision has specifically addressed the question of whether a lender’s refusal to advance funds under a discretionary line of credit must be made in good faith, however, K.M.C. would be strong persuasive authority.

Good faith principles are frequently applied to analyze the termination of credit to a borrower when the borrower is in default or having financial difficulty. In a number of decisions from various jurisdictions, the courts have imposed upon lenders an obligation of good faith and fair dealing in terminating the lending relationship. Certainly this is an issue of interest to Iowa attorneys representing either lenders or borrowers who may have suffered difficulties as a result of the declining farm economy.

An interesting case from Massachusetts, *In re Martin Specialty Vehicles, Inc.*, involved a lender that moved too quickly in terminating its relationship with a borrower. In that case, the bank was concerned about the reputed organized crime connections of one of the principal stockholders of the borrower. A bank representative appeared one day at the borrower’s factory, foreclosed on the collateral, and padlocked the building. The court found that there had been no default by the borrower, that the bank had acted in violation of the “good faith” obligation of *U.C.C.* section 1-203, and assessed damages at $713,905. The bank acted hastily in this case, providing a good example of one commentator’s “commandment” to lenders that “thou shalt not make a sudden move.” Nonetheless, it is interesting to note that if a lender does nothing in the face of knowledge of fraud or other violations of law by its borrower, it risks being held liable for “aiding and abetting” a fraud. Thus, when lenders suspect or have knowledge of illegal activities by their borrowers, they must tread a very narrow line between acting in bad faith (if the lender decides to terminate the relationship or to turn the borrower in to legal authorities) and aiding and abetting a fraud (if the lender decides to do nothing).

There is one Iowa Supreme Court decision, *Farmers Cooperative Elevator, Inc. v. State Bank*, that addresses a lender’s liability for termination of credit to a borrower. In *Farmers Cooperative*, the grain elevator already owed the bank $272,000 and the elevator’s officers told the bank they needed an additional $50,000 within the next two weeks. The bank knew that the elevator had been losing money in the most recent fiscal year.

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202. Id. at 250-56.
204. Id. at 757.
205. Id. at 766-68.
206. Id. at 759.
208. Id. at 675.
209. Id.
Then, when the elevator closed suddenly for two business days, the bank accelerated the debt pursuant to an insecurity clause, and set off the elevator’s notes against the elevator’s checking account balance. The grain elevator then brought an action against the bank for wrongfully terminating its credit by setting off its checking account balance and dishonoring its checks. Under U.C.C. section 1-208, a term allowing a party to accelerate payment upon deeming itself insecure is construed to mean that the party shall have the power to do so only if that party believes in good faith that the prospect of repayment or performance is impaired. Thus, the issue was whether the bank had a good faith belief that the prospect of payment was impaired when it accelerated the debt and set off the notes against the borrower’s checking account. The Iowa Supreme Court agreed with the majority of jurisdictions in holding that the test of good faith under the Uniform Commercial Code is a wholly subjective one of honesty. The court found that the elevator had not proved “that the bank’s concern about the security of its loans, whether or not reasonable, was not genuine or that the bank had an ulterior motive.” Accordingly, the Iowa Supreme Court affirmed the trial court’s judgment notwithstanding the verdict, which had set aside the jury’s award of both compensatory and punitive damages against the bank.

Another case arising in Iowa, Jensen v. State Bank, also addressed the issue of a bank’s acceleration of a debt in good faith under U.C.C. section 1-208. In Jensen, the bank was clearly given considerable discretion

210. The insecurity clause made the following an event of default: “The Secured Party deems itself insecure for any reason whatsoever.” Id. at 677.
211. Id. at 676.
212. Id. at 677.
213. U.C.C. § 1-208 (1987); see also IOWA CODE § 554.1208 (1989).
214. Section 1-208 of the Uniform Commercial Code contains a specific good faith requirement for the acceleration of debt:

A term providing that one party or that party’s successor in interest may accelerate payment or performance or require collateral or additional collateral “at will” or “when the party deems itself insecure” or in words of similar import shall be construed to mean that the party shall have power to do so only if that party 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.

U.C.C. § 1-208 (1987); see also IOWA CODE § 554.1208 (1989).
216. Id.
217. Id.
218. Id. at 682.
in its decision whether to accelerate the debt. The court observed that the "bank's judgment in deeming itself insecure" was "clearly open to question, and its heavy-handed treatment of its customer without prior notification is cause for dismay," it nonetheless upheld the district court's finding that the bank acted in good faith. Because Jensen was decided by a federal court prior to any Iowa authority on the subject, it is doubtful whether it has much precedential value.

Under the subjective standard of good faith set forth in Farmers Cooperative, the reasonableness of the lender's action will not be examined; the only question is whether the lender has an honest concern about the prospect of repayment. While the subjective standard was easy to follow in Farmers Cooperative, in which the bank's action was not only honest, but also was no doubt objectively reasonable, the true test of whether the subjective standard will be followed in Iowa will come in a case in which a lender, honestly concerned about repayment, takes an action (such as acceleration of a loan) that is objectively unreasonable. The K.M.C. decision clearly set forth an objective standard of good faith, that is, whether the lender acted reasonably, and other authorities have suggested that there must be some objective component. Thus, while lenders may take temporary refuge in the knowledge that the Iowa courts have professed not to judge their conduct against an objectively reasonable standard of good faith, the final chapter may not have yet been written on this issue.

While Farmers Cooperative applied the good faith requirement of U.C.C. section 1-208 to the acceleration of a debt not yet due, one open issue in Iowa and elsewhere is whether U.C.C. section 1-208 or other good faith principles apply to a lender's request for payment on a note payable "on demand." The K.M.C. court held that the lender's discretion to demand repayment pursuant to such a provision is limited by an obligation of good faith. The demand provision, the court said, "is a kind of acceleration clause, upon which the Uniform Commercial Code and the courts have imposed limitations of reasonableness and fairness." Some other courts, however, have held that the good faith requirement does not apply to a loan payable on demand. The K.M.C. decision appears to be in direct conflict with the official comment to U.C.C. section 1-208, which provides:

222. Id.
223. Id.
224. K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 761 (6th Cir. 1985); see also Reid v. Key Bank of Southern Maine, Inc., 821 F.2d 9, 14 (1st Cir. 1987); Black v. Peoples Bank & Trust, 437 So. 2d 26, 29 (Miss. 1983).
226. K.M.C. Co. v. Irving Trust Co., 757 F.2d at 760.
Obviously this section [limiting the exercise of acceleration clauses to those made in good faith] has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an agreement or to paper which in the first instance is payable at a future date.228

The Iowa courts have not yet faced the issue of whether a good faith requirement applies to an instrument payable on demand. While it would appear from the official comment to section 1-208 that lenders should be free to demand repayment at any time, cautious lenders should be aware of this issue and would be well advised to provide advance notice to the borrower before demanding repayment.

B. Tortious Breach of Implied Covenant of Good Faith and Fair Dealing

In addition to the covenant of good faith and fair dealing under the Uniform Commercial Code, there may be a common law duty to act in good faith in performance of a contract.229 A breach of either the Uniform Commercial Code or common law duty to act in good faith gives rise to an action against the breaching party under general contract principles. Courts in some jurisdictions have begun to extend the good faith obligation to give rise to an action under tort principles for breach of the obligation of good faith.230 The advantage to a borrower in casting the "bad faith" cause of action in principles of tort, rather than contract, is the easier availability of punitive damages as well as damages for mental or emotional distress.231 In addition, damages for lost profits may be easier to obtain in tort because of the restriction under contract law that damages be reasonably foreseeable.232

228. U.C.C. § 1-208 comment (1987); see also Iowa Code Ann. § 554.1208 official comment (West 1967).
229. See supra note 186.
231. Punitive damages are normally not available in Iowa for breach of contract, unless the conduct also constitutes an independent tort. Higgins v. Blue Cross, 319 N.W.2d 232, 235 (Iowa 1982) (citing Pogge v. Fullerton Lumber Co., 277 N.W.2d 916, 920 (Iowa 1979)). Damages for mental anguish incident to a breach of contract are not ordinarily recoverable unless the breach accompanies a bodily injury or when the breach is of such a kind that serious emotional disturbance is a particularly likely result of breach. Bossuyt v. Osage Farmers Nat'l Bank, 360 N.W.2d 769 (Iowa 1985) (quoting Restatement (Second) of Torts § 353 comment a (1981)) (refusal of bank to honor its cashier's check not the sort of breach of contract likely to lead to emotional disturbance).
232. See R.E.T. Corp. v. Frank Paxton Co., 329 N.W.2d 416 (Iowa 1983) (distinction between contract and negligence theories of recovery is that damages not even anticipated are
The concept of a tortious breach of a covenant of good faith developed first in the context of bad faith actions against insurers and has gradually been applied to other relationships. California and Montana have been the leaders in developing the law of good faith under tort principles. At the time of writing this article, the tortious breach of the implied covenant of good faith already seems to have had its rise and fall in California. In Montana, meanwhile, the tort action for lack of good faith appears to be alive and well.

California applied the good faith principle in a banking context in *Commercial Cotton Co. v. United California Bank*. In *Commercial Cotton*, the bank negligently debited a customer's bank account in payment of a $4,000 check containing unauthorized signatures. After the customer discovered the error, the bank raised allegedly spurious defenses to refunding the money. The customer sued and recovered $4,000 in compensatory damages and $100,000 in punitive damages for the bank's breach of the implied covenant of good faith and fair dealing. The appellate court affirmed, observing that “banking and insurance have much in common, both being highly regulated industries performing vital public services” affecting the public welfare. The court further noted that “the relationship of bank to depositor is at least quasi-fiduciary” and depositors reasonably expect a bank not to raise spurious defenses after it negligently disburses entrusted funds.

In a later case, *Barrett v. Bank of America*, a California appeals court similarly characterized the relationship between a bank and a loan customer. The issue in *Barrett* was whether the trial court should have given a jury instruction on constructive fraud. The court observed that “[c]onstructive fraud usually arises from a breach of duty where a relation of trust and confidence exists,” and further stated that the “relationship of recoverable in tort, while only those damages as were reasonably contemplated by parties at time of entering into agreement are recoverable in contract).

235. See supra note 148.
237. Id. at 514, 209 Cal. Rptr. at 553.
238. Id.
239. Id. at 513, 209 Cal. Rptr. at 552. The jury also awarded $20,000 for emotional distress but that award was reversed. Id. at 517, 209 Cal. Rptr. at 555.
240. Id. at 516, 209 Cal. Rptr. at 554.
241. Id.
243. Id. at 1368, 229 Cal. Rptr. at 20.
bank to depositor is at least quasi-fiduciary.”244 Interestingly, the Barrett court then cited, among others, the Iowa case of First National Bank v. Brown245 for the proposition that “a similar relationship of trust and confidence exists between a bank and its loan customers.”246

A recent California Supreme Court decision, Foley v. Interactive Data Corp.,247 appears to reverse the course for the development of the tort of breach of the implied covenant of good faith and fair dealing.248 The court refused to extend the doctrine beyond insurance cases to a case involving wrongful termination of employment.249 Commentators have suggested that Foley will have a significant impact on lender liability cases, both in California, where many lender liability claims contain a count for breach of the implied covenant of good faith and fair dealing, and in other jurisdictions where the state courts are struggling with the issue of whether borrowers are entitled to sue for tort and punitive damages on breach of good faith and fair dealing claims.250

In another recent decision from California, Mitsui Manufacturers Bank v. Superior Court,251 an intermediate appellate court held that the Foley decision precluded claims for tort damages for breach of the good faith covenant “in an ordinary commercial context where a lender refuses to honor an oral commitment to extend a loan.”252 In Mitsui Manufacturers Bank, the court characterized the contract between the parties as a “quintessentially ordinary arms-length commercial transaction between two parties of equal bargaining strength.”253 The court observed that Foley impliedly limited the ability to recover tort damages in breach of contract situations to those where the respective positions of the contracting parties have fiduciary characteristics.254 Thus, it appears that tort damages for breach of the implied covenant of good faith will not be available in California in most cases, but may still be available where there is a fiduciary relationship.

Tortious breach of the implied covenant of good faith and fair dealing is receiving a better reception in Montana.255 In the leading Montana case on

244. Id.
248. Id. at 654, 765 P.2d at 373, 254 Cal. Rptr. at 211.
249. Id. at 683, 765 P.2d at 389, 254 Cal. Rptr. at 227.
250. California High Court Refuses to Extend Right to Tort Damages Beyond Insurance, 52 BANKING REP. (BNA) 129 (Jan. 16, 1989).
252. Id. at 730, 260 Cal. Rptr. at 795.
253. Id. at 731, 260 Cal. Rptr. at 796.
254. Id.
this issue, First National Bank v. Twombley,\textsuperscript{256} the borrower signed a promissory note requiring repayment in a single lump-sum.\textsuperscript{257} When the borrower began to encounter financial difficulties, shortly prior to the due date of the note, he arranged with his loan officer to have the note converted into an installment note.\textsuperscript{258} Although the loan officer was to be out of town on the date scheduled for the loan conversion, he advised that another bank officer would handle the conversion.\textsuperscript{259} The other officer, however, said he had no knowledge of the proposed conversion and had determined that the loan was in jeopardy, demanded that the borrower pay off the note immediately, pursuant to an acceleration clause, even though the note was not due for another two weeks.\textsuperscript{260} The banker offset the loan balance against the borrower's checking account and then failed to notify the borrower of this fact, resulting in the return of several of the borrower's checks for insufficient funds.\textsuperscript{261}

The Montana Supreme Court held that where the duty to exercise good faith is imposed by law (as in this case by the duty of good faith imposed by the U.C.C.), rather than the contract itself, the breach of that duty is tortious.\textsuperscript{262} The court further held that because the bank had acted in reckless disregard of the borrowers' rights, the borrowers were entitled to punitive damages.\textsuperscript{263}

No Iowa appellate court has addressed the issue of whether there is relief under tort principles for a lender's breach of an implied covenant of good faith and fair dealing. In Dolan v. AID Insurance Co.,\textsuperscript{264} the Iowa Supreme Court recognized a cause of action in tort against an insurance carrier for bad faith conduct relating to a claim made by its insured.\textsuperscript{265} The court said it was convinced that traditional damages for breach of contract would not always adequately compensate an insured for an insurer's bad faith conduct.\textsuperscript{266} The Iowa Supreme Court's decision allowing such an action in insurance cases was narrowly crafted, however, and did not appear to suggest that the court was inclined to expand the doctrine to other contexts, such as employment or lender liability cases. The good faith and fair dealing area is clearly an area that will likely be further developed in the next several years, as more courts address this issue.

\textsuperscript{257} Id. at 67, 689 P.2d at 1227.
\textsuperscript{258} Id. at 69, 689 P.2d at 1228.
\textsuperscript{259} Id.
\textsuperscript{260} Id.
\textsuperscript{261} Id. at 70, 689 P.2d at 1229.
\textsuperscript{262} Id. at 72, 689 P.2d at 1230.
\textsuperscript{263} Id.
\textsuperscript{264} Dolan v. AID Ins. Co., 431 N.W.2d 790 (Iowa 1988).
\textsuperscript{265} Id.
\textsuperscript{266} Id. at 794.
IV. CONTRACT THEORIES OF LIABILITY

A. Court Decisions

Another major area of concern in lender liability cases is the alleged breach of contract by a lender. Frequently, the claim will relate to an alleged breach of a lender's oral commitment to loan money.\(^{267}\) Breach of contract cases may also arise out of a lender's alleged promise to renew financing,\(^ {268}\) or to extend the due date on a note.\(^{269}\) Lenders who believe that they are under no obligation to make a loan until the loan documents have been signed may be in for a surprise. If the bank and the borrower intend to make a deal, they may have a binding contract even though significant terms are left unresolved or undiscussed, particularly if those terms can be ascertained by prior conduct between the parties or by standard commercial practice.\(^{270}\) The Restatement (Second) of Contracts provides that the terms of the contract must only be "reasonably certain."\(^{271}\)

Several of the most prominent lender liability cases nationally have arisen out of a breach of contract.\(^{272}\) In a celebrated California case, a jury awarded $18.5 million in damages to a potential borrower where the lender orally agreed over dinner to loan $10 million on a real estate construction

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267. See, e.g., Penthouse Int'l, Ltd. v. Dominion Fed. Sav. & Loan Ass'n, 855 F.2d 963, 968 (2d Cir. 1988); Crystal Springs Trout Co. v. First State Bank, 225 Mont. 139, 736 P.2d 95 (Mont. 1987).


271. The Restatement (Second) of Contracts § 33 (1979) provides as follows with respect to indefiniteness of contracts:

§ 33. Certainty
(1) Even though a manifestation of intention is intended to be understood as an offer, it cannot be accepted so as to form a contract unless the terms of the contract are reasonably certain.
(2) The terms of a contract are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy.
(3) The fact that one or more terms of a proposed bargain are left open or uncertain may show that a manifestation of intention is not intended to be understood as an offer or as an acceptance.

Corbin on Contracts § 95 at 395 (1963), explains the issue as follows:

A court cannot enforce a contract unless it can determine what it is. It is not enough that the parties think that they have made a contract; they must have expressed their intention in a manner that is capable of understanding. It is not even enough that they have actually agreed, if their expressions, when interpreted in the light of accompanying factors and circumstances, are not such that the court can determine what the terms of that agreement are. Vagueness of expression, indefiniteness, and uncertainty as to any of the essential terms of an agreement have often been held to prevent the creation of an enforceable contract.

project and later reneged. Although the parties had not spelled out the details of the agreement, the jury award was affirmed.

In *Penthouse International, Ltd. v. Dominion Federal Savings & Loan Association*, a borrower obtained a $128 million judgment against a lender for its anticipatory repudiation of an agreement to participate in a loan for a hotel-casino project. The lender, Dominion Federal, was one of a group of institutions that agreed to lend a total of $97 million to Penthouse for the project. Three weeks before the loan commitment period expired, the lenders and the borrower held a preclosing meeting at which the lead bank presented draft loan documents. Counsel for Dominion stated that the draft documents, which were on preprinted legal forms, were "idiotic" and noted that there were several unsatisfied closing conditions. Dominion, which was to be a participant in the loans, indicated that unless the closing conditions were met and the documents overhauled, it would not proceed to fund the $35 million to which it had committed. After the preclosing meeting, Dominion continued to make numerous requests for information and demanded certain changes in the way the deal was to be structured. The district court stated that "[f]rom the date of the preclosing meeting on, [Dominion's attorney] became Dominion's hatchet man intent on destroying the deal." The court concluded that Dominion's conduct amounted to anticipatory repudiation of its loan commitment.

The Second Circuit reversed the district court's decision and remanded with instructions to enter judgment in favor of Dominion. First, the Second Circuit noted that several of the supposed new conditions required by Dominion were not asserted by Dominion until after the expiration of the loan commitment period, and were therefore not relevant to a determination of anticipatory repudiation. After the expiration of the loan commitment period, the court observed, Dominion had no further obligation to fund the loan. As to the actions of Dominion prior to the expiration of the loan commitment, including its conduct at the preclosing meeting, the court held

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274. *Id.* at 1371.
277. *Id.* at 303.
278. *Id.* at 307.
279. *Id.*
280. *Id.*
281. *Id.* at 309.
282. *Id.* at 308.
283. *Id.* at 310-11.
285. *Id.* at 975-76.
286. *Id.* at 976.
that Dominion had not made a "'clear and unequivocal declaration' that performance would not be forthcoming."\textsuperscript{287} Moreover, the court held that Dominion's insistence on overhauling the deal to meet the closing conditions was justified and did not constitute anticipatory repudiation.\textsuperscript{288} Finally, the court concluded that because Penthouse had failed to satisfy certain closing conditions prior to the expiration of the loan commitment period, it could not carry its burden to show that it was ready, willing, and able to perform its own contractual obligations, and thus could not recover on a claim for breach of contract in any event.\textsuperscript{289}

The \textit{Penthouse} decision has been hailed as a significant victory for lenders, representing a "return to emphasis on the written word over the acts and conduct . . . of the parties."\textsuperscript{290} Others, assessing the \textit{Penthouse} decision, have noted that "when you have sophisticated contracting parties, represented by able counsel in a very complex commercial transaction, they are going to have to live by the words of the documents they draft."\textsuperscript{291} Indeed, the \textit{Penthouse} decision should provide comfort to lenders who wish to strictly enforce the terms of a loan commitment, particularly larger commercial loans, in which written loan commitments and loan agreements are more common. It is interesting that the court in \textit{Penthouse} followed the terms of the loan commitment in finding that once the commitment had expired, without satisfaction of certain conditions, the lender had no further obligation to fund the loan. One could easily imagine a court imposing a "good faith" duty to allow the borrower extra time to satisfy the remaining closing conditions before terminating the obligation to fund a loan of this magnitude, on which the borrower had expended a great deal of time. Instead, the court followed the unambiguous language of the contract and found that when the borrower failed to meet specified conditions by a specified date, the lender owed no further duty to the borrower. \textit{Penthouse} is a reprieve to lenders in the Second Circuit, and it is likely that Iowa lenders, too, can in most circumstances insist upon strict compliance with loan documents. Nonetheless, all contracts are subject to the "good faith" standard, which means something different to each court, and insistence upon every contractual term may be "bad faith" in the eyes of a court.

Another recent case, \textit{Kruse v. Bank of America},\textsuperscript{292} involved a bank's denial to extend additional credit to a borrower's apple-farming business, which subsequently collapsed.\textsuperscript{293} The borrower sued Bank of America,
claiming that the bank deliberately reneged on its promise to provide financing to the borrower. A jury found the bank liable to the borrower on theories of fraud and bad faith denial of a contract and awarded the borrower compensatory and punitive damages in the aggregate amount of nearly $47 million. A California appellate court reversed the jury verdict on the ground that the borrower had no enforceable commitment from the bank to lend additional funds. The borrower asserted that the bank had committed to a long-term loan on the basis of, among other things, the bank's loan officer's comments on a visit to the construction site, recommendations to superiors, and credit reports. The appellate court found that these actions were merely preliminary negotiations and that the loan was "left open to future negotiations and agreement." The court found that the essential elements of a binding agreement were absent—"namely, the amount of the loan, the rate of interest, the terms of repayment, applicable loan fees and charges." At best, the borrower had an "expectation" that the loan would be made, but there was no binding contract, oral or written. The attorney for Bank of America indicated that banks do not guarantee their borrowers' solvency, and that "words of encouragement or favorable comments do not commit a bank to provide long-term financing to a borrower."

Many breach of contract cases in the lender liability area deal with whether a contract is sufficiently definite to be enforced. The Iowa courts have dealt with this issue somewhat more restrictively than courts in other jurisdictions, such as California. Generally, in order to be binding, the Iowa courts have said that an agreement must be "sufficiently definite and certain as to its terms to enable the court to give it an exact meaning." If the parties expressions, in light of the attendant circumstances, are not such that the court can determine the essential terms of the agreement, it does not matter whether the parties have reached any agreement.

Although it occurred outside the context of an agreement to lend money, the case of Gildea v. Kapenis is instructive in determining the

294. Id. at 52, 248 Cal. Rptr. at 224.
295. Id. at 44, 248 Cal. Rptr. at 219.
296. Id. at 60, 248 Cal. Rptr. at 230.
297. Id. at 58, 248 Cal. Rptr. at 229.
298. Id. at 59, 248 Cal. Rptr. at 229.
299. Id. at 60, 248 Cal. Rptr. at 230.
300. Id. at 59, 248 Cal. Rptr. at 229.
303. Id. at 459 (quoting 1 CORBIN, CONTRACTS § 95 at 394 (1963); RESTATEMENT (SECOND) OF CONTRACTS § 33 (1981) (terms of the contract must be "reasonably certain").
requisite definiteness of a contract under Iowa law. In Gildea, a purchase agreement for residential real estate stated that the agreement was "subject to buyer obtaining suitable financing at an interest rate no greater than 12-3/4%." The court held that a contract "generally reciting that performance of the contract is contingent upon the buyer securing suitable financing terms, with the only limitation being an interest rate ceiling, is too indefinite and uncertain for a meeting of the minds to have occurred regarding financing." This is a very restrictive interpretation of the necessary definiteness of a contract and would appear to render many contracts containing any significant contingencies unenforceable.

One reported Iowa decision has addressed the question of whether an oral commitment to loan money can be enforced. In Harsha v. State Savings Bank, the borrower brought an action against the bank and its president for failing to lend money to the borrower to operate a new livestock feed sales business. Apparently there was evidence that the bank orally agreed to lend the borrowers up to $25,000 on a long-term basis, to be guaranteed by the Small Business Administration ("SBA"). An SBA guarantee of $25,000 was obtained and the borrowers signed a note for that amount. After the bank had disbursed $15,000 pursuant to the note, it became dissatisfied with borrower's management for "running up large accounts receivables . . . and failing to collect accounts vigorously." The bank informed the SBA and the borrower that it would lend no more long-term money than the $15,000 already disbursed. The borrower then developed a serious cash-flow problem and eventually closed its business and filed for bankruptcy. The borrower later sued the bank for breach of its oral contract to lend money, tortious interference with prospective business relationships of the borrower, and intentional infliction of emotional distress on the borrower. The jury returned verdicts in favor of the borrower and against the bank on each of these counts.

The Iowa Supreme Court affirmed the borrower's award for breach of contract. The court held that the jury could have found that "the bank initially promised to [loan the borrower] $25,000 at interest, subject to SBA

305. Id. at 459.
306. Id. at 458.
307. Id. at 462.
309. Id. at 794.
310. Id.
311. Id.
312. Id.
313. Id.
314. Id. at 794-95.
315. Id. at 794.
316. Id.
317. Id. at 801.
approval which was obtained. The bank argued that before its promise to lend could be enforceable, consideration for the promise was essential: such as the borrower's return promise to borrow $25,000 at interest. The court stated that the record could not support a finding that the borrower expressly promised to borrow $25,000. The court determined, however, that the borrower's agreement to borrow the full $25,000 was not essential and that adequate consideration was given by the borrower when it gave the bank the $25,000 promissory note. The Iowa Supreme Court reversed the verdict in favor of the borrower on the tortious interference and emotional distress counts, stating that the claims should not have been submitted to the jury. As to the emotional distress claim, the court held that the bank's breach of its contract to loan the final $10,000 did not satisfy "the requisite standard of outrageousness which is necessary to create liability."

While the Iowa Supreme Court has indicated that an oral agreement must be sufficiently definite for the court to ascertain its essential terms, it has not spelled out the specific terms that must be agreed upon in an oral contract to lend money. The North Dakota Supreme Court in Union State Bank v. Woell, has recently tried to define the necessary standard of "definiteness" for an oral contract to lend:

Essential terms of an oral contract to continue lending money in the future include the amount and duration of the loans, interest rates, and where appropriate, the methods of repayment and collateral for the loans, if any . . . . Taken alone, the absence of any one of these terms may not be of great significance; however, viewed collectively, their absence is fatal to the existence of a binding contract.

In Union State Bank, the borrower failed to present evidence that "the Bank agreed to lend him in the future a specified amount of money over a specified period at a specified interest to be repaid under specified terms." The Iowa Supreme Court will likely consider factors similar to those considered by the North Dakota Supreme Court in determining whether there is an enforceable commitment to lend. It is unlikely, however, that a formulaic test will be developed in this area, and the determination of whether a contract has been found will depend upon all the attendant facts and circumstances. Lenders should not expect that the absence of a single factor, such as an agreement on the interest rate, will negate the existence of a contract.

318. Id. at 796.
319. Id.
320. Id.
321. Id.
322. Id. at 801.
323. Id.
324. See supra note 298 and accompanying text.
326. Id.
Analogizing to the Uniform Commercial Code, the court will likely supply certain missing terms, if at least some of the essential terms are present and the parties intend to be bound.327

Breach of contract claims may be asserted against lenders in a variety of circumstances other than an oral commitment to lend. Even if the parties have been careful about not making oral commitments and have instead documented their negotiations in writing, there may be a dispute as to whether the lender has agreed to loan funds to the borrower. A variety of written documents may be used in the course of loan negotiations, including loan proposal letters and letters of intent, which are generally not binding, and loan commitment letters, which generally are binding subject to the terms specified in the commitment letter. The distinctions here are not clear, however, and lenders may find out that what they intended as a non-binding letter of intent may constitute a binding commitment to lend.328

B. Statutory Restrictions on Contractual Liability

A number of states have adopted lender liability limitation statutes that either expressly bring loan agreements within the scope of the existing statute of frauds, or by separate statute, provide for similar treatment for loan agreements. By the end of 1989 twenty-five states had enacted such statutes.329 The primary motivating factor for states adopting such statutes is the spate of lender liability lawsuits concerning the alleged breach of an oral loan commitment, primarily in commercial and agricultural loans.

The Iowa Legislature passed a lender liability statute, 1990 Iowa Acts chapter 1176, which requires credit agreements be in writing to be enforceable.330 The new Iowa lender liability statute is effective for credit agreements or modifications to credit agreements entered into on or after January 1, 1991.331 The statute appears to be a well-drafted provision that hopefully will avoid some of the unintended results of the first lender liability statutes enacted in other states several years ago.332

328. See Sterling Faucet Co. v. First Mun. Leasing Corp., 716 F.2d 543 (8th Cir. 1983) (letter was a binding contract to loan money and not a mere invitation to negotiate a contract). But see Willowood Condominium Ass'n, Inc. v. HNC Realty Co., 531 F.2d 1249 (5th Cir. 1976) (letters not sufficiently detailed to constitute enforceable commitment).
330. 1990 Iowa Acts ch. 1176 (to be codified at Iowa Code § 535.17 (1991)).
331. Id.
332. See, Culhane & Gramlich, supra note 329, at 1780 (indicating, for example, that the early Colorado and Kansas statutes had the unintended effect of making it difficult for provid-
A task force of the Section of Business Law of the American Bar Association ("ABA") has recently addressed the issue of lender liability limitation statutes and amendments to state statutes of frauds.\textsuperscript{333} The task force believes that the goal in drafting such statutes is as follows:

[T]o protect the lender against claims raised by sophisticated borrowers who were or could have been represented by counsel and who could have had any agreements reduced to written form. At the same time, the state legislature must also be sensitive to the interests of less sophisticated borrowers who were not or could not have been represented by counsel and who may not, because of their lack of bargaining power, have been in a position to insist upon having their full agreements reduced to written form.\textsuperscript{334}

In the course of its survey of state legislative activity, the ABA task force identified several issues that state legislatures have considered in trying to accommodate these goals. The issues include:

(i) What types of agreements will be covered by the statute?
(ii) Will the statute apply both to an agreement and to any changes or modifications to that agreement?
   
   (iv) Will the statute apply equally to all lenders and to all borrowers?
   (v) What requirements must the written agreement satisfy before an action may be brought upon the agreement?
   
   (vii) Should the statute curtail common law means of avoiding a statute of frauds defense or alternative legal theories based upon the same facts which would be alleged to prove an oral agreement or modification of an existing agreement?\textsuperscript{335}

These issues will be the focus of this Article's discussion concerning Iowa's lender liability statute.

As to the nature of the agreements covered by the statute, Iowa has broadly defined the term "credit agreement" to include any contract made or acquired by a lender to loan money, finance any transaction, or otherwise extend credit for any purpose.\textsuperscript{336} Iowa has not restricted the statute, for example, to loan commitments.\textsuperscript{337} Also, it is not merely loans, but extensions of credit that are included. A credit agreement does not include certain credit card transactions, transactions involving a home equity line of credit,
or certain other consumer credit transactions. 338 In addition, there is an exclusion for any credit agreement made primarily for a personal, family, or household purpose when the credit extended is twenty thousand dollars ($20,000) or less. 339 Unlike some other states, Iowa has made the statute applicable to changes or modifications to the agreement. 340 However, in order for the Iowa statute to apply to modifications, the lender must notify the borrower of the requirement that the contract be in writing. 341

As to the requirement of a writing, the new Iowa statute provides that a credit agreement is not enforceable in contract law by way of action or defense by any party unless a writing exists which contains all of the material terms of the agreement and is signed by the party against whom enforcement is sought. 342 The requirements for modification of a credit agreement are similar. Such a modification of a credit agreement is not enforceable in contract law by way of action or defense by any party unless the modification is in a writing that contains the material terms of the modification and the modification is signed by the party against whom enforcement is sought. 343 However, prior to the alleged modification the party asserting the modification must have been notified in writing that oral or implied modifications to the credit agreement are unenforceable. 344 This notification can be included among the terms of a credit agreement, on a separate form, or together with other disclosures that are provided when the credit agreement is made. 345 Notification may also be given wholly apart from the credit agreement and at any time after the credit agreement has been made. 346 To be effective the notification and its language must be conspicuous. 347 A notification in the following form in bold face, ten point type, complies with the requirements of the statute:

IMPORTANT: READ BEFORE SIGNING. THE TERMS OF THIS AGREEMENT SHOULD BE READ CAREFULLY BECAUSE ONLY THOSE TERMS IN WRITING ARE ENFORCEABLE. NO OTHER TERMS OR ORAL PROMISES NOT CONTAINED IN THIS WRITTEN CONTRACT MAY BE LEGALLY ENFORCED. YOU MAY CHANGE THE TERMS OF THIS AGREEMENT ONLY BE ANOTHER WRITTEN

338. 1990 Iowa Acts ch. 1176 (to be codified at Iowa Code 535.17(5)(c) (1991)).
339. Id. (to be codified at Iowa Code § 535.17(5)(a) (1991)).
340. See Culhane & Garmich, supra note 329, at 1787 (noting that California, Georgia, Kansas, and North Dakota have all chosen not to have their statutes apply to modifications of the original agreement).
341. See infra text accompanying notes 344-47.
342. 1990 Iowa Acts ch. 1176 (to be codified at Iowa Code § 535.17 (1) (1991)).
343. Id. (to be codified at Iowa Code § 535.17(2) (1991)).
344. Id.
345. Id.
346. Id.
347. Id.
Another issue in lender liability statute interpretation is what parties are covered by the statute. The Iowa statute only applies to a contract made or acquired by a "lender." A "lender is defined as a "person primarily in the business of loaning money, or financing sales, leases, or other provision of property or services." This definition would certainly include most banks, savings and loans, and consumer finance companies, but would probably exclude insurance companies. While insurance companies frequently make loans, it is doubtful whether they are "primarily" in the business of loaning money. Certainly, there are other businesses and individuals as well that loan money on at least an occasional basis, but who are not primarily in the business of loaning money.

A final issue that lender liability statutes typically address is "the extent to which the statute will curtail the common law exceptions to a statute of frauds, such as part performance or promissory or equitable estoppel, or preclude the use of alternative legal theories based upon the same fact that would be alleged to prove an oral agreement." The Iowa statute provides that it entirely displaces principles of common law and equity that would make or recognize exceptions to or otherwise limit or dilute the force and effect of its provisions concerning the enforcement in contract law of credit agreements or modifications of credit agreements. Thus, common law exceptions to the statute of frauds, such as part performance or promissory estoppel, should not apply to the Iowa lender liability statute. The Iowa statute does not, however, prohibit a borrower from suing on alternative legal theories based on the same facts needed to prove a breach of an oral agreement. For example, instead of suing for breach of contract, a borrower may assert that a lender "negligently misrepresented" that a loan would be made. A claim based on such a negligent misrepresentation theory would not appear to be barred by the Iowa statute.

V. LIABILITY ARISING FROM "CONTROL" OF A BORROWER

Another important source of potential liability for lenders, either in contract, in tort, or for statutory violations, arises when there is a "controlling" relationship of a lender over its borrower. If the lender controls the affairs of its borrower to the extent that the borrower is an agent or instrumentality of the lender, the lender may be held liable for actions of the

348. Id. (to be codified at IOWA CODE § 535.17(3) (1991)).
349. Culhane & Gramlich, supra note 329, at 1788-89.
350. 1990 Iowa Acts ch. 1176 (to be codified at IOWA CODE § 535.17 (7) (1991)).
351. Id.
352. Culhane & Gramlich, supra note 329, at 1791.
353. 1990 Iowa Acts ch. 1176 (to be codified at IOWA CODE § 535.17(7) (1991)).
354. See supra text accompanying notes 114-130.
355. 1990 Iowa Acts ch 1176 (to be codified at IOWA CODE § 535.17(5)(e) (1991)).
borrower. Controlling creditors may also incur liability for the borrower's violations of federal securities laws or federal environmental laws. One of the leading national cases, Metge v. Baehler, discusses a lender's liability under a control theory for federal securities law violations of the borrower. A lender's control of a borrower may also result in equitable subordination in bankruptcy proceedings, a remedy whereby the claim of a dominant lender that used its control in an inequitable fashion is subordinated to the claims of other creditors. The focus here, however, will be on control liability arising out of common law agency principles.

In A. Gay Jenson Farms Co. v. Cargill, Inc., the Minnesota Supreme Court found that Cargill, a major grain dealer, exercised such control over a local grain elevator it was financing, that Cargill was liable on contracts entered into by the local grain elevator under a principal-agent theory. The court looked at various factors, including: Cargill's frequent recommendations to the elevator by telephone; the elevator's inability to enter into mortgages, purchase stock, or pay dividends without Cargill's approval; Cargill's right of entry onto the elevator's premises; Cargill's advice concerning the elevator's finances, inventory, and officers' salaries; Cargill's total financing of the elevator's grain purchases and operating expenses; and Cargill's ability to discontinue financing. The court looked at "all the circumstances surrounding Cargill's aggressive financing" of the elevator and concluded that the elevator was merely an agent of Cargill.

The Cargill case is worrisome because several of the factors considered

356. Both section 15 of the Securities Act of 1933, 15 U.S.C. § 770, and section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a), provide that controlling persons shall be held jointly and severally liable for securities violations committed by persons who they control. The SEC has defined control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405 (1986).


361. Id. at 290-92.

362. Id. at 291.

363. Id. at 291-92.
by the court to indicate the creditor's control are standard provisions in loan agreements. Nonetheless, the facts in Cargill, while perhaps not extreme, were at least more indicative of a control relationship than the usual debtor-creditor relationship. Moreover, Cargill is one of only a handful of cases finding a lender liable under the "instrumentality" theory and so, at this point, liability for exercising control over a debtor should not be a substantial risk for lenders, except in rare circumstances. Generally, a lender should not be liable under this theory unless it exercises "actual, participatory, total control of the debtor." A lender is more likely to be held liable under a control theory when in violation of the various federal statutes. The lender may be subjected to equitable subordination in bankruptcy.

VI. CONCLUSION

Lenders have increasingly become subject to various claims by borrowers that have loosely coalesced under the term "lender liability." While the legal underpinnings of these various claims may be different, there are some common elements. One attorney aptly supplied a working definition: "Taken together, lender liability claims are simply those that arise from a financial relationship which is, or becomes, or is perceived to be, one in which economic leverage is too one-sided and may have been abused." It should be expected that Iowa borrowers will continue to keep the economic power of their lenders in check by asserting various common law theories of liability such as have been discussed, or which are yet to emerge. Courts, for their part, should be cognizant of the fact that the lender and borrower are generally engaged in an arms-length commercial transaction; a relationship much different than that of attorney and client. While ordinary standards of commercial behavior may be expected, a lender should not generally be required to protect the borrower from the borrower's own problems. Lenders, finally, should be aware of the growing possibility that their conduct will later be examined in court, and should attempt to comport themselves so that any duty or standard of conduct that may be imposed upon them has been satisfied.

364. For example, restrictions on entering into mortgages, purchasing stock or paying dividends are common loan agreement provisions. The right of entry onto the borrower's premises for inspections and audits is also common.

