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THE ASSOCIATION OF COMMERCIAL FINANCE ATTORNEYS, INC.

October 17, 1994

A LEAD LENDER'S "FIDUCIARY DUTIES" TO A PARTICIPANT

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## A LEAD LENDER'S FIDUCIARY DUTIES TO A PARTICIPANT

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October 17, 1994

The relationship between a lead lender and a loan participant arises from, and is governed by, contract. Courts are reluctant to create any fiduciary duty out of this contractual relationship, although a few have done so. Even when they are unwilling to find a fiduciary obligation, however, courts may impose upon lead banks heightened duties of disclosure to potential participants.

### 1. The Existence of a Fiduciary Duty

Courts have split on whether a loan participation creates fiduciary duties owed by the lead to participants.

- a. Cases finding a fiduciary duty have done so based upon specific language in the participation agreement.
  - i. *Chemical Bank v. Security Pacific Nat'l Bank*, 20 F.3d 375 (9th Cir. 1994).

Security Pacific and two other banks entered into a credit agreement to provide the borrower \$25 million in credit. The agreement specified that Security Pacific would be the "agent" for the three banks. Security Pacific first advanced \$15 million and filed a UCC-1 listing itself as the secured party. The two participants later advanced their share of the loan, but Security Pacific did not file a new financing statement. When the borrower filed for bankruptcy, Security Pacific was treated as a secured creditor and made whole, while the other two banks were treated as unsecured.

The Ninth Circuit held "[t]hat Security Pacific owed a fiduciary duty to the [participants] is established by the credit agreement, . . . which unequivocally identifies Security Pacific as the *agent* bank. The very meaning of being an agent is assuming fiduciary duties to one's principal." *Id.* at 377 (emphasis added). The court also found that "[i]mpressed with a fiduciary duty, Security Pacific failed to carry it out. Beyond question, it breached its duty and its contract." *Id.* The case was remanded for a determination of whether language in the agreement limiting Security Pacific's liability to instances of "gross negligence or willful misconduct" exonerated the lead.

- ii. *Women's Federal S&L Ass'n v. Nevada Nat'l Bank*, 811 F.2d 1255 (9th Cir. 1987).

The loan participation agreement provided for the lead to sell a 90% participation interest in a loan to the participant, with the lead "to act 'as a trustee *with fiduciary duties*' to protect [the participant's] interests." *Id.* at 1258 (emphasis added). Rejecting the argument that this language did not impose any enforceable duties on the lead, the Ninth Circuit stated, "[w]e believe this suggestion flies in the face of the special concern common law courts have traditionally and consistently exhibited to supervise and enforce fiduciary relationships." *Id.*

- iii. *Manchester Bank v. Connecticut Bank & Trust Co.*, 497 F. Supp. 1304 (D.N.H. 1980).

The court refused to dismiss a participant's claim against the lead for breach of fiduciary duty, holding that the existence and breach of any fiduciary duty on the part of the lead is a question of fact. The court stated that a fiduciary relationship exists "wherever influence has been acquired or confidence has been reposed and betrayed." The court also noted the trend toward "liberalization of the concept [of fiduciary duty] for the purpose of preventing unjust enrichment." *Id.* at 1316.

- b. Numerous courts have held that absent express language in the participation agreement, a lead does *not* owe fiduciary duties to a participant.

- i. *Banco Espanol de Credito v. Security Pacific Nat'l Bank*, 763 F. Supp. 36 (S.D.N.Y. 1991), *aff'd*, 973 F.2d 51 (2d Cir. 1992), *cert. denied*, 113 S. Ct. 2992 (1993).

Participants sued the lead for, among other things, breach of fiduciary duty for failure to disclose negative information about the borrower to the participants. Significantly, no confidential information was involved, and the supposed negative information about the borrower was public. The district court ruled that "[i]n the case of arm's length transactions between large financial institutions, no fiduciary relationship exists unless one was created in the agreement." 763 F. Supp. at 45. Affirming, the Second Circuit held that "as an arms length transaction between sophisticated financial institutions, the law imposed no independent duty on [the lead] to disclose information that plaintiffs could have discovered through their own efforts." 973 F.2d at 56. *See also Aaron Ferer & Sons v. Chase Manhattan Bank*, 731 F.2d 112, 122 (2d Cir. 1984) ("[a] correspondent bank relationship, standing alone, does not create a [fiduciary] relationship").

- ii. *First Citizens Federal S&L Ass'n v. Worthen Bank & Trust Co.*, 919 F.2d 510 (9th Cir. 1990).

The participation agreement obligated the lead to "administer and service the loan in accordance with the same degree of care that [the lead] would exercise in the servicing and administering of a loan as its own account." *Id.* at 513. The Ninth Circuit held that this language created a "lower standard of care than that imposed on fiduciaries, who generally must exercise greater care in handling property with which they are entrusted than in handling their own." *Id.* The court explained:

Unlike the automatic, status-based fiduciary duty which exists, for example, between attorney and client, fiduciary duties among loan participants depend upon the terms their contract. . . .

In the context of loan participation agreements among sophisticated lending institutions, we are of the opinion that fiduciary relationships should not be inferred absent unequivocal contractual language. . . . Banks and savings institutions engaged in commercial transactions normally deal with one another at arm's length and not as fiduciaries. . . . This rule holds true for institutions engaged in loan participation agreements.

*Id.* at 513-14 (citations omitted).

- iii. *People's Heritage Sav. Bank v. Recoll Mgmt.*, 814 F. Supp. 159 (D. Me. 1993).

In this action by a participant against the lead for mismanagement of a loan for the construction of townhouses in Maine, the participant alleged that the lead's failure to perform its duties as stated in the participation agreement constituted a breach of fiduciary duty. The district court dismissed this claim because the participant failed to allege specific facts showing that the relationship "went beyond the ordinary originating bank/participant situation." *Id.* at 170. In particular, the lead's contractual obligation to perform certain duties regarding servicing and collecting on the loan did not invest "trust and confidence" in the lead, and there was no "disparity of position" between the lead and the participant.

- iv. Other courts have dismissed participants' claims against leads for breach of fiduciary duty, although without specifically holding that no such duty exists as a matter of law. *E.g., In re Continental Resources Corp.*, 799 F.2d 622 (10th Cir. 1986) (specific terms of

participation agreement qualified whatever fiduciary duty might exist); *Carondelet S&L Ass'n v. Citizen S&L Ass'n*, 604 F.2d 464 (7th Cir. 1979) (no breach of fiduciary duty because lead exercised reasonable and prudent care).

## 2. The Existence of a Duty of Disclosure

Although courts are unwilling to imply a fiduciary duty on the part of the lead, some courts have held that leads do owe participants a heightened duty of disclosure. This duty may arise where (1) the lead has access to superior information about the borrower, (2) that information is not readily available to the participant, and (3) the lead knows the participant is acting on the basis of mistaken information. In such circumstances, even waivers in the participation agreement itself may not relieve the lead from breach of its duty of disclosure.

### a. Cases finding breach of a duty of disclosure.

- i. *Banque Arabe et Internationale D'Investissement v. Maryland Nat'l Bank*, 819 F. Supp. 1282 (S.D.N.Y. 1993) (decision on summary judgment) ("*Banque Arabe I*"); 850 F. Supp. 1199 (S.D.N.Y. 1994) (decision after trial) ("*Banque Arabe II*").

- (1) **Facts.** The lead lender, Maryland National Bank ("MNB") originated a \$35 million package of loans to real estate partnerships controlled by a New York City developer, Robert K. Marceca. The borrowers were to convert apartment buildings to co-ops and use the proceeds from the co-op sales to pay back the loan. MNB solicited BAII Banking Corp. ("BAII") to purchase a \$10 million participation interest in the loan. BAII conducted due diligence (including meeting with Marceca), and, in July 1988, committed to purchase a \$10 million participation, provided the underlying loan documents were modified to provide a form of cross-collateralization.

While these cross-collateralization documents were being prepared, the New York Department of Law raised serious concerns about the adequacy of disclosures in the offering plans for the properties, particularly with respect to MNB's role, which was not disclosed. The effect of the Department of Law's concerns was to delay the projected paydown of the loan for at least several months, rendering the paydown schedules MNB had provided to BAII inaccurate and raising questions about Marceca's character and capacity to complete the conversion process. MNB learned of this "co-sponsorship issue" from Marceca as soon as it arose in August

1988, but failed to inform BAI of this issue before BAI funded its participation in October 1988. When Marceca defaulted, BAI's parent, to whom the participation had been assigned, sued MNB for rescission for fraud and deceit.

- (2) ***Banque Arabe I.*** The district court refused to dismiss BAI's fraud claim on summary judgment. The court held that a duty to disclose exists under New York law "where one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge." 819 F. Supp. at 1290, (citing *Brass v. American Film Technologies, Inc.*, 987 F.2d 142 (2d Cir. 1993)). The court found that knowledge of the co-sponsorship issue and the attendant delays was not readily available to BAI because the Department of Law does not comment publicly upon matters it is investigating, and industry custom and practice precluded BAI from direct access to Marceca. Acknowledging that BAI could have been more aggressive in seeking information about the status of the properties, the court nevertheless held that the existence of the co-sponsorship issue, although "present," was not "manifest," and BAI was not required to engage in a "60 Minutes style investigation of the status of the necessary Department of Law approvals." *Id.* at 1291.

The court also held that disclaimers in the participation agreement that BAI had conducted an independent credit analysis and based its decision to purchase the participation on its own analysis and "without reliance on MNB" did not bar BAI's fraud claim. Under New York law, "even an express disclaimer will not be given effect where the facts are peculiarly within the knowledge of the party invoking it." *Id.* at 1292.

- (3) ***Banque Arabe II.*** Following a six-day bench trial in November, 1993, the district court entered judgment for MNB. The court re-affirmed that MNB "clearly" had a duty to disclose the existence of the "co-sponsorship issue," because this information was "peculiarly within MNB's knowledge." However, MNB had no duty to disclose that the paydown projections were no longer accurate, because BAI could have discovered from the Department of Law that the offering plan had not been approved, even if the reason for the delay was confidential. The court also found the "co-sponsorship issue" material to BAI's decision to fund the participation, because it implicated the question of Marceca's

creditworthiness, and the delay in approval made it less likely Marceca could repay the loan. However, the delay in the paydown schedules was not material, because bankers from both sides testified they were simply "estimates." *Id.* at 1218-19. The court also found that BAII would have relied upon the information had it been disclosed, and that MNB's failure to disclose caused BAII to enter into the transaction and suffer a loss.

Nevertheless, the court entered judgment for MNB on the ground BAII failed to prove that MNB had acted with scienter. The court found that MNB's loan officer believed the issue was "a minor impediment" that would be resolved shortly. His failure to inform BAII was an "error of judgment," but did not rise to the level of recklessness or intent necessary under New York law to obtain rescission, as well as damages. *Id.* at 1225. The case is on appeal.

- ii. *First Federal Savings & Loan Ass'n v. Twin City Savings Bank*, 868 F.2d 725 (5th Cir. 1989).

The participant sought rescission and damages under Louisiana law for misrepresentations by the lead during the sales process. The district court had found that although the lead had made material misrepresentations regarding a condominium project construction loan, the participant's own negligence in failing to detect the lead's fraud barred the claim. The Fifth Circuit reversed, reasoning that under Louisiana law then in effect (but subsequently modified), a defrauded party's negligence may deprive that party of a rescission remedy, but did not preclude damages. The case was remanded for a determination of whether the participant's actions gave rise to defenses of laches and/or ratification.

- b. Cases Finding No Breach of a Duty of Disclosure

- i. *Union Nat'l Bank of Little Rock v. Farmers Bank*, 786 F.2d 881 (8th Cir. 1986).

The participant, Union Bank, alleged that the lead, Farmers Bank, committed fraud by failing to disclose material information. Originally, Farmers Bank had sold Union Bank a \$70,000 participation in a loan to Tucker Oil. At the initial meeting between the banks' officers, the lead's president gave the participant the most recent financial information on Tucker Oil. After reading the information, the participant decided to purchase the participation.

Within months, Tucker Oil's status had deteriorated, and Tucker Oil filed for bankruptcy. The participant demanded that the lead repurchase the loan. When the lead refused, the participant filed suit, alleging that the lead had an affirmative duty to reveal certain information about Tucker.

After trial, the district court granted judgment for the lead. The Eighth Circuit affirmed the trial court's decision and held that no special relationship existed between the banks; therefore, the lead had no duty to disclose information other than what it did disclose. The court reasoned that the banks entered into an arm's-length transaction and that the participant was to blame because it did not seek out available information.

- ii. *Banco Totta e Acores v. Fleet Nat'l Bank*, 768 F. Supp. 943 (D.R.I. 1991).

The participant, Banco Totta e Acores ("BTA") attempted to rescind its participation agreement with the lead, Fleet National Bank ("Fleet") for alleged misrepresentations by Fleet about the loan. Specifically, BTA claimed that Fleet knew the borrower, a nursing home operator, was under investigation for Medicare fraud and failed to disclose this fact to BTA before BTA purchased its participation, or, even if Fleet did not know about the investigation, BTA justifiably relied upon Fleet's credit assessment of the borrower and suffered pecuniary loss. The investigation allegedly was reported in a Florida newspaper before BTA funded its participation. The court dismissed BTA's claims on the grounds that the disclaimer clause in the participation agreement, in which BTA represented that it made its decision to purchase the participation based solely on its own independent credit evaluation of the loan, rendered "legally irrelevant all misrepresentations" Fleet made to BTA before the agreement was signed. *Id.* at 949.

\* \* \* \* \*

In sum, courts view the relationship between a lead and a participant as one of arm's length, with no disparity of bargaining power. Absent express language in the participation agreement itself creating a fiduciary duty, courts will not hold lead banks to the standards of a fiduciary. Nevertheless, courts have recognized that lead banks have greater access to information than participants, and may hold the lead liable for failure to disclose material, non-public information during the sales process, if the lead had superior access to the information, the participant could not readily have discovered the information, and the lead knew that the participant was acting on the basis of mistaken knowledge. Language in the participation agreement disavowing the participant's reliance on the lead may not relieve the lead from this duty of disclosure.

THE ASSOCIATION OF COMMERCIAL FINANCE ATTORNEYS  
PRESENTATION ON  
FIDUCIARY DUTY CONCEPTS

October 17, 1994

**OUTLINE:**  
**THE FIDUCIARY DUTY OF A LENDER TO ITS BORROWER**

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- I. General Rule: there is no fiduciary duty between a lender and its borrower absent special circumstances.
  - A.
    1. Aaron Ferrer & Sons, Ltd. v. Chase Manhattan Bank, 731 F.2d 112, 122 (2d Cir. 1984) ("New York law is clear that the usual relationship of bank and customer is that of debtor and creditor.") (citations omitted).
    2. Frutico, S.A. de C.V. v. Bankers Trust Co., 833 F. Supp. 288, 301 (S.D.N.Y. 1993) ("New York law posits a relationship of debtor and creditor between a bank and its customer. As a result, a bank does not owe its customers the kind of fiduciary duties which arise in a special relationship between the parties.") (citations omitted) (aff'd in decision not for publication).
    2. Daniels v. Army Nat'l Bank, 249 Kan. 654, 822 P.2d 39, 42 (1991) ("The traditional rule is that the lender-borrower relationship creates no special duty.") (citation omitted).
    3. Idaho First Nat. Bank v. Bliss Valley Foods, 121 Idaho 266, 824 P.2d 841, 853 (Idaho 1991) ("[A] borrower-lender situation does not create a fiduciary relationship.")
    4. Garrett v. Bankwest, Inc., 459 N.W.2d 833, 838 (S.D. 1990) (adopting North Dakota court's formulation that "the relationship between a bank and its customer is normally viewed as a debtor-creditor relationship which imposes no special or fiduciary duties upon the bank.").

5. First Security Bank v. Banberry Dev. Corp., 786 P.2d 1326, 1332 (Utah 1990) (“[T]he relation of mortgagor and mortgagee is not of a fiduciary character.”) (citation omitted).
6. Simmons v. Jenkins, 750 P.2d 1067, 1070 (Mont. 1988) (“The relationship between a bank and its customer usually does not give rise to a fiduciary duty.”) (citation omitted).
7. Flaherty v. Baybank Merimack Valley, N.A., 808 F. Supp. 55, 64 (D. Mass. 1992) (“Traditionally, Massachusetts courts have viewed a bank’s relationship to its customers simply as one of creditor and debtor, a relationship which imposes no duty to counsel or to make disclosures to the customer.”) (citation omitted).

B. Rationale for the general rule:

1. Relationship is governed by a contract.
  - a. Haroco, Inc. v. American Nat’l Bank and Trust Co., 647 F. Supp. 1026, 1035 (N.D. Ill. 1986) (Where lender and borrowers’ relationship was governed by contracts, “[t]hat [borrowers] trusted [lender] to perform its contractual obligations does not make [lender] their fiduciary.”)
2. Transaction is usually at arm’s-length.
  - b. Trans-Global Alloy v. First Nat’l Bank, 583 So.2d 443, 452 (La. 1991) (concurring with defendant that “under general principles of lender liability and banking law, creditor and debtor have arm’s length relationship which imposes no independent duty of care, and specifically, no fiduciary duty, on lender.”)
  - c. Idaho First Nat. Bank v. Bliss Valley Foods, Inc., 121 Idaho 266, 824 P.2d 841, 856 (Idaho 1991). (“To hold the bank to the standard of a fiduciary in this [arm’s-length] financing transaction, thus requiring it to act primarily for the benefit of the borrower rather than for itself, 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.”) (citation omitted).
3. Parties may be represented by attorneys.
  - a. Clay v. Federal Deposit Ins. Corp., 934 F.2d 69, 72 (5th Cir. 1991) (where parties conducted the transaction at arm’s length

and were represented by counsel, no fiduciary duty arose between them).

- b. Busby v. Parish Nat'l Bank, 464 So.2d 374, 379 (1st Cir. La. 1985) (where plaintiff was an experienced businessman and was represented by counsel, no fiduciary duty arose between the parties).

II. Factors giving rise to special circumstances, imposing a fiduciary duty on the lender toward its borrower:

A. Where the lender has superior knowledge, that is, has information to which the borrower does not and could not have access. Certain jurisdictions treat superior knowledge as giving rise to a duty to disclose that is independent of a fiduciary duty.

1. Morris v. Resolution Trust Corp., 622 A.2d 708 (Me. 1993). RTC, as successor to bank lender, appealed jury finding that a fiduciary duty existed by lender to borrower. Borrower had asked bank officer whether a certain contractor was reliable; bank officer replied that he was, that plaintiff should not look for another contractor, and that the bank would monitor his performance. Bank officer urged borrower to borrow from bank to make immediate funds available to contractor. The officer did not tell borrower that the contractor was delinquent on several loans with the bank, and that money advanced to contractor would be used to reduce contractor's delinquent loans from bank. The contractor discontinued working on borrower's project, borrower sued the bank, and bank counter-claimed. In affirming the lower court's ruling, held that the bank had superior knowledge with respect to the contractor's business reliability and that borrower relied on it, giving rise to a fiduciary duty.
2. Atlantic Nat'l Bank of Florida v. Vest, 480 So.2d 1328, 1333 (2d Dist. Fla. 1985) (dictum) (even where lender does not represent that it has superior knowledge, where borrower reposes its trust in bank by asking a question, it creates "a position of superiority and influence on the part of the bank in providing the information.")
3. Aaron Ferrer & Sons Ltd. v. Chase Manhattan Bank, 731 F.2d 112, 123 (2d Cir. 1984) ("During the course of negotiations surrounding a business transaction, a duty to disclose may arise in two situations: first, where the parties enjoy a fiduciary relationship; and second, where one party possesses superior knowledge, not readily available

to the other, and knows that the other is acting on the basis of mistaken knowledge.”) (citations omitted).

B. Where the lender exerts control over the borrower.

1. Garrett v. Bankwest, Inc., 459 N.W.2d 833 (S.D. 1990). Plaintiff alleged, *inter alia*, that lender took control of his farm’s operations through an agreement on borrower’s use of cash flow as part of a refinancing of pre-existing loan. Plaintiff claimed a fiduciary duty on the part of the bank to lend plaintiff additional funds to stave off foreclosure. The court noted that plaintiff and the bank had mutually agreed on a repayment schedule, and that they both had contributed to the cash flow projections contained in it. Plaintiff also had had the option to refuse the refinancing plan. The court held that lender did not have an advantage over borrower as to knowledge of the relevant facts of the business nor was it in charge of day-to-day operations. Accordingly, it did not owe any fiduciary duty to plaintiff. *Cf. Waddell v. Dewey Co. Bank*, 471 N.W.2d 591 (S.D. 1991) (holding that under South Dakota law, three elements must be proved to establish a fiduciary duty between lender and borrower: the borrower’s reposing trust in lender, borrower’s inequality with lender in terms of dependence, ignorance, or frailty, and the lender’s control of the borrower’s business.)
2. In re Heartland Chemicals, 136 B.R. 503, 517 (C.D. Ill. 1992). Unsecured creditors’ committee argued that secured lender should be equitably subordinated because it breached its fiduciary duty to the bankrupt company by leading borrower and its supplier to believe that bank would continue financing. The court held that the standard to impose a fiduciary duty on the lender was for “the lending institution to become the alter ego of the customer.” It noted that the lender did not operate the company on a daily basis, did not own stock in it, did not influence its choice of management or coerce it to sign their loan agreement. Accordingly, no fiduciary duty arose between lender and borrower, even if “the Bank’s decision not to renew . . . left Heartland without any available line of credit, propelled Heartland into bankruptcy, and destroyed Heartland’s going concern value.” 136 B.R. at 519.

C. Where the lender’s relationship with the borrower exceeds that of a creditor, as in a joint venture or a partnership.

1. Frutico, S.A. de C.V. v. Bankers Trust Co., 833 F. Supp. 288 (S.D.N.Y. 1993) (*aff’d* in decision not for publication). Plaintiffs

alleged that their relationship with the lender, including their long history of negotiations, the lender's consideration of taking an equity position in plaintiff's business, and the parties allegedly entering into a contract, gave rise to a fiduciary duty owed by the lender to the plaintiffs. The court held that plaintiffs' claim depended on a contract whose existence had not been proven and, since no joint venture agreement had been established, there was no fiduciary duty by the lender to the plaintiffs.

2. Mutual Life Ins. Co. of New York v. Brush Hill Assocs., 1994 U.S. Dist. LEXIS 11834 (N.D. Ill. 1994). Plaintiff entered into a joint venture agreement with defendant and also agreed to extend a mortgage loan for the Project. The agreement specifically provided that the lender would not be treated as a fiduciary with respect to the mortgage loan, and that plaintiff had the exclusive option to refinance the mortgage loan. When the other joint venture partners wanted to refinance the mortgage loan, plaintiff refused. Defendants claimed that plaintiff had breached its fiduciary duty, as a partner, by refusing to permit refinancing of the mortgage loan. The court held that plaintiff had availed itself of rights available under the loan agreement and, accordingly, had not breached any fiduciary duties to defendants.
3. Mellon Bank N.A. v. Miglin, 1993 U.S. Dist. LEXIS 5813 (N.D. Ill. 1993). Mellon Bank sued to collect on a loan guaranteed by defendants. They counterclaimed that they had entered into a joint venture agreement with the Bank when it approved their development plans, encouraged them to proceed with them, and extended the maturity of the loan. The court held that these factors only established that the parties had a business relationship, not a joint venture, and noted, among other factors, that the bank had no interest in the project other than the repayment of its loan.

D. Where the lender gives advice to the borrower or where the borrower reposes its trust in the lender, in circumstances where borrower reasonably relies on lender. Different jurisdictions may apply different standards, depending on the borrower's reliance upon that advice and depending on the borrower's business acumen. This is an increasingly important theory, especially in complex transactions.

1. Lowery v. Guaranty Bank & Trust Co., 592 So.2d 79 (Miss. 1991). Lender extended a series of loans to plaintiffs' husband secured by credit life insurance. Loan matured while husband was out of town. Bank officer did not tell plaintiff that the credit life insurance was about to expire. Plaintiff's husband died while away, and after the life

insurance expired, so bank alleged there was no security for the loan. The appellate court reversed summary judgment for defendant bank and found material fact issue as to whether bank's conduct "created a fiduciary duty to notify [plaintiff and her husband] of the coverage of the credit life insurance." *Id.* at 85.

2. Daniels v. Army Nat'l Bank, 249 Kan. 654, 822 P.2d 39, 43 (Kan. 1991). Plaintiffs told the lender that they were going to be away during the construction of their home. The builder, who had recommended the bank, told plaintiffs that the bank would monitor the construction. The bank did not inspect the construction and, after being told by plaintiffs that the construction was deficient, it released funds to the builder in payment of the construction. Plaintiffs had not told bank not to release the proceeds of the loan to the builder. The court declined to find a fiduciary duty on the bank's part and held that "[a] person who is not under any disability or disadvantage may not abandon all caution and responsibility for his own protection and unilaterally impose a fiduciary relationship on another without a conscious assumption of such duties by the one sought to be held liable as a fiduciary." (citation omitted).
3. Mancuso v. United Bank of Pueblo, 818 P.2d 732, 738 (Colo. 1991). Plaintiff alleged that when she opened a bank account, she told the officer that she wanted her son to have access to the funds only when she was traveling or in an emergency. The bank recommended that she open a joint bank account. Subsequently, the son obtained loans from the bank, and was told to list the funds in his mother's account as his assets, since the account was joint. The son defaulted on his loans, and the bank seized the mother's funds. Plaintiff sued for breach of fiduciary duty. In reversing the lower court's grant of defendant's motion for summary judgment, it was held that "[w]hen a bank moves into the role of an advisor, the resulting relationship extends beyond the relationship of debtor and creditor and may give rise to higher duties" (citations omitted).
4. Peoples Trust Bank v. Braun, 443 N.E.2d 875, 879 (3rd Dist. Ind. 1983) ("Although the existence of a confidential relationship depends upon the facts of each case, it can generally be stated that a confidential relationship exists whenever confidence is reposed by one party in another with resulting superiority and influence exerted by the other. Not only must there be confidence by one party in the other, the party reposing the confidence must also be in a position of inequality, dependence, weakness or lack of knowledge. Furthermore, it must be shown that the dominant party wrongfully

abused the confidence by improperly influencing the weaker so as to obtain an unconscionable advantage.”) (citations omitted).

- III. There is no fiduciary duty between the lender and other affected parties, absent special circumstances.
  - A. Lender owes no fiduciary duties toward the borrower’s investors.
    - 1. In re Rexplore, Inc. Securities Litigation, 685 F. Supp. 1132, 1140 (N.D. Cal. 1988).
  - B. Lender owes no fiduciary duties toward the borrower’s guarantors.
    - 1. Manufacturers Hanover Trust Co. v. Yanakas, 7 F.3d 310, 318 (2d Cir. 1993).
    - 2. Cf. Kondelik v. First Fidelity Bank of Glendive, 259 Mont. 446, 857 P.2d 687, 692 (Mont. 1993).
  - C. Lender owes no fiduciary duties toward the borrower’s shareholders.
    - 1. Kondelik v. First Fidelity Bank of Glendive, 259 Mont. 446, 857 P.2d 687, 692 (Mont. 1993).
  - D. Lender owes no fiduciary duties toward the borrower’s other creditors.
    - 1. Atlanta Shipping Corp., Inc. v. Chemical Bank, 631 F. Supp. 335 (S.D.N.Y. 1986), aff’d 818 F.2d 240 (2d Cir. 1987).

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## AUDITOR/ACCOUNTANT FIDUCIARY DUTY?

### I. Introduction

A. Topic Question: Status of accountant's/auditors's fiduciary duty to client

B. Relevancy:

1. S&L, FIRREA litigation
2. Statute of limitations
3. Jury appeal
4. Limited other potential claims

C. Example

1. Compare RTC v. Peat Marwick, et al. (Horizon Federal), 844 F. Supp. 431 (N.D. Ill. 1994) (held no fiduciary duty)
2. With RTC v. Peat Marwick (Hill Financial) (E.D. Pa. 1993) (unreported) (claim is fact question and survives pleadings and summary judgment motions)

D. Conclusion

1. Special Circumstances: Absent special circumstances, the prevailing view is that auditor will not be deemed a fiduciary of the client. There are, however, cases to the contrary.
2. Question of fiduciary duty of non-auditor accountant may be different and depends on facts and circumstances.

### II. Authority Finding No Fiduciary Duty

A. Opening Proposition

1. Generally Not: Courts generally begin with proposition that auditors are not fiduciaries. Fund of Funds, Ltd. v. Arthur Andersen & Co., 545 F. Supp. 1314 (S.D.N.Y. 1982). See also FDIC v. Schoenberger, 781 F. Supp. 1155 (E.D. La. 1992); Mishkin v. Peat Marwick, 744 F. Supp. 531 (S.D.N.Y. 1990)

B. Function of Auditor

1. Auditing Services: Verification of information contained in entity's financial statements through examination of underlying accounting records.
2. Public and Private Function of Audit.

C. Independence of Auditor

1. Identification of Auditor Function as Public: The "auditor assumes a public responsibility" U.S. v. Arthur Young & Co., 465 U.S. 805 (1984).
2. Perceived Importance of Independence: "Independence in mental attitude is required from an auditor in all matters associated with the assignment" AICPA Standards § 220.01-06; "total independence" necessary to fulfill public role. Id.

D. Sufficiency of Existing Procedures

1. Alternative Remedies
2. Existing Professional Regulations and Standards
  - AICPA: Requirements for objectivity.

III. Authority in Favor

A. Opening Proposition

1. Generally Isn't Always: General proposition of no fiduciary duty doesn't necessarily preclude finding of such
2. Stainton Test: An accountant is not automatically a fiduciary for his client. "plaintiffs had burden of proving that the accounting services and confidential financial advice. . . provided them gave rise to a confidential relationship." Stainton v. Tarantino, 637 F. Supp. 1051 (E.D. Pa. 1986.)
3. In re De Lorean Motor Co., 56 B.R. 936, 945 (E.D. Mich. 1986). Auditor is fiduciary of client "when performing audits"; In re Investors Funding Corp., 523 F. Supp 533, 542 n.4 (S.D.N.Y. 1980).

B. Relationship as Matter of Fact

1. Confidence and trust on one side, dominance and influence on other. e.g.,

Carey Elec. Contracting Inc. v. First National Bank, 74 Ill. App. 3d 233, 237, 392 N.E.2d 759, 763 (2d Dist. 1979) (not accountant case.)

2. Substantial Control: Surrender of substantial control over some portion of business defines confidential relationship under Pa. law. Stainton, supra.
3. Longstanding Relationships
4. Fiduciary duty much more likely in cases of non-auditing relationships such as long time personal accountant. e.g. Anderson v. Marquette Nat'l Bank, 518 N.E.2d 196 (1st Dist. 1987.)