BANK NOTES

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$3,600,000 Verdict Against Bank for Breaching Loan Commitment

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A Pennsylvania jury recently awarded "lender liability" damages against a bank stemming from the bank's refusal to fund a loan it was found to have committed. The case serves as a reminder to lending institutions that "lender liability" risk begins upon the issuance of a loan commitment – not the funding of the loan.

In 2008-2009, Harleysville National Bank negotiated with a developer for $12MM to finance a development project in Bucks County. After exchanging a series of "term sheets," Harleysville notified the borrower that it was withdrawing its offer to make the loan. The borrower was unable to secure alternative financing and ultimately lost the project. It brought litigation against Harleysville seeking compensation for the profits lost as a result of not developing the real estate.

Harleysville's defense consisted of two primary arguments- (1) that it had never committed to making the loan; and (2) if a commitment had been extended, that the borrower failed to timely satisfy its conditions.

Harleysville contended the various documentation and term sheets exchanged with the borrower were non-binding "proposals" but fell short of a mutually binding "Loan Commitment" and therefore, the bank bore no responsibility for any losses suffered by the plaintiff as a result of not obtaining financing.

According to the Court, the essential terms of a loan commitment are:

- parties
- manner of advance
- interest rate
- closing date
- term
- collateral
- manner of repayment

The jury dismissed this "form-over-substance" argument. In doing so, it held that the essential terms of a loan commitment were in the various "proposal" documentation. Additionally, it found the conduct of the bank and developer to be consistent with that of parties who believed themselves to be in agreement about the making of the loan.

Since the various term sheets addressed these items, they were deemed to constitute a binding "Loan Commitment" even in the absence of any single document calling itself so.

Being found to have committed to make the loan, Harleysville argued the borrower failed to satisfy the conditions of the loan commitment. Pointing to a provision in the correspondence with borrower requiring "government approvals" for the development, the bank argued the borrower's failure to provide a highway occupancy permit as a basis for not funding the loan.

The Court was not persuaded by this argument. During the trial, the plaintiff was able to show that immediately after the loan was negotiated, the bank's financials took a serious turn for the worse in part due to a concentration in commercial real estate loans. Around this time, Harleysville was found to have imposed a series of unsatisfiable, commercially unreasonable conditions on the borrower after a commitment was deemed to exist. Analyzing the series of unreasonable conditions together with the bank's deteriorating financial condition, the Court concluded that Harleysville's actions were an intentional effort to sabotage the loan commitment.

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The case illustrates some very important lessons for commercial lenders. First, that a loan commitment can be deemed to exist if a bank and borrower are found to have agreed to all of the material terms of a commitment – regardless of the title of such document and even if the material terms are not set forth in a single document. Further, key conditions and contingencies to a loan should be spelled out with specificity in a written loan commitment. Finally, lenders must deal with borrowers and prospective borrowers in good faith. Conditions to a loan commitment should have commercially reasonable basis to protect a legitimate interest of the bank.

While these lessons are sound policy for all loan transactions, the potential for significant damages is most prevalent when a prospective borrower is seeking financing for a purchase or end-of-term refinance transaction. In such instances the lender risks exposure to a borrower for lost profits, as we saw in the Harleysville case, or for other damages should the bank's failure to make the loan cause the prospective borrower to default in an obligation to a seller or lender. By being thorough and specific in drafting loan commitments, and by ensuring that none of its actions could be perceived as having an ulterior motive, banks can avoid exposure to the financial and reputational risk that come with lender liability lawsuits.

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