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FINANCERS AS FIDUCIARIES: AN EXAMINATION OF RECENT TRENDS IN LENDER LIABILITY

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The number of cases discussing the existence and scope of an obligation of good faith and fair dealing in borrower-lender relations is sufficiently numerous today that there is now an annotation on the subject.¹ Yet, at the same time there is an emerging consensus that some courts have gone too far in utilizing the good faith concept and other theories to rewrite loan documents or to impose a standard of justice compatible with an appellate court’s personal conscience.² At best, a number of the lender liability decisions are “not the product of a carefully thought-through plan.”³ The purpose of this article is to analyze these cases in the context of efforts to impose fiduciary-like duties on the parties to a loan transaction.

Implied Duties of Good Faith in Oklahoma: The Impact of Rodgers v. Tecumseh Bank

In an important recent case, Rodgers v. Tecumseh Bank,⁴ the Oklahoma Supreme Court shed considerable light on its view of the good faith-fair dealing aspects of lender liability cases. In this case the court declined to recognize a commercial loan agreement as the basis for the creation of a special or fiduciary relationship per se. It also held that absent a special relationship between the parties or gross recklessness or wanton negligence on behalf of a party to a contract, the violation of a resultant duty sounds in contract alone.⁵

Outside the Uniform Commercial Code (UCC) and insurance cases (which are rooted in statute), no Oklahoma decision with precedential effect has found an implied covenant to act in accordance with any special standard of good faith or fair dealing in a lending agreement as a matter of general contract

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⁵ Ebke & Griffin, Lender Liability to Debtors: Toward a Conceptual Framework, 40 S.W. L.J. 775, 813 (1986).
⁷ Id. at 1227.
law. Further, no Oklahoma decision has found that an aggrieved party may recover punitive damages in tort for breach of such an agreement. In the context of the acceleration of loan payments under UCC section 1-208, the Oklahoma Supreme Court has ruled that a creditor's good faith belief in default or insecurity is to be judged by an objective standard of good faith based on commercial reasonableness, despite the fact that the definition of "good faith" applicable to that section requires only honesty in fact and does not incorporate standards of commercial reasonableness. But in cases not involving a statute, contractual provision, or confidential relationship imposing special liabilities based on a fiduciary duty or an obligation of commercial good faith and fair dealing, such duties, or a tort remedy for their breach, will probably not be implied in Oklahoma. A brief review of recent case law provides support for this conclusion.

The Implied Covenant in Oklahoma

Prior to Rodgers v. Tecumseh Bank, it was not clear whether or to what extent there was an implied covenant of good faith and fair dealing in lending transactions in Oklahoma. In 1936 the Oklahoma Supreme Court, in Wright v. Fidelity & Deposit Co. of Maryland, quoted the New York Court of Appeals for the proposition that every contract contains an implied covenant that neither party shall do anything that will destroy or injure another party's right to receive the fruits of the contract. In Wright the court also quoted from a Texas Court of Civil Appeals decision that spoke conservatively about implying covenants in contracts. Those citations were made in the context of the court extending a surety's obligation of "faithful performance" in a contractor's bond to cover fraudulent overcharges; even though the bond did not mention "honesty" or "fidelity," the term "faithful" was construed to include those concepts. This is a far cry, however, from imposing special standards of good faith and fair dealing in every lending transaction.

Similarly, in 1985 in Hall v. Farmer's Ins. Exchange, the Oklahoma Supreme Court noted that "each contract carries an implicit and mutual cove-
nant by the parties to act toward each other in good faith."16 Without proper attribution, the court quoted from the two New York Court of Appeals cases cited in Wright v. Fidelity & Deposit Co. of Maryland.17 In Hall the court found an implied covenant of good faith in an insurance agency contract containing a termination-at-will clause. The court held that the insurance company principal could be liable for damages for termination made pursuant to its printed form agreement (imposed on all agents) if that termination option was exercised in bad faith.18 The court stated that if the insurance company principal acted with an intent to wrongfully deprive the agent of the fruits of his contract when it terminated his agency, it would stand in breach of the implied covenant of good faith.19 The court used as its standard of conduct the nineteenth-century general definition of good faith,20 which means both honesty in fact and lack of unconscionable use of what is technically lawful.21 Because the principal invoked its termination clause in bad faith, the law gave the agent a remedy of contractual damages commensurate with the injury caused.22 Notably, this was once again based on the common law concept of good faith, and recovery was limited to contract damages.

Prior to Hall, the Oklahoma Supreme Court addressed the issue of "good faith" in a lending context in Mitchell v. Ford Motor Credit Co.23 That case turned, however, not on the common law implication but on section 1-208 of the UCC.24 The court held that the creditor's good faith belief that it was either insecure so as to invoke the acceleration clause in a security agreement or that a default existed is to be judged by an objective standard based upon commercial reasonableness.25 As noted, this holding is curious because the applicable definition of "good faith" in the UCC requires only honesty in fact and does not incorporate standards of commercial reasonableness.26 However, the case is distinguishable from those involving general contract issues because it was governed largely by the UCC.

At the time the Oklahoma Supreme Court was applying the implied-in-law good faith covenant to termination-at-will clauses in insurance agency

16. Id. at 1029.
18. 713 P.2d at 1031.
19. Id. at 1030.
20. Id. at 1031 n.8.
22. 713 P.2d at 1031.
25. 688 P.2d at 44-45.
agreements, the Oklahoma Court of Appeals, in *Eke Builders, Inc. v. Quail Bluff Assc.*,
held (without citing any Oklahoma authority) that an implied covenant of good faith and fair dealing exists in all contracts, not merely the construction contract involved in that case. The exact language of the court bears repeating:


In *Eke Builders* the Oklahoma Court of Appeals bootstrapped the special good faith obligation, implied from statute in insurance contracts in cases such as *Christian v. American Home Assurance Co.*, into a construction contract to allow punitive damages on a theory of tortious breach of contract. As noted, no Oklahoma authority was cited. These authors believe that despite *Wright* and *Hall*, this kind of special covenant of good faith and fair dealing does not clearly apply to contracts generally in Oklahoma. The two cases cited by the *Eke Builders* court in the quotation above are not persuasive. The *Transcontainer Services* decision was decided by the Ninth Circuit on the basis of the lien law of the United Kingdom. The *Seaman’s Direct Buying Service* case is a per curiam opinion simply citing established California law that such a covenant is implied in every California contract.

The Restatement (Second) of Contracts section 205 adopts the California line of cases, but thus far has not been widely followed. The Texas Supreme Court recently characterized that position as: “[A] novel theory of law enunciated only by California courts . . . which would abolish our system of government according to settled rules of law and let each case be decided upon what might seem ‘fair and in good faith,’ by each fact finder.” The Texas Supreme Court of Appeals for the Seventh District followed the lead of the Texas Supreme Court in holding that a special duty of good faith does not arise in a contract setting absent a special relationship between the parties. *See Lovell v. Western Nat’l Life Ins. Co.*, 754 S.W.2d 298 (Tex. App. - Amarillo 1988, *writ den’d*). However, the Texas Court of Appeals for the Eighth District,

27. 714 P.2d 604 (Okla. Ct. App. 1985). This decision was authored by Judge Brightmire and concurred in by one other judge. It was released for publication by order of the Court of Appeals and, therefore, is not accorded precedential value but may be cited as persuasive. 12 OKLA. STAT. ch. 15 app. 2 Rule 1.200C(B) (Supp. 1987).
28. 714 P.2d at 608.
29. Id.
32. *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983). In a recent case, the Texas Court of Appeals for the Seventh District followed the lead of the Texas Supreme Court in holding that a special duty of good faith does not arise in a contract setting absent a special relationship between the parties. *See Lovell v. Western Nat’l Life Ins. Co.*, 754 S.W.2d 298 (Tex. App. - Amarillo 1988, *writ den’d*). However, the Texas Court of Appeals for the Eighth District,

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Court rejected the Restatement position by expressly holding that as a matter of general contract law there is no implied covenant of good faith and fair dealing. In a concurring opinion, two justices noted that under extant Texas law an implied covenant of good faith would not override express terms of a contract. The concurring justices noted, however, that where there is a special relationship, either because of the element of trust necessary to accomplish the goal of the undertaking or to correct an imbalance of bargaining power, prior Texas cases would allow implication of a good faith or fair dealing obligation. Two justices dissented, expressly holding that such a covenant is implied. The concurring opinion in this case has some obvious appeal where the parties have not explicitly delineated the terms of their agreement, and both understand that one party is relying on the honest judgment of the other. Here, a special relationship is created and the parties should deal with one another openly in a spirit of good faith and fairness, judged by community standards of commercial reasonableness.

This position has been adopted by several courts. It also conforms with the Texas Court of Appeals decision quoted with approval in Wright. However, imposing a duty of good faith and fairness where a special relationship exists is far different from imposing a special duty of good faith, i.e., incorporating community standards or standards of fair dealing and commercial reasonableness, into contracts generally or on lenders specifically, e.g., under UCC section 1-201(19). Quite a difference exists between the Wright and Hall position requiring some intentional interference with another party’s rights to the fruits of a contract, and the California and Restatement position in El Paso, seems to be going its own way and in two recent cases has found (or at least assumed the existence of) special duties of good faith as an independent basis for liability in the context of lending transactions. See Coleman v. Federal Deposit Insurance Corp., No. 08-87-00235-CV (Tex. App. - El Paso Nov. 23, 1988, writ requested) (not yet reported); Olney Savings & Loan Assoc. v. Farmers Market of Odessa, Inc., No. 08-88-00113-CV (Jan. 25, 1989) (not yet reported). See also Aranda v. Ins. Co. of North America, 748 S.W.2d 210 (Tex. 1988); Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165 (Tex. 1987).

33. Id. at 522.
34. Id. at 524. The above author, Justice Spears, wrote a five-member majority in Aranda v. Ins. Co. of N. Am., 748 S.W.2d 210 (Tex. 1988), which has seemingly adopted his viewpoint in the context of a workers’ compensation insurer and an injured employee of a covered insured. A special relation was found to exist, thus justifying implication of the good faith covenant.
35. English, 660 S.W.2d at 525.
38. See supra note 12.
39. As noted, this would be appropriate for merchants selling goods, under section 2-103(1)(b), but not for lenders generally, since section 1-201(19) is limited by its terms to “honesty in fact” and does not incorporate standards of commercial reasonableness. See supra notes 6-9 and accompanying text. Cf. the quotation from Eke Builders, Inc., supra in the text accompanying note 29.
that a general good faith-fair dealing covenant should be implied in every contract, giving rise to tort liability on the basis of community standards. The suggestion in Eke Builders, Inc., that a duty of fair dealing incorporating community standards of commercial reasonableness is appropriate for contracts generally, left lenders with a real concern that the Oklahoma courts might adopt the more extreme California and Restatement view.40

This concern was reinforced by a subsequent Oklahoma case. While rejecting the California position that an employer has a legal duty not to terminate an at-will employee in bad faith, the Oklahoma Supreme Court in Hinson v. Cameron41 for the first time expressly discussed the implied good faith and fair dealing covenant. Citing California case law as authority,42 it held that "the general principle of good faith and fair dealing is infused by force of law into every contract."43 The covenant "requires that neither party do anything that will injure the rights of others to receive the benefits of their agreements."44

Hinson raises additional questions, such as whether a breach is actionable in tort, and whether the standard of good faith is based on a subjective or objective analysis. For example, a court, when applying the UCC, normally will construe the statutorily implied good faith covenant from an objective standpoint. If, however, such a covenant is implied generally in all contracts, there is no basis for determining whether that covenant should be analyzed from an objective45 or subjective46 viewpoint. Such concerns suggested that Oklahoma courts might allow juries to review commercial transactions to determine whether some nebulous "community standard" of fairness is violated every time a party to a contract cries "foul," resulting in punitive damages in tort as the "normal" remedy for breach of contract.

Rodgers v. Tecumseh Bank

Many of these concerns seemingly were put to rest when the Oklahoma Supreme Court decided Rodgers v. Tecumseh Bank.47 In this case the court squarely faced the issue whether it "should extend the implied-in-law duty of good faith and fair dealing, now imposed upon contracts of insurance,

40. 714 P.2d at 608-09.
42. Id. at 553 n.13.
43. Id. at 554 (emphasis by the court).
44. Id. at 553.
47. 756 P.2d 1223 (Okla. 1988).
to contracts for commercial loans in order to support a cause of action for 'tortious breach of contract.'

Merely by answering that question in the negative, the court clarified several matters. The court's framing of the issues made it obvious that not every breach of the implied covenant of good faith will give rise to an action for tortious breach of contract. In addition, the court did not discuss breach of the implied covenant of good faith and fair dealing in terms of a general theory of contractual breach. Apparently that omission was intentional. As stated by the court, the narrow dispositive issue was not whether the court "should extend the implied-in-law duty of good faith and fair dealing, now imposed upon contracts of insurance, to contracts for commercial loans in order to support a cause of action for 'tortious breach of contract,' " but rather "whether the facts support a cause of action for [breach of] the express terms of a written contract." By limiting redress to breach of contract the court seemed to draw a firm distinction between contract and tort liabilities and remedies. The court concluded by ruling as a general proposition that the breach of a commercial lending agreement ordinarily will not result in tort liability and, additionally, that the lender can be deemed to have breached the express terms of a contract without consideration of issues relating to good faith or lack of it. This suggests a reaffirmation of traditional common law concepts.

In Rodgers v. Tecumseh Bank, Rodgers and his co-borrowers executed a promissory note and mortgage to Tecumseh Bank. The loan had a one-year term and the mortgage contained the following language: "Final payment may be refinanced at any time it is due without penalty and at terms no less favorable than original terms." At maturity the bank declined to renew or extend the loan. In an unusual twist of events for a lender liability case, the borrowers repaid the loan. Thereafter, they sued the bank alleging both breach of contract and "tortious breach of contract." Both the borrowers and the bank moved for summary judgment. The trial court ruled in favor of the bank and dismissed the petition. The Oklahoma Court of Appeals affirmed in an unpublished decision. On certiorari, the Oklahoma Supreme Court vacated the appellate court's opinion and affirmed the trial court's dismissal of the tortious breach of contract count. However, it reversed and remanded the case for a determination of damages against the bank for breach of the terms of the mortgage contract.

48. Id.
49. Presumably this was a reference to the special duties of good faith implied in the insurance cases, such as Christian v. American Home Assurance Co., rather than a rejection of the traditional common law contracts concept illustrated by Hall v. Farmer's Ins. Exch.
50. Id. at 1225. The court simply resorted to rules of contractual construction. Breach vel non of the covenant under the law of contracts is not addressed.
51. Id. at 1224.
52. Id. at 1226-27.
53. Id. at 1224 (emphasis by the court).
54. Id. at 1227.
55. Id.
Adhering to the single transaction view of what is a cause of action or claim for relief, the Oklahoma Supreme Court noted that "tortious breach of contract" is simply a theory of recovery and is not a separate claim for relief. The bank committed only one wrong in the case by refusing to renew or extend the loan. The court declined the borrowers' invitation to apply the doctrine of Christian v. American Home Assurance Co. and McCorkle v. Great Atlantic Ins. Co. by extending the special implied-in-law duty of good faith and fair dealings applicable in insurance contracts to commercial loan agreements, which would allow an action in tort for breach of that implied covenant. The court's refusal in Rodgers to extend that doctrine generally to commercial loan agreements is premised on "the inherent differences between insurance policies and commercial loan agreements."

The principal distinction relied on by the court concerned the basic nature of an insurance policy as an adhesion contract in which the insured as "the weaker party has no realistic choice as to its terms." In a commercial loan agreement, however, the transaction is normally a negotiated arrangement with multiple potential competitors offering contractual concessions to obtain the business. Indeed, in Rodgers the court noted that the borrower was a sophisticated investor and that:

The borrowers shopped around and came to the bank because it offered the most favorable interest rates, and in negotiating the contract the borrowers were successful in having a favorable term inserted into the printed form. Here we have arm's-length negotiating, a relatively equal bargaining capacity and no snares or traps for the unwary, quite unlike the circumstances surrounding the issuance of an insurance policy.

Significantly, the court noted the absence of any "special relationship" under the facts of the case. As discussed later, a "special relationship" traditionally is a prerequisite to a fiduciary-like duty, which in turn gives rise to strict limitations on transactions between the parties. Rather, and in keeping with prior pronouncements on the subject, the court stated that absent such a relationship, "[p]arties should be free to contract for any lawful purpose and upon such terms as they believe to be in their mutual interest." The court further noted that imposing tort liability generally on commercial lenders for breach of a contract "would only serve to chill commercial transactions." The court was careful, however, not to foreclose resort to the theory of tortious breach

56. Id. at 1227.
57. 577 P.2d 899 (Okla. 1977).
59. 756 P.2d at 1226.
60. Id.
61. Id.
62. Id. at 1226.
63. Id. at 1226-27.
64. Id. at 1227.
of contract when a breach is grossly reckless or wantonly negligent.\textsuperscript{66}

The court closed its discussion of the primary issue with this somewhat enigmatic paragraph:

Lastly, in \textit{Christian} we found a pre-existing statutory duty imposed upon insurers to make immediate payment of claims. Further, commercial transactions under 12A O.S. 1981, § 1.203 [sic] carry an obligation of good faith in their performance and enforcement. Likewise, under the common law each contract carries an implicit and mutual covenant to act towards each other in good faith.\textsuperscript{67}

Because \textit{Christian} was based on a statute, that line of decisions is further distinguished. The reason the court mentions section 1-203 of the UCC and the now squarely articulated common law implied covenant of mutual good faith is unclear.\textsuperscript{68} The language is not essential to the opinion as the breach of contract claim was resolved by rules of construction and without mention of any implied covenants. Is the court hinting that in some cases an independent claim for relief in contract will lie for breach of the implied good faith covenant either under the UCC\textsuperscript{69} or common law? Or is the court merely reaffirming its adherence to traditional contract concepts of good faith, as illustrated by \textit{Hall}? These authors lean toward the latter view, but the full implications are not yet clear.

Although the court’s decision in \textit{Rodgers v. Tecumseh Bank} should be applauded as a setback to those who would turn every breach of contract into a tort or every relation into a fiduciary one, many questions still remain unanswered. Is the breach of the good faith covenant simply a shield (an affirmative defense to enforcement of the express terms of a contract), or may it be used offensively as a sword? Will breach of the implied covenant of good faith and fair dealing without breach of an express provision of an agreement constitute a claim upon which relief may be granted? Will the court extend the \textit{Christian} line of cases to consumer lending contracts, which typically are not the result of arm’s-length negotiations between persons of relatively equal bargaining power? Finally, what is the “special relationship” that will give rise to circumstances under which the court might impose \textit{Christian}-like or fiduciary liabilities on a lender? The lack of this “special relationship” in \textit{Rodgers} was central to the court’s decision: “Where, as here, there is no special relationship, parties should be free “to contract for any lawful purpose and upon such terms as they believe to be in their best interest.”\textsuperscript{70} Obviously, the rejection of implied-in-law duties of good faith and fair dealing as a basis for liability, and perhaps even the rejection of punitive damages in lending transactions, was far from absolute. The court suggested that

\textsuperscript{66} 756 P.2d at 1227.
\textsuperscript{67} Id.
\textsuperscript{68} 12A OKLA. STAT. § 1-203 (1981).
\textsuperscript{69} Id. See also \textit{supra} notes 7 & 9.
\textsuperscript{70} 756 P.2d at 1226-27.
"[g]ross recklessness or wanton negligence" in the context of a "special relationship" might call for application of a theory of recovery based on tortious breach of contract.\textsuperscript{71} Nonetheless, the court's refusal to impose tort liability as a matter of course, based on implied-in-law duties of good faith and fair dealing, is a victory for sound application of the common law and the Uniform Commercial Code. It is also a rejection of theories that would seek to include a tort or breach of fiduciary duty in every contract dispute.\textsuperscript{72}

\textit{Is Rodgers v. Tecumseh Bank Part of an Emerging Trend?}

Two important cases from other jurisdictions suggest that other courts also are reacting against some of the more extreme lender liability cases.\textsuperscript{73} In \textit{Kruse v. Bank of America}\textsuperscript{74} and \textit{Penthouse International, Ltd. v. Dominion Federal Savings & Loan Ass'n},\textsuperscript{75} a state appellate court on the West Coast and a federal court of appeals on the East Coast, respectively, dealt with divergent fact patterns and wrote opinions strikingly similar to \textit{Rodgers}. They each suggested limitations on a borrower's right to recover for breach of good faith under a "special" or fiduciary relationship theory and other "lender liability" theories.

In \textit{Kruse} the district court held the lender liable because it was involved in a series of transactions that led the borrower to expand its operation. The borrower assisted and then purchased the business of a troubled apple processing plant with which the borrower (an apple grower) did business, apparently on the expectation that the bank would provide financing. Both businesses were customers of the bank, and the bank's refusal to extend a line of credit to the troubled processor prompted the series of assistance transactions between that processor and the apple grower. The apple grower periodically sought the bank's help in assisting the processor. When the apple grower ultimately purchased the troubled processor, and then itself suffered reverses and filed bankruptcy (partly, it was alleged, because the bank continued to decline to extend the necessary financing), the parties sued the bank. The allegations included fraud, bad faith, interference with the business, and infliction of emotional distress, and the jury returned a verdict of almost $47 million in direct and punitive damages.

The California Court of Appeals reversed the jury verdict. The court discounted the plaintiffs' theories of special or fiduciary relationships, suggesting that even if such a duty existed it was not breached in this case, and noted the absence of any evidence of fraud.\textsuperscript{76} The court further concluded that the

\textsuperscript{71} Id.

\textsuperscript{72} Id. at 1225.

\textsuperscript{73} For a more thorough discussion of these two cases from a national perspective, see Dennis & Endler, \textit{Bank of America and Penthouse, Is the Lender Liability Pendulum Swinging Back?} \textit{Consumer Fin. L.Q. Rep.} 3 (1989) [hereinafter Dennis & Endler].


borrowers’ reliance on an expectation of further financing was not reasonable under the facts of this case, and it emphasized that even in a fiduciary relationship the beneficiary has an obligation to investigate “facts of which he has actual notice.” Although, as discussed later, there was speculation that this case might be reviewed by the California Supreme Court, that did not occur. This case, like Rodgers v. Tecumseh Bank, may represent an important milestone in defining the limits of lender liability in the context of a bank’s “special relationship” and in defining the limits of the duty of good faith to the bank’s customers and potential customers.

Several important aspects of the court’s analysis stand out in Kruse v. Bank of America. First, as in Rodgers, the court was unwilling to extend special protections to a lending transaction per se where the borrower was a sophisticated business person. In both cases the courts emphasized the arm’s-length nature of transactions between equally sophisticated parties and held each party to a standard of reasonable responsibility for protecting its own interests. In effect this reaffirms the common law characterization of the basic relationship as one of debtor-creditor rather than beneficiary-fiduciary. Together these cases represent a significant reaffirmation of private contract law rather than public policy as the guide for resolving private commercial disputes.

Like Rodgers, Kruse involved unique facts limiting its usefulness as a broad principle of law. Moreover, like Rodgers, Kruse does not represent a total repudiation of the theories involving good faith or special relationships in a lender context. For example, the California Court of Appeals repeatedly rejected the plaintiffs’ theories of bad faith breach on grounds that there was no contract between the parties because the borrowers’ expectation of a loan was both unreasonable and inadequate as the sole basis for formation of a contract. Nonetheless, the court seemed to reject the rationale of cases such as Djowharzadeh v. City National Bank & Trust Co. and Jacques v. First Nat’l. Bank of Maryland, which recognized such good faith duties as arising from the “special relationship” between a bank and its potential customers. While the latter cases are easily distinguishable because they involved less sophisticated parties or clearer evidence of wrongdoing by the .

163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985), as representing “murky waters” which it apparently was pleased to avoid.
78. See infra text accompanying at note 87.
79. See infra note 123.
81. Id., 248 Cal. Rptr. at 231.
82. Id., 248 Cal. Rptr. 228-33.
83. 646 P.2d 616 (Okla. Ct. App. 1982), discussed infra at text and accompanying notes 102-104. See also Harrell, supra note 37, at 642-47.
84. 307 Md. 527, 515 A.2d 756 (1986). See also infra text accompanying note 104.
85. It is not clear that this is a distinguishing characteristic in Djowharzadeh.
banker, the inescapable conclusion is still that Kruse and Rodgers sharply limit the intrusion of special good faith and fiduciary duty concepts into general contracts law in the context of a lending transaction. But no one can logically contend that under Kruse or Rodgers this intrusion has been wholly eliminated.

Penthouse adds further fiber to this body of law. In Penthouse a lender refused to close a lending transaction to which it had committed on grounds that the borrower had not met the conditions stipulated in the loan commitment. The trial court concluded that the lender was acting in bad faith by insisting on an excessively strict compliance with the terms of the commitment in an effort to escape from the deal. The Second Circuit rejected this view, upholding the right of the lender to insist on strict compliance with the loan commitment terms.

Once again this decision represents a rejection of broad and expansive concepts of good faith or a "special relationship" as a basis for imposing special liability in a commercial setting. As in Rodgers and Kruse, the court emphasized that this was an arm's-length transaction between sophisticated parties, and defined that relationship by the contract terms rather than by reference to obligations implied in law. While Penthouse raises some troubling questions regarding the relationship between lead and participating lenders, in the area of lender-borrower relations it clearly joins Rodgers and Kruse as a reaffirmation of the primacy of contract law over public policy considerations for defining the rights of private parties in commercial transactions.

Kruse is particularly noteworthy for its emphasis on the concept of justifiable reliance. For example, the opinion uses the term "justifiable reliance" (or equivalent words) roughly ten times in two and a half pages. The heart of the opinion seems to be that the borrower's reliance on its expectations of additional financing was not justifiable, and as a result, no special relationship or duty of good faith arose. If this is indeed the case, then the initial inquiry must be whether the parties' relationship gives rise to a level of justifiable reliance sufficient to create a "special relationship" and concom-

86. This factor more validly distinguishes Djojarazdeh.
88. 665 F. Supp. at 310.
89. 855 F.2d 963 (2d Cir. 1988), cert. denied April 3, 1989.
90. See, e.g., Dennis & Endler, supra note 73.
92. Cf. Harrell, supra note 37, at 679-682.
mitant special duties of good faith and fair dealing, as in the insurance cases. Clearly in the right circumstances any of these courts would recognize a kind of "special relationship" giving rise to such duties. But each of these cases dealt with a transaction which, for the reasons stated by the courts, did not rise to the level of a "special relationship." Therefore further examination is necessary to attempt delineation of the possible boundaries and implications of such a relationship.

The Elements and Consequences of a "Special Relationship"

The concept of a confidential or special relationship has long been recognized in Oklahoma. A typical description is:

A confidential relation arises by reason of kinship, between parties, or professional, business, or social relations that would reasonably lead an ordinary prudent person in the management of his business affairs to repose that degree of confidence in the defendant which largely results in the substitution of the will of the defendant for that of the plaintiff in material matters involved in the transaction.

As this suggests, the definition of a "special relationship" is likely to be broad and fluid. In 1927 the Oklahoma Supreme Court quoted Pomeroy's definition:

It has been said that [a special relation] exists, and that relief is granted, in all cases in which influence has been acquired and abused, in which confidence has been reposed and betrayed. The origin of the confidence and the source of the influence are immaterial. The rule embraces both technical fiduciary relations and those informal relations which exist whenever one man trusts in and relies upon another. The only question is, Does such a relation in fact exist?

The most recent pronouncement by the Oklahoma Supreme Court is consistent with the broad, nonspecific approach articulated by these authorities and earlier case law. In Lowrance v. Patton, the Supreme Court unanimously stated:

In determining whether a fiduciary relationship was established, there are several rules couched in general terms which have been

93. As suggested by Rodgers and Kruse, an important part of this inquiry would depend on the relative sophistication of the parties and the extent to which the transaction was negotiated at arm's-length.


95. See also Hamburg v. Doak, 207 Okla. 517, 251 P.2d 510, 514 (1952); Mcrury v. Low, 94 Okla. 41, 220 P. 945 (1923) (syllabus I).


adopted to serve as a guide in the determination of this question. It is settled law that courts of equity will not set any bounds to the facts and circumstances out of which a fiduciary relationship may spring. It includes not only all legal relationships such as guardian and ward, attorney and client, principal and agent, and the like, but it extends to every possible case from which there is confidence reposed on one side and resulting domination and influence on the other. The relationship need not be legal but it may be either moral, social, domestic or merely personal. Therefore, a fiduciary relationship which is recognized and enforced equitably does not rest on any particular legal relationship.

Rather, a fiduciary relationship springs from an attitude of trust and confidence and it is based on some form of agreement, either express or implied, from which it can be said the minds have been met to create a mutual obligation.98

Interestingly, the court did not cite any Oklahoma cases as authority for its statement, but relied on four Tenth Circuit decisions.99

The debtor-creditor relation created in a loan transaction is by nature essentially one of contract. If, however, there is a meeting of the minds, express or implied, in which can be inferred an additional special obligation of trust and confidence, then a fact finder may find that a fiduciary or confidential relation exists. If that critical relation is found to exist, the burden of proof shifts from the claimant-borrower to the fiduciary-lender to prove by clear and convincing evidence that no advantage was taken and that the transaction was fair and conscientious.100

The common thread running throughout these descriptions of special or fiduciary relationship is the concept of reliance. In virtually all the special or fiduciary relationship cases involving lenders, the court has focused on some aspect of the transaction that led the injured party to a justified belief that he could abandon independent judgment and rely instead on his trust in the other party. This concept of reliance has been identified in previous commentary, especially regarding banking transactions,101 but has not received adequate attention or been fully recognized as the essential ingredient in many lender liability cases.

98. Id. at 111-12.
99. See Raeder v. Boyd, 252 F.2d 585 (10th Cir. 1957) (federal common law applied); Appleman v. Kansas-Nebraska Natural Gas, 217 F.2d 843 (10th Cir. 1955) (Kansas law; joint venture); Oldland v. Gray, 179 F.2d 408 (10th Cir. 1950) (Colorado law; cited Oklahoma cases); Blankner v. McDermott, 176 F.2d 498 (10th Cir. 1949) (Wyoming law; joint venture).
A Review of Oklahoma Lender Liability Case Law

The starting point in any review of Oklahoma jurisprudence regarding the potential and nature of a financial institution's "special relationship" with a customer or potential customer is Djowharzadeh v. City Nat'l Bank & Trust Co. Djowharzadeh dealt with the kind of relationship created when a prospective borrower applies for a loan. The court said:

The relationship created when a prospective borrower applies for a loan from a bank is a very special one. It has not yet ripened into a contract—because it has not yet crossed the threshold of formal agreement. Neither is it fiducial—because it is by nature an arm's length transaction. It does, however, impose special duties on each party which go beyond mere matters of courtesy.

... We hold . . . Bank’s relationship to a loan applicant implicitly imposes the duty to keep the contents of loan applications confidential. This duty has existed traditionally and continues to exist, if not specifically in the law books, at least in the mind of the public in general and within the banking community in particular. Djowharzadeh has no precedential value in Oklahoma because it was decided by the Oklahoma Court of Appeals. It has, however, been cited with some limited approval by a court of last resort.

The latest example in Oklahoma's reported case law in which a court has attempted as a matter of law to impress a fiduciary-like quality on a relation qua relation is Smith v. Citizens State Bank of Hugo. In Smith, Judge Brightmire wrote "a bank has a duty to deal fairly and honestly with its depositors and to do otherwise can subject it to principles of estoppel, as well as a charge of bad faith breach of contract." In a supporting footnote he stated: "Bad faith breach of a fiduciary duty (such as exists between bank and depositor) will support punitive damages." To support this leap of faith Judge Brightmire cited a decision he authored in McCa...
relationship’’ of good faith inherent in the dealings between an insurer and its insured.111 As discussed previously, in Rodgers the Oklahoma Supreme Court recently rejected an effort to extend the Christian rationale to lending transactions. In addition, the language in Smith suggesting there is a fiduciary relation is directly contrary to settled Oklahoma case law that the bank-depositor relationship, without limitation or qualification, is a debtor-creditor, and therefore contractual, relationship.112 Clearly, more than just the bank-customer relationship is necessary to create the kind of ‘‘special relationship’’ leading to imposition of a fiduciary relationship or other special obligations.

Case Law from Other Jurisdictions

Not surprisingly, California, the birthplace of the good faith/fair dealing implied-covenant doctrine, has gone the farthest in finding a confidential relationship in the bank-customer context. One particular decision concerning a bank’s relationship with its depositors is Commercial Cotton Co. v. United California Bank.113 In Commercial Cotton the appellate court stated with regard to the bank-customer relationship: ‘‘The relationship of a bank to a depositor is at least quasi-fiduciary, and depositors reasonably expect a bank not to claim nonexistent legal defenses to avoid reimbursement when the bank negligently disburses the entrusted funds.’’114 This broad, consumerist characterization of the relationship does not seem to have spread beyond the borders of California. It has, however, spread to the bank-lender relationship in California. In Barrett v. Bank of America Nat’l Trust & Savings Ass’n,115 the court held the trial court erred in refusing a constructive trust instruction where loan customers shared confidential information about unfavorable developments with a banker, relied on the banker in seeking a merger, and

111. Id.

112. W.R. Grimshaw Co. v. First Nat’l Bank & Tr. Co., 563 P.2d 117 (Okla. 1977); Ingram v. Liberty Nat’l Bank & Tr. Co., 533 P.2d 975 (Okla. 1975); Waitman v. Waitman, 505 P.2d 171 (Okla. 1972). A bank can possibly incur fiduciary-like responsibilities in a depository context. That may occur where there is a qualification or limitation on the deposit, or in the case of a general, unqualified deposit where there has been a misappropriation of trust funds in making the deposit or, even absent the deposit being a wrongful misappropriation of trust funds, where the bank has knowledge or notice of an improper withdrawal of funds or that a breach of trust is being committed by improper withdrawal. Security State Bank of Commanche v. W.R. Johnston & Co., 204 Okla. 160, 228 P.2d 169 (1951); Board of County Commrs of McCurtain County v. State Nat’l Bank of Idabel, 160 Okla. 182, 36 P.2d 281 (1934); New Amsterdam Cas. Co. v. First Nat’l Bank, 154 Okla. 74, 6 P.2d 779 (1931); Dempsey Oil & Gas Co. v. Citizens Nat’l Bank, 110 Okla. 39, 235 P. 1104 (1925).

Where a guarantor is concerned, there is a clear pronouncement that the relation is contractual. Riverside Nat’l Bank v. Manolakis, 613 P.2d 438, 441 (Okla. 1980). That statement, however, does not prevent that contractual relation from being characterized as confidential if the requisite facts are present.


the banker made conflicting statements to the customers and to a prospective merger partner. The appeals court relied on Commercial Cotton Co. in stating that confidential and fiduciary relationships are, in law, synonymous and may be said to exist whenever trust or confidence is reposed by one person in another. The California cases seem to require only that the borrower or depositor repose trust or confidence in the bank.

As noted, the California Court of Appeals recently reversed a jury verdict of over $26 million against Bank of America in the widely noted Kruse v. Bank of America case. While the decision turned on the court's reversal of a number of factual determinations made by a jury (limiting to some extent its precedential value), the case is important because of its narrow reading of troublesome California precedents, including the 1984 California Supreme Court decision in Seaman's Direct Buying Service, Inc. v. Standard Oil Co. There was speculation that the California Supreme Court might use this case as a vehicle to impose broad fiduciary duties on lenders as the Maryland Court of Appeals did in Jacques v. First Nat'l Bank of Maryland, (citing the Oklahoma Court of Appeals decision in Djowharzadeh v. City Nat'l Bank & Trust Co. of Norman with limited approval), but apparently this was not to be. Kruse may represent a significant backtracking by the California courts toward the more traditional position evidenced by Rodgers v. Tecumseh Bank.

Consistent with this, Oklahoma traditionally requires evidence of reliance plus some element of domination or influence as the standard prerequisites to a "special relationship." These requirements are consistent with most cases from other jurisdictions. While the Oklahoma courts may not have articulated a "community standard" to determine whether there is a special, fiduciary, or confidential relationship, the cases indicate that the facts of each case will dictate whether such a relationship may be found. Investigating the kinds of factual situations where such a relationship has or has not been found, in Oklahoma and in other states, is useful as means of refining the concept of "special relationship" into an element of commercial law in Oklahoma.

Examples of a "Special Relationship"

In Smith v. Saginaw Savings & Loan Ass'n, a fiduciary relationship was found between a bank and a frail elderly couple where an eager

116. Id., 229 Cal. Rptr. at 18.
117. Id., 229 Cal. Rptr. at 20.
118. Whether the California courts require any form of justification for this reliance or whether it is being recognized as a matter of law due to special characteristics of the bank-customer relation is unclear. See Harrell, supra note 37, at 679-82.
121. 307 Md. 527, 515 A.2d 756 (1985). See also supra notes 83-84, 102-104.
122. 646 P.2d 616 (Okla. Ct. App. 1982). See also supra notes 83-84, 102-104.
123. Seaman's, 686 P.2d at 1171.
loan officer agreed not only to loan the plaintiffs money for the construction of their home, but also approved the builder (whom he knew to be in financial trouble), the building contract, and the building specifications. The plaintiffs lived approximately 250 miles from the proposed building site. The loan officer also agreed to make sure the construction was completed without cost overruns and promised that no money would be released to the prime contractor until the work was actually completed. The unique facts of this case supported the finding by a Michigan appellate court of a relationship whereby the plaintiffs reposed faith, confidence, and trust in the judgment and advice of the lender.

Similarly, following the Restatement (Second) of Torts § 551 (1977), the Iowa Court of Appeals held that a twenty-year relationship between a lender and guarantor had ripened into a fiduciary relationship. In this case the lender persuaded the guarantor to grant a large mortgage on her unencumbered, exempt homestead to secure a preexisting debt but did not advise her that her homestead could not otherwise have been reached by the lender. The guarantor’s husband had just suffered a heart attack at the time she mortgaged the homestead.

In another case involving a farm, a jury gave the bank judgment on its $700,000 debt but granted the family farmers an award of $1,040,000 for the lender’s breach of fiduciary duties. The bank had advised the debtor-family farmer when and how to market products, how to manage the farm operation, and had assisted the plaintiffs in analyzing their financial position. The bank even had induced the farmer to fire his independent marketing consultant. The court submitted the case to the jury on the theories of negligence in structuring loans and economic duress exerted by the lender in persuading the debtors to follow its advice. The case was settled pending appeal.

A lender who takes control of a company to liquidate its assets and satisfy its own debt may experience equitable subordination of its claim to the claims of all general unsecured creditors. In In re American Lumber Co., because the lender exercised excessive control, including taking physical possession of the premises, terminating the borrower’s employees in excess of those necessary for liquidation, becoming the sole signatory on the borrower’s checks, monitoring the borrower’s mail, and paying only those general unsecured creditors who would assist the lender in the liquidation process, the lender was placed in a fiduciary position not only to the borrower but to the unsecured creditors. Once that relation was established, the concomitant duty to deal fairly and impartially with a debtor and its creditors arose.

129. 7 Bankr. 519 (Bankr. D. Minn. 1979), affirmed 5 Bankr. 470 (D. Minn. 1980).
130. Id. at 529.
In another case the court found an implied partnership in a situation where a lender overreached.\textsuperscript{131} In \textit{Security Pacific Nat'l Bank v. Williams},\textsuperscript{132} a trial judge awarded a borrower $2.3 million in compensatory damages and $2.5 million in punitive damages, based on findings that the lender had a fiduciary relationship with the owner of a car dealership the lender financed, and that the lender misled the owner into taking certain actions respecting his business that caused him injury. In that case Williams operated a Buick dealership in San Diego. He was a favored customer of the bank. In early 1979, Williams and his loan officer, Ross, in whom he placed a great deal of trust, met to discuss Williams' purchase of a second car dealership. Ross vetoed several of Williams' suggestions and even threatened to "pull the chain" on Williams' loans if Williams persisted. Then Ross indicated to Williams that he should purchase a dealership in Los Angeles called Viking Dodge. Ross offered Security Pacific's assistance with the purchase. Ross was familiar with Viking Dodge because it was one of his troubled loans. During negotiations Ross made some fraudulent representations to Williams about Viking's finances. Later that year the gasoline crisis struck California. Ultimately Williams had to turn over Viking Dodge to Chrysler Credit, which then obtained a deficiency judgment against him. Security Pacific became increasingly difficult on Williams' original Buick operation. Ross urged Williams to find a new investor but refused to provide a letter assuring the investor of the bank's continued financial support. Williams then filed bankruptcy. In sustaining Williams' counterclaim in the bank's suit on Williams' guaranty, the trial court found that a relationship of trust existed: "The Williams-Security Pacific National Bank relationship went far beyond a lender-borrower relationship. It was an all-encompassing, mutually beneficial, day-to-day relationship in which both sides reposed trust and confidence in one another. . . . The relationship here had much the makings of a mutually beneficial partnership."\textsuperscript{133} This idea of mutuality is consistent with the Oklahoma Supreme Court's language in \textit{Lowrance v. Patton}\textsuperscript{134} and \textit{Rodgers v. Tecumseh Bank}. Oklahoma, therefore, possibly would find a fiduciary or special relation in a case such as \textit{Williams}.\textsuperscript{135}

Not every egregious situation, however, results in a finding of a confidential relation. In \textit{Karth v. Van Horn},\textsuperscript{136} a bank was not liable for allowing a sick eighty-year old man to mortgage his farm to help a tenant.\textsuperscript{137} No evidence was presented that the elderly borrower relied on the bank for advice, nor was there any showing that the bank misled him. The bank did not have a duty to demand that he secure counsel because "this form of protectionism

\textsuperscript{131} The facts are taken from Chairmain, \textit{The Ten Commandments for Avoiding Lender Liability (Annotated)}, in \textit{CURRENT ISSUES IN LENDER LIABILITY} (4th ed. 1987).
\textsuperscript{132} Nos. 457727 and 457728 (Super. Ct. of San Diego County, Cal. 1986).
\textsuperscript{133} Id. (emphasis added).
\textsuperscript{134} 710 P.2d 108 (Okla. 1985).
\textsuperscript{135} See Rollison v. Muir, 163 Okla. 266, 21 P.2d 1062, 1065 (1932).
\textsuperscript{136} 380 N.W.2d 693 (Iowa 1986).
\textsuperscript{137} Id. at 694.
goes beyond the banker's responsibility in this case." In other words, the bank had no affirmative duty to prevent the old man from doing what the evidence clearly showed he wanted to do. The Iowa court followed the Kansas decision in *Denison State Bank v. Madeira,* which held that as a matter of law a bank was not a fiduciary to a potential buyer of a customer's business where the buyer could have discovered substantial seller overdrafts at the bank just by looking at the seller's records.

In another case, in overruling a motion to dismiss for failure to state a claim upon which relief could be granted, the United States District Court for the District of Columbia ruled that a loan broker who took an application for a home loan from consumers and passed it on to a permanent lender owed the applicants a duty of good faith and fair dealing, may have owed them a duty to act in their best interests and, therefore, may have occupied a fiduciary relation to the applicants. The court focused on both the flexible definition of fiduciary in the District of Columbia and concentrated on the finding of a "special confidential relationship" that transcended an ordinary business transaction requiring each party to act with the interests of the other in mind.

In *Shiplett v. First Sec. Bank of Livingston,* the Montana Supreme Court found that no special circumstances were present to create an exception to the general rule that a bank's relationship with its customer is not confidential. The gist of the Shipletts' complaint was that in 1978 the bank agreed to loan them money at a 10 percent rate for five years but did not do so. In January 1978, the Shipletts signed a note that did not contain the five-year term. In renewing the debt in 1979, they signed a note that did not contain either the five-year term or the 10 percent rate. A FmHA guaranty of the loan expired in 1984. In order to renew the debt and obtain a new FmHA guaranty, the Shipletts, after negotiations in which they were represented by counsel, executed new loan documents containing more onerous terms. The next month they sued the lender. The court noted that while the bank had advised the Shipletts on the operation of their ranch, that advice was not always heeded and, in fact, the Shipletts believed they knew more about ranching than did the bank's agent. Also important to the decision was the fact that they were represented by counsel. Under these facts the absence of sufficient reliance was fatal to the claim of fiduciary liability.

Earlier in 1988 the same Montana court found that a confidential relation did exist in a breach of credit line agreement case. There the bank encouraged and advised the borrowers to expand a cattle operation and "participated in and encouraged the changes" made in the borrowers' operation. In view

138. *Id.* at 697.
139. 230 Kan. 684, 640 P.2d 1235 (1982): "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." (syllabus 10 by the court, 640 P.2d at 1237).
141. 762 P.2d 242 (Mont. 1988).
of the fact that the bank effectively controlled the debtors' finances, the borrower had no other financial choice, the parties were in an unequal bargaining position, and the bank actually participated in the borrowers' decision, a confidential relationship existed and liability was imposed.

Another interesting case involving fiduciary liability also comes from Montana. In Deist v. Wachholz,143 a bank officer, but not the bank itself, was found to have occupied a fiduciary position to the bank customer. The plaintiff and her deceased husband had a relation with the bank lasting more than twenty-four years. The nature of the association and the widow's reliance, combined with her husband's years of dealing with the bank on essentially the same matters, were held to be sufficient to make a prima facie case of the existence of a fiduciary relation. The bank's marketing officer became a silent partner with a party who ultimately purchased the widow's ranch. The wrong that occurred was that the bank officer did not disclose "fairly and honestly all the information which might be presumed to have influenced [the plaintiff] in the transaction."144 In refuting the bank officer's contention that the judgment exonerating the bank but imposing fiduciary liability on him was nonsensical, the Montana court stated that an individual may incur a fiduciary duty coextensive with the "internal association" that gave rise to the duty.145 "The bank was unquestionably involved in the sale of the ranch, and [the marketing officer] was not so detached that imposition of fiduciary responsibilities would be impermissible."146

In a construction lending case, a complaint by a contractor against a lender has recently been reinstated. In refusing to apply the trial court's balancing test, the New Mexico Court of Appeals ruled that "a bank can be held accountable under a given set of facts to both the customer and the third party."147 Allowing a jury to balance the duty of confidentiality to a customer versus a duty to disclose facts so that the contractor will not be working to his detriment was held to be "unworkable." Instead, the factfinder should determine whether there are special circumstances that give rise to a duty of disclosure to the third party notwithstanding the established duty of confidentiality to the customer. While the case is typically fact specific, it stands for the propositions that the concept of a confidential relation is very fluid and that an abuse of a reliance or confidence is actionable even in the context of a third party who is otherwise not dealing with the bank.

Conclusion

While there is no simple litmus test for determining when a relationship becomes one of confidence or trust, such a relationship has been found in

144. Id., 678 P.2d at 195.
145. "Equity is not compromised by holding [the defendant bank marketing officer] to a fiduciary duty to [plaintiff widow] in those dealings intimately associated with the offices of the Bank, so long as the duty reaches no further than the internal association that gave rise to it." Id., 678 P.2d at 194.
146. Id.
a borrower-lender context when the borrower places trust or confidence in some representation by the lender. Generally this requires several findings: some affirmative act by the lender inducing a justifiable reliance on the part of the borrower; a genuine imbalance of bargaining power between the parties; an extraordinary scope to the parties' relation; express or implied acceptance by the lender of the borrower's trust; and finally, some unsavory dealing by the lender for its own interest dehors the relation with the borrower. Most aggrieved borrowers are unlikely to plead, much less prove, a claim based on fiduciary duty or a special relationship without meeting most of these requirements. By the same token, however, in those instances where the lender has overreached in a context of confidence, that lender has a very good reason to be concerned if the aggrieved borrower asserts a claim for breach of a fiduciary or confidential relation.

While Rodgers v. Tecumseh Bank and the other recent cases do not define the parameters of these issues, they strongly suggest that, absent some special relationship or grossly willful abuse of trust, lenders will not be liable for punitive damages in tort for breach of a lending agreement. As noted, the single most significant factor emerging from these opinions is the importance of the doctrine of justifiable reliance as the basis for imposition of special obligations in a contracts setting. These cases indicate that reliance is the foundation on which allegations of a special relationship and duties of good faith and fair dealing must be built. As a result, cases like Rodgers, Kruse, and Penthouse recognize a reduced level of lender responsibility in contractual arrangements that have been negotiated at arm's-length between parties of roughly equal sophistication. However, within this broad statement lies the potential for a myriad of qualifications and exceptions, suggesting a continued need for lenders and their counsel to monitor legal developments in this area and to exercise extreme caution in the interpretation and enforcement of loan agreements.

148. See the 1987 amendment to section 11 of the Oklahoma Pleading Code. That now tracks Federal Rule of Civil Procedure 11, which adopts an objective standard for a pleader. Theretofore, original section 11 of the Pleading Code embodies a subjective standard which allowed a pleader to claim most anything with impunity.