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The Hidden Risk for Lenders for Implied Fiduciary Duty

APRIL 11, 2024 Written by Eric S. Rein

Fiduciary duty may be implied in certain "special circumstances where a lender (i) takes on "extra services" for the borrower, (ii) receives greater economic benefit from a typical transaction; or (iii) exercises extensive control. *MSC Cruises Inc. v. Merrick Bank*, 2014 WL 12531533 (S.D. Fla. June 6, 2014); *see also Klein v. First Edina Nat. Bank*, 293 Minn. 418 (S. Ct. Minn. 1972); and *Tokarz v. Frontier Federal SA. & Loan Ass'n*, 656 P. 2d 1089 (Wash. Ct. App. 1980). A fiduciary duty may also be implied if a borrower demonstrates that a lender acted as a financial advisor to a subservient borrower and the borrower relied on the lender's advice. *Niemuth v. Medford National Bank*, 157 Wis. 2d 262 (Wisc. Ct. App. 1990). But no such relationship arises if the advising lender is offering nothing more than optional advice or the statements are reasonably related to protect the lender's interest in collateral. *Id*. Texas law amplifies that a fiduciary relationship can be implied where there is a longstanding relationship and the lender recommends the loan and deliberately withholds material information. *Middaugh v. Interbank*, 528 F.Supp.3d 509 (N.D. Tx. 2021)

Currently, no factual situation has imputed an implied duty. But a lender needs to be cognizant of situations where excessive control has been raised.

- *MSC Cruises*
  - Lender contracted to provide credit card services.
  - Lender acted as an agent to procure chargeback insurance.
- *Rosewell Cap. Partners, LLC v. Alt Const. Tech*, 638 F.Supp.2d 360 (S.D.N.Y. 2009).
  - Lender had convertible notes and power to appoint two board members.
  - Lender got additional stock from borrower.
  - Lender appointed two members to board.
  - Lender prevented additional funding.
  - Lender merely exercised rights as a creditor.
- *Pinkey Originals, Inc. v. Bank of India*, 1996 WL 603969 (S.D.N.Y. Oct. 21, 1996).
  - Lender visited borrower's showroom and warehouse.
  - Inspected product.
  - Received business plans.
  - Had regular meetings.
  - Spoke frequently on phone.
  - Closely monitored account.
  - Merely describes normal oversight of a lending relationship.
- *Middaugh, supra*.
  - Lender told borrower working capital was above lending limit.

- Borrower had to sign several notes with much smaller face values.
- Subjective reliance of borrower, and the adversarial nature of the relationship does not give rise to fiduciary duty.

- *In re BH Sutton Mezz., LLC*, 2016 WL 8352445 (S.D.N.Y. Dec. 1, 2016).
  - Lender dominated meetings.
  - Limited options following initial financing.
  - Limited ability to pursue equity investment and values.
  - Lender had no ability to appoint directors or authority over hiring and firings.
  - No showing lender assumed actual participation and total control.

Lenders Be Wary…

- Look beyond mere contractual provisions and consider if exercising creditor's rights beyond a typical transaction.
- Establish no more control rights than is reasonably necessary.
- Be wary of excessive control.

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