RECENT DEVELOPMENTS IN THE AREA OF LENDER LIABILITY LAW

*By Gerald L. Blanchard**

The past year presented a broad cross-section of lender liability litigation. As usual, a fair number of cases involved traditional theories, such as breach of oral agreements, breach of the obligation of good faith and fair dealing, fraud, and negligent misrepresentation. In addition, the year saw continued development in the area of deepening insolvency. In the case of deepening insolvency, the courts had been wrestling with the issue of whether deepening insolvency is a distinct tort from existing causes of action or whether it is simply old wine put in new bottles.

BREACH OF ORAL CONTRACT/BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING.

The traditional theories of breach of contract and breach of obligation of good faith and fair dealing were presented in the case of *Lettunich v. Key Bank*.[1] Edward Lettunich approached Key Bank in March 2000 to negotiate a financing arrangement to allow him to buy his brother's interest in a cattle farming operation pursuant to a court order issued as part of the dissolution of the brothers' partnership. The property was scheduled to be sold at auction on April 26. The proposed financing would take the form of three individual loans: (1) real estate; (2) cattle; and (3) a working capital line of credit. On April 25, 2000, the loan officer at Key Bank sent Lettunich a separate commitment letter for each loan. Each commitment letter contained the following clause:

> This commitment and the two related commitments supersede all oral negotiations and oral agreements between us with respect to the subject matter hereof. No waiver of any provisions hereof shall be effective unless in writing and then only in the specific instance and for the specific purpose specified. Pursuant to Idaho Code § 9-505(5), a promise or commitment to lend money or to grant or extend credit in an original principal amount of $50,000 or more shall be made in writing or the agreement is invalid.[2]

Each of the three loans was for an amount in excess of $50,000. The commitment letter for the real estate loan involved another proposed

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borrower by the name of Larry Williams, who would also be required to sign the commitment as borrower and guarantor. Williams was also required to sign the commitment for the cattle loan agreeing to provide a guarantee in the amount of $500,000.

Lettunich and Williams were unable to agree upon how the cattle business would be structured going forward, and thus Williams did not sign the commitment letters. On April 25, the day before the court-ordered sale, Edward Lettunich met again with the bank officer to discuss his options now that the transaction with Williams had fallen through. Lettunich testified that the loan officer informed him that he should move forward with his plan to purchase cattle at the court-ordered sale and that the purchase price would be covered by a Key Bank loan. Lettunich then went ahead and purchased the cattle at the sale for an amount in excess of $400,000. Lettunich also signed the existing commitment letters on April 26 and returned them to the bank. Subsequent to the purchase of the cattle, Key Bank refused to fund the loans, sending him a letter stating, "Thank you for applying to us for credit. We have given your request careful consideration and regret that we are unable to extend credit to you at this time."

Following the refusal by Key Bank to extend credit to him, Lettunich filed suit claiming breach of oral contract, breach of the covenant of good faith and fair dealing, and fraud. At trial Key Bank moved for summary judgment on the ground that the statute of frauds covered the claims. The bank's motion was granted and Lettunich appealed.

The first issue the court reviewed was whether the oral agreement was barred by the Idaho Statute of Frauds. As noted above, Idaho Code § 9-505(5) provides that a promise or a commitment to lend money in excess of $50,000 must be made in writing. In this case the commitment letters could not be used to satisfy the writing requirement because one of the guarantors, Larry Williams, never signed the documents. The court then went into an analysis of whether there were any exceptions to the statute of frauds that would bring the case outside the scope of the statute. The first argument raised by Lettunich was the doctrine of part performance. The part performance on the part of Lettunich was the purchase of cattle at the auction. The court found that this was not sufficient because the alleged oral agreement did not contain sufficient information about the amount of the loan, the interest rate, disbursement schedule, term of repayment, security, or rights after default. The court concluded that the doctrine of equitable estoppel did not apply for the same reasons. Likewise, promissory estoppel did not give Lettunich a claim because there was no complete promise to be enforced. As the court noted, "promissory estoppel is simply a substitute for consideration, not a substitute for an agreement between parties."[3]

The court examined Lettunich's claim for breach of the implied covenant of good faith and fair dealing and concluded that there could be no breach of the obligation of good faith and fair dealing because there was no contractual agreement to be enforced.[4]

BREACH OF IMPLIED DUTY OF GOOD FAITH AND FAIR DEALING

The *Grand Housing, Inc. v. Bombardier Capital, Inc.*[5] case arose out of a retail dealer agreement between Grand Housing, a company selling manufactured homes, and Bombardier Capital. Under the contractual agreement, Bombardier provided retail financing for individuals buying manufactured housing. In 2000, two years after the relationship commenced, Bombardier discovered that Grand Housing had defaulted on certain sales made to individual retail customers. As a result, Bombardier demanded that Grand Housing repurchase several contracts. Grand Housing responded by filing suit alleging tortious interference and breach of the obligation of good faith and fair dealing. The district court granted a motion for summary judgment for Bombardier. On appeal, Grand Housing argued that Bombardier had not acted in good faith by canceling the floorplan and reducing the line of credit. The Fifth Circuit, in analyzing Mississippi Contract Law, noted that Mississippi courts required a showing of more than negligence to make a showing of lack of good faith and fair dealing. Rather, they required a violation of a standard of decency, fairness, or reasonableness. The court found that Bombardier acted completely within its contractual rights to reduce the floorplan and that such activity could not give rise to a claim for a breach of the obligation of good faith and fair dealing.

BREACH OF CONTRACT/STATUTE OF FRAUDS/GOOD FAITH AND FAIR DEALING

In *Farmers Bank and Trust Company of Georgetown, Kentucky v. Willmott Hardwoods Inc.*,[6] the Kentucky Supreme Court was faced with claims against a lender arising out of an alleged breach of promise to make a loan. John Willmott operated a logging business which was indebted to Fifth Third Bank. After becoming dissatisfied with that banking relationship, Willmott sought financing from another lender, including a $780,000 loan from Farmers Bank and Trust Company of Georgetown, Kentucky and several other banks.

Farmers sent Willmott a commitment letter dated July 11, 1996, stating that the commitment would expire unless the loan was closed by August 10, 1996. Willmott signed the commitment letter and paid a commitment fee in the amount of $2,500. On August 2, 1996, a loan officer at Farmers

sent Willmott a draft loan agreement. Subsequent to this event, Willmott informed Farmers that one of the other banks he was negotiating with could not come to terms and that he would therefore be unable to close the loan by August 10. Willmott claimed that the loan officer agreed to extend the closing to August 23, and allegedly acknowledged that if Willmott did not obtain the loan by September 1 the business would be forced to close.

On August 19, the loan officer contacted Willmott to tell him that the loan would not close on August 23 and would have to be resubmitted to the Board of Directors of the bank during its next meeting in September. On September 1, the business closed and liquidated its assets to satisfy Fifth Third, and Wilmott filed suit. The trial court entered summary judgment in favor of the bank. The Kentucky Court of Appeals reversed on the basis that detrimental reliance had occurred by Willmott which was sufficient to take the transaction out of the statute of frauds. The court of appeals also reversed the trial court's summary judgment grant to the bank on the issues of good faith and fair dealing.

On appeal, the Kentucky Supreme Court first examined the statute of frauds issue, noting that the first commitment letter clearly fell within the statute of frauds. Any agreement to extend the closing date of the loan commitment would also need to be in writing *if* time was of the essence in the contract. The statute of frauds would not apply under Kentucky law to an oral modification of time or performance if time was not of the essence of the contract.

The commitment letter itself did not expressly state whether time of closing was of the essence. The court held, however, that because of the specific language stating that the contract would expire if the loan was not closed by August 10, 1996, at least by implication, the closing time was truly of the essence of the contract. Thus the alleged oral extension of the contract was unenforceable.[7]

The court went on to find that equitable estoppel was also not applicable. The court of appeals had found detrimental reliance on the part of the plaintiff which acted as a bar to the statute of frauds. The Kentucky Supreme Court held that relief such as equitable estoppel "…should only be granted under the most limited circumstances, lest the Court run afoul of separation of powers."[8] The court noted that where the facts showed that Farmers was ready and able to perform according to the terms of the commitment and that Wilmott was the party that could not close, equitable estoppel simply wasn't applicable.

Wilmott also asserted fraud and fraudulent representation claims. One of the fundamental elements of such a claim is that the defendant needs to have made a material representation which it knew to be false at the time made.[9] The court noted that there was no evidence that Farmers

did not intend to make the loan, and thus the claim for fraud and fraudulent misrepresentation failed.

BREACH OF CONTRACT/FRAUDULENT MISREPRESENTATION/BREACH OF COVENANT AND GOOD FAITH AND FAIR DEALING

In *Cordry v. Vanderbilt Mortgage and Finance, Inc.*,[10] the plaintiff operated a manufactured home retail lot in Lebanon, Missouri and had floor plan financing through Deutsche Financial Services Corporation ("DFS") for both new and used manufactured homes. The floor plan agreement was eventually assigned to Vanderbilt Mortgage and Finance, Inc. In January 2003, Cordry requested financing for four manufactured homes. Vanderbilt offered to provide financing at a level which Cordry believed was approximately 35% of the value that the original lender, Deutsche Financial Services Corporation, would have provided. Cordry later filed suit against Vanderbilt for various breach of contract claims, fraudulent misrepresentation, negligent misrepresentation, breach of covenant and good faith and fair dealing, and interference with contractual relations. Cordry struck out on all counts, although the court did show some sympathy toward its situation. Apparently, DFS provided financing for used manufactured homes based on a percentage of the NADA *retail* value instead of the *wholesale* value that was actually called for in the addendum to the floorplan agreement. Vanderbilt proposed financing at the wholesale value, which was within the terms of the written contract but had not been the practice of DFS. Thus, a representation by Vanderbilt at the time it assumed the floorplan agreement that it would provide the same credit line under the same terms and conditions was not a negligent misrepresentation based upon a clear reading of the written contract. With respect to the obligation of good faith and fair dealing, Cordry argued that Vanderbilt violated the duty by relying on language in the contract that provided that Vanderbilt could advance whatever amount it wanted, if any. Vanderbilt responded that exercising its discretion under the contract could not violate its obligation to good faith and fair dealing. The court rejected the theory that Vanderbilt had "unfettered, unreviewable decision making," noting that discretion is subject to some limits. The court, however, found no facts that would support a showing of bad faith by Vanderbilt even if the testimony showed evidence of lack of diligence on Vanderbilt's part.

GOOD FAITH AND FAIR DEALING

The *Cable and Associates Insurance Agency, Inc. v. The Commercial National Bank of Pennsylvania*[11] case follows the *Creeger Brick and Building Supply, Inc. v. Mid-State Bank and Trust*[12] opinion, which stands for

the proposition that while every contract imposes on the parties to a contract the obligation of good faith and fair dealing, a party complaining of a lender's actions must show that the lender did more than simply negotiate terms which were more favorable to the lender than to the borrower. Likewise, the duty of good faith does not require a lender to surrender rights given to advice statute or by the terms of the contract. Thus normal lender actions taken in collecting and working out a problem loan, such as refusing to advance additional funds or releasing collateral at the request of a borrower, do not constitute a lack of good faith on the part of the lender regardless of the possible financial squeeze it puts on the borrower. In the *Cable* case, the borrower argued that the lender had violated its obligation of good faith by refusing to surrender a security interest in accounts receivable so that the borrower could sell or transfer the collateral to another party. The lender ultimately decided not to release its lien, and the court held that that decision, as a matter of law, would not constitute a breach of the obligation of good faith and fair dealing.

BREACH OF FIDUCIARY DUTY

Schwan's Sales Enterprises, Inc. v. Commerce Bank & Trust Company[13] arose out of the failure of a company called Good Stuff Entertainment Corporation, a marketing firm which was financed by Commerce Bank & Trust Company. Schwan's had hired Good Stuff for marketing services. Good Stuff had a $1 million revolving line of credit with Commerce Bank which was secured by its accounts receivables. Availability under the line of credit was limited by a borrowing base.

Schwan's was the owner of the Freschetta Frozen Pizza line and contracted with Good Stuff to market the pizza across the country during 2002. The marketing campaign included 320 events, six buses, and a distribution of over 500,000 samples, all to take place during the summer of 2002. Good Stuff invoiced Schwan's in advance for the services totaling approximately $736,000 over a period of several months. As Good Stuff invoiced Schwan's, it submitted the invoices to Commerce Bank, and Commerce provided financing based upon the borrowing base. In the winter of 2001 and early spring of 2002, the bank encouraged Good Stuff to collect its accounts receivables from Schwan's, although there was no testimony that Good Stuff was encouraged to accelerate any prepayments. During this time, Commerce Bank directed Good Stuff to hire a consultant as the Chief Financial Officer, although later Good Stuff was directed to fire him and hire a different person. The loan officer at Commerce Bank had conversations with Good Stuff concerning what bills should be paid. In April 2002 the loan officer informed Good Stuff: "Looks like I have to baby sit you guys again and lay the law down. The answers are very simple, either collect the AR or slow down payables."[14]

During this time period the lender's goal was to keep Good Stuff alive long enough for it to enter into a forbearance agreement and eventually find new financing. Good Stuff, however, eventually filed for relief under Chapter 11.

The litigation was initiated by Schwan's, who argued that during this time period Commerce Bank was in complete control of Good Stuff and caused it to breach its obligations to Schwan's with respect to the Freschetta marketing campaign. Schwan's asserted breach of fiduciary duty as well as instrumentality, arguing that Good Stuff had simply become a conduit for Commerce Bank.

Generally speaking, lenders are not fiduciaries with respect to their borrowers; nor are they fiduciaries to third parties in the absence of some specific set of facts showing that the lender was in control over a borrower.[15] Schwan's argued that Good Stuff was under the control of Commerce as evidenced by the bank's control over the financing of Good Stuff and its direction to the company to hire a new chief financial officer. The court compared the facts present in this case to those in the infamous *Clark Pipe* case,[16] where the Fifth Circuit noted that exercising rights under loan documentation did not rise to the level of control over the management affairs of a company. The court in *Schwan's* noted that, as in *Clark Pipe*, there was no question that the bank exercised a fair amount of practical control over the business affairs of Good Stuff. This is simply the practical effect of an asset-based loan arrangement. The court followed the well-established rule that a lender does not exert excessive control over a borrower simply by making advances and reducing funding pursuant to the terms of the loan documentation. Likewise, directing the company to hire a consultant does not in and of itself put a lender in control over the borrower.

AIDING AND ABETTING FRAUD

In the case of *Chance World Trading E.C. v. Heritage Bank of Commerce*,[17] two distant relatives formed a company called Chance World Trading E.C. to finance a business product which would be developed by Construction Navigator, Inc. Construction Navigator opened up a checking account with Heritage Bank of Commerce, which required two signatures to authorize transfers of the account for any amount over $10,000. One of the parties, in violation of the investment they had entered into, used the funds that had been deposited at Heritage Bank to pay for personal items and other expenses not related to the development of the product. In order to accomplish this, the individual opened a second account at Heritage Bank and presented the bank's employees with a corporate resolution to open a bank account signed by the president/secretary. This account allowed checks to be signed by only one person, and

over time the individual was able to move money from the first checking account to the second checking account and eventually misappropriate the entire $200,000 that had been deposited there.

Chance World filed suit against Heritage seeking compensation for the misappropriation, alleging that the bank had aided and abetted the carrying on of the fraud. Under California law the claim for aiding and abetting a tort requires knowledge of the underlying tort and substantial assistance. Most courts require that the knowledge be actual knowledge and not implied knowledge. Courts are generally reluctant to infer aiding and abetting simply from the fact that a bank allowed an individual or entity engaged in fraud to operate a checking account. In this case Heritage Bank acknowledged that it provided substantial assistance to the party who was withdrawing funds. Chance World argued that the knowledge could be inferred from a combination of facts, including that Heritage knew that Construction Navigator was a start-up business funded by venture capital and that withdrawals of over $10,000 were required to be signed by multiple parties. The court noted that the fact that the entity was a start-up business and funded by venture capitalists did not lead to a conclusion that a party is misusing funds. Likewise, the fact that transfers out of the first checking account did not comply with Heritage Bank's rules is also insufficient to show that the lender was fully aware of the misuse of the funds. The court did note that there was support in California for the proposition that atypical banking procedures might allow for inference in certain situations. Atypical banking procedures, however, requires a set of unusual facts beyond simple negligence by a bank officer in allowing withdrawals from an account. In this case the only evidence that Chance World attempted to notify Heritage Bank and put them on actual notice of the alleged misappropriation was an e-mail sent to the bank—but to an incorrect e-mail address. Reviewing the totality of the evidence, the court had no difficulty in finding that Heritage Bank was not aware of the misappropriation and therefore did not aid and abet the underlying fraud.

Aiding and abetting was also raised in the case of *Casey v. US Bank*,[18] where a bankruptcy trustee brought suit against a bank for allegedly aiding and abetting a fraudulent scheme by the officers of a corporation to loot it. The trustee brought suit against City National Bank, U.S. Bank, and Wells Fargo in connection with a company called DFJ Italia, LTD. (DFJ). DFJ held itself out as an investment house allegedly supported by a royal Sicilian family trust worth billions of dollars. DFJ raised approximately $47 million from investors. DFJ operated through various fraudulent entities which acted together to defraud investors. The trustee alleged that the individual officers, directors, and their families removed large sums of cash, often in excess of $250,000 at a time from the banks in

unmarked duffel bags. The trustee sought damages from the banks in excess of $36 million.

A cause of action for aiding and abetting a breach of fiduciary duty under California law is based upon the common law of rule, which subjects defendants to liability if they know that the other person's conduct constitutes a breach of duty, they provide substantial assistance to the other party, or they provide assistance to the malfeasor and their own conduct separately considered would constitute a breach of duty to the third person.[19] The trustee alleged that the banks knew that the DFJ fiduciaries had breached their fiduciary duty, and that they assisted them in this by allowing the opening of accounts for sham entities, allowing money to be transferred on forged checks and allowing the various parties to carry away large sums of cash in unmarked duffel bags.

The banks defended on the basis that engaging in an ordinary business transaction with a bank customer, without more, could not constitute aiding and abiding. In analyzing this position the court noted that there is federal authority on the question that would suggest that a jury could determine that a bank's policy of extending instant credit and allowing overdrafts on an escrow account could be found to provide substantial assistance to a breach of fiduciary duty.[20] The court noted that while there were no California cases directly on point, common sense suggested that ordinary business transactions could in fact satisfy the substantial assistance element if the bank was aware that the transactions assisted the customer in committing a tort. The courts sought guidance from several federal cases. The first was *In re Sharp International Corp.*,[21] in which the court noted that mere suspicion about the activities of the principals of a company was not sufficient to constitute actual knowledge. The second case was *Neilson v. Union Bank of California*,[22] which involved a Ponzi scheme causing losses to investors in the neighborhood of $250 million. The plaintiffs alleged that the banks had provided a steady flow of funds to the scam artist, a mechanism for managing custodial accounts and other atypical banking procedures. These allegations were found to be sufficient to establish actual knowledge. In contrast, the court found that the facts in the present case fell short of those asserted in *Neilson*. The court noted that under California law a bank owed no duty to nondepositors to investigate suspicious activities on the part of a customer. Doing so would violate an account-holder's right of privacy with the bank. Thus, even if a bank is aware that a check kiting scheme is occurring, it is under no obligation to notify third parties that the kite has occurred. The court concluded that even if the banks were suspicious of some of the activity, even suspecting money laundering was occurring, the banks did not incur liability to third parties for failing to notify them of such suspicions. In this case the trustee would have to allege that the banks knew that the corpo-

rate officers were stealing corporate funds in order to state a claim that would not be dismissed.

An interesting claim was raised in the case of *In re OODC, LLC v. Majestic Management, Inc., et al.*[23] This case arose out of a busted leveraged buyout. A bankruptcy trustee brought a number of claims against various lenders seeking to collapse the LBO. One of the more interesting claims the trustee asserted was one for improvident lending on the part of the banks. The claim alleged that the bank, knowing the inadequacy of the consideration received by the debtor, improvidently lent funds, and that this gave rise to a cause of action. The cause of action seems to be related to an allegation of commercial bad faith and aiding and abetting fraud. The banks, not surprisingly, responded that no such cause of action existed. The bankruptcy court, in analyzing the cases cited by the lenders,[24] concluded that several of the cases suggested that a lender has a duty of reasonable care when dealing with a borrower, particularly if the facts suggest a situation where a borrower was making some sort of investment and seeking advice from the lender. To this author, it would appear that the court has taken quite a jump from cases where a lender is actually advising a borrower concerning an investment to a situation where the lender has made a loan in good faith which later turned out to be a bad decision. Most courts, when faced with this situation, have found that the lender does not owe a duty of care to a borrower or third parties, and that the only parties who have a complaint against the management of a lender in this type of situation are the shareholders of the lender who have been harmed by a reduction in the bank's assets. One hopes then that this case will prove to be more of an aberration than a precedent-setter.[25]

THE TORT OF DEEPENING INSOLVENCY

One of the more interesting areas of lender liability cases dealt with in the past year was the tort of deepening insolvency. Is it a new tort? Is it old wine in a new bottle? Over the past year, the courts struggled with these issues.

The theory of deepening insolvency seems, in part, to derive from an almost off-hand comment in the 1983 case of *Schacht v. Brown*,[26] from the Seventh Circuit, involving a failed insurance carrier. The liquidator raised claims against certain corporate insiders. In determining that a cause of action against the insiders existed for artificially lengthening its life, the court stated that "the corporate body is ineluctably damaged by the deepening of its insolvency."[27]

From this small beginning, the phrase has taken on a life of its own and has become a favorite cause of action tossed in with other traditional

lender liability claims. The case that has done the most to bring the tort to people's attention is *In re Exide Technologies, Inc.*,[28] in which the court stated that Delaware law recognized the tort of deepening insolvency. That case has generated a veritable cornucopia of law review articles and new cases citing it.[29] For example, the bankruptcy court in the case of *In re Del-met Corp. v. Buerger, et al*[30] published a very lengthy opinion which mixed claims for breach of fiduciary duty, deepening insolvency, unjust enrichment, and alter ego and veil piercing. The relationship between breach of fiduciary duty and deepening insolvency appears to be a close one. In the *Del-met* case, the court analyzed the fiduciary duty claims against officers and directors. It analyzed the various ways in which the corporate insiders engaged in self-dealing to the detriment of the corporation. The court then noted that under both New York and Delaware law, a third party could owe a fiduciary duty to the corporation when it undertook some type of control or responsibility for the corporation. The court noted that under Tennessee law, the majority shareholders of the corporation could be found in certain situations to owe a fiduciary duty to minority shareholders. The court further noted that looking beyond corporate insiders, Tennessee courts had acknowledged the possibility that duties could arise in a lending relationship under certain circumstances, most likely in those situations where a lender exercises excessive control over its borrower.

The court then went on to analyze the theory of deepening insolvency, noting that the theory presupposes that extending the life of an insolvent corporation damages creditors. The court noted those cases that have recognized it as an independent cause of action[31] and those courts which have looked at deepening insolvency as merely a theory of damages.[32] The court recognized that some courts have rejected it outright.[33] The *Del-Met* court first noted that it was unnecessary to decide whether it was a separate cause of action or simply a theory of damages, but that what was necessary was that the defendant "prolonged the company's life in breach of a separate duty or committed an actionable tort that contributed to the continued operation of a corporation and its increased debt."[34] Tennessee case law did not address the issue of whether deepening insolvency constituted a valid cause of action, and so the court resolved to look at three factors to determine whether the Tennessee Supreme Court would recognize a tort of deepening insolvency as a valid claim. The three factors are: (1) the basic soundness of the theory; (2) whether the theory is growing in adoption by other state and federal courts; and (3) how the theory works into the general remedial theme found in a particular state's law.

In this instance, the court determined that the tort was sound citing the logic set forth in the *Schact v. Brown*[35] opinion that:

> [T]he corporate body is ineluctably damaged by the deepening of its insolvency through increased exposure to creditor liability. Indeed, in most cases, it would be crucial that the insolvency of the corporation be disclosed, so that shareholders may exercise their right to dissolve the corporation in order to cut their losses. Thus, acceptance of a rule which would bar a corporation from recovering damages due to the hiding of information concerning its insolvency would create perverse instances for wrongdoing officers and directors to conceal the true financial condition of the corporation from the corporate body as long as possible."[36]

The court then noted the growing acceptance of the theory, and finally found that under Tennessee law, where there is a tort, the law must provide a remedy. On this basis the court concluded that the complaint asserted a valid cause of action.

Other federal courts over the past year have been more reluctant to find that deepening insolvency is a new recognizable cause of action. For example, in *In re Parmalat Securities Litigation*,[37] the federal court sitting in New York examined the issue of whether deepening insolvency would be recognized under North Carolina law. The court noted that North Carolina courts had not really dealt with the issue and that there was no compelling reason for the courts to have to deal with this issue inasmuch as existing causes of action seemed capable of handling such fact patterns. If corporate insiders breached a fiduciary duty to the corporation by deepening an insolvency, and that action was aided and abetted by a third party, then existing case law would be sufficient to seek damages against the party that assisted the breach of fiduciary duty. The court declined "…to recognize a novel tort duty giving rise to a novel cause of action under North Carolina law. North Carolina already imposes on every person a duty not to aid and abet a breach of fiduciary duty by another."[38] Thus, the cause of action was dismissed as duplicative of existing causes of action found in the complaint for aiding and abetting breaches of fiduciary duty.

The bankruptcy court in the case of *Vartec Telecom, Inc.*[39] reached a similar conclusion. First, the court examined a bankruptcy court decision in New York, *Kittay v. Atlantic Bank of New York*, (*In re Global Service Group, LLC*),[40] in which the court recognized that the deepening insolvency theory evolved from the dictum of the Seventh Circuit in the *Schact v. Brown* case cited above. The court noted that deepening insolvency is not defined under the bankruptcy code or other federal law and that federal courts dealing with the issue have to look to state law. In the *Vartec* case, the state in question was Texas. Taking the same line of analysis that Judge Lundin took in the *Del-Met* case, the court, looking to other federal decisions, noted that the majority seemed to be tending toward finding that the deepening insolvency theory was really a theory of damages and not a separate

tort.[41] The court found no case law in Texas that would support such a cause of action, and held that the injury in question was already covered by existing torts recognized under Texas law. Essentially, deepening insolvency was simply an existing tort, such as a breach of fiduciary duty, accounting malpractice, or some other recognized cause of action under a different name. "Much like the little old lady in the fast-food commercials, the Court looks at the bottom of the deepening insolvency hamburger bun and is forced to ask 'Where's the tort?'"[42]

In the case of *In re Greater Southeast Community Hospital Corp.*,[43] the court noted that whether one adopted the theory of deepening insolvency as a separate cause of action or simply as a theory of damages, the prerequisite under either permutation was that the defendant needed to breach some separate duty of care in connection with the increasing insolvency. The court went on to say, though, that recognizing the condition as harmful and recognizing it as a separate tort are two different things. The court held that the claim for deepening insolvency was merely duplicative of other traditional torts such as breach of fiduciary duty, noting as it did so that the claim for the deepening insolvency cause of action in the claim was almost word-for-word identical to the claim for aiding and abetting a breach of fiduciary duty.[44]

CONCLUSION

The traditional theories of breach of contract, lack of good faith and fair dealing, breach of fiduciary duty, fraud, and fraudulent misrepresentation continue to be raised and litigated, although lenders seem to be on the winning side of such litigation, at least in regards to traditional lender-borrower fact patterns. The revisions to the statute of frauds which most states undertook in the 1980s and 90s have clearly leveled the playing field in favor of lenders on such claims. The overall state of the economy has also played a hand in this result in that fewer deep recessions generate less lender liability litigation on the whole. Plaintiffs' lawyers continue to be creative in developing new theories, however, as seen by the popularity of deepening insolvency claims. The clear trend of cases, at least on the federal level, seems to suggest, though, that the high point of deepening insolvency as a separate cause of action may have come and gone. The elements of the cause of action seem to be merely a restatement of aiding and abetting existing causes of action, and it will probably cease to be relied upon as a cause of action unless some higher state courts adopt it.

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Norton Bankr. L. & Prac. 2d §§ 153:1 to 153:58.

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2. Lettunich 109 P.3d at 1107.

3. Lettunich 109 P.3d at 1109.

4. Lettunich 109 P.3d at 1110.

5. Grand Housing, Inc. v. Bombardier Capital, Inc., 2005 WL 673267 (5th Cir. 2005).

6. Farmers Bank and Trust Co. of Georgetown, Kentucky v. Willmott Hardwoods, Inc., 171 S.W.3d 4 (Ky. 2005).

7. Farmers Bank and Trust, 171 S.W.3d at 9.

8. Farmers Bank and Trust, 171 S.W.3d at 10.

9. See Blanchard, Lender Liability: Law, Practice and Prevention, § 6.04.

10. Cordry v. Vanderbilt Mortg. & Finance, Inc., 370 F. Supp. 2d 923 (W.D. Mo. 2005).

11. Cable & Associates Ins. Agency, Inc. v. Commercial Nat. Bank of Pennsylvania, 2005 PA Super 186, 875 A.2d 361 (2005).

12. Creeger Brick and Bldg. Supply Inc. v. Mid-State Bank and Trust Co., 385 Pa. Super. 30, 560 A.2d 151, 9 U.C.C. Rep. Serv. 2d 438 (1989).

13. Schwan's Sales Enterprises, Inc. v. Commerce Bank & Trust Co., 397 F. Supp. 2d 189 (D. Mass. 2005).

14. Schwan's, 397 F. Supp. 2d at 193.

15. See Blanchard, Lender Liability: Law, Practice and Prevention, § 5:3.

16. Matter of Clark Pipe and Supply Co., Inc., 893 F.2d 693, 20 Bankr. Ct. Dec. (CRR) 68, 22 Collier Bankr. Cas. 2d (MB) 500 (5th Cir. 1990).

17. Chance World Trading E.C. v. Heritage Bank of Commerce, 2005 WL 2989298 (N.D. Cal. 2005).

18. Casey v. U.S. Bank National Ass'n, 127 Cal. App. 4th 1138, 26 Cal. Rptr. 3d 401 (4th Dist. 2005), review denied, (June 29, 2005).

19. See Restatement (Second) of Torts § 876.

20. See Lawyers Title Ins. Corp. v. United American Bank of Memphis, 21 F. Supp. 2d 785, 38 U.C.C. Rep. Serv. 2d 438 (W.D. Tenn. 1998); Neilson v. Union Bank of California, N.A., 290 F. Supp. 2d 1101 (C.D. Cal. 2003).

21. In re Sharp Intern. Corp., 281 B.R. 506, 39 Bankr. Ct. Dec. (CRR) 253 (Bankr. E.D. N.Y. 2002), aff'd, 302 B.R. 760 (E.D. N.Y. 2003), aff'd, 403 F.3d 43, 44 Bankr. Ct. Dec. (CRR) 146 (2d Cir. 2005).

22. Neilson, 290 F. Supp. 2d 1101.

23. In re OODC, LLC, 321 B.R. 128 (Bankr. D. Del. 2005).

24. See, e.g., Ramsdell v. Bowles, 64 F.3d 5 (1st Cir. 1995); In re Fordham, 130 B.R. 632, 646, 15 U.C.C. Rep. Serv. 2d 400 (Bankr. D. Mass. 1991); Hill v. Equitable Bank, 655 F. Supp. 631, 646, Fed. Sec. L. Rep. (CCH) P 93229 (D. Del. 1987), judgment aff'd, 851 F.2d 691, Blue Sky L. Rep. (CCH) P 72762, Fed. Sec. L. Rep. (CCH) P 93919 (3d Cir. 1988); Ulrich v. Federal Land Bank of St. Paul, 192 Mich. App. 194, 480 N.W.2d 910, 912-13 (1991); Commercial Nat. Bank in Shreveport v. Audubon Meadow Partnership, 566 So. 2d 1136 (La. Ct. App. 2d Cir. 1990).

25. See generally Blanchard, Lender Liability: Law, Practice and Prevention, Chapter 7 Negligent Loan Processing.

26. Schacht v. Brown, 711 F.2d 1343 (7th Cir. 1983).

27. Schacht, 711 F.2d at 1350.

28. In re Exide Technologies, Inc., 299 Br. 732 (BC Dist. Del. 2003).

29. See generally Willet, The Shallows of Deepening Insolvency, 60 Bus. Law 549 (Feb. 2005); Deepening Insolvency in Alabama; Is it a Tort, a Damages Theory or Neither of the Above?, 66 Ala. Law 190 (May 2005); Brighton, Deepening Insolvency, 23-3 American Bankruptcy Institute Journal 34 (Apr. 2004).

30. In re Del-Met Corp., 322 B.R. 781 (Bankr. M.D. Tenn. 2005).

31. Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 349-52 (3d Cir. 2001); Official Committee of Unsecured Creditors v. Credit Suisse First Boston (In re Exide Technologies, Inc., 299 B.R. 732, 750-52 (BC D Del. 2003).

32. Schacht, 711 F.2d 1343; Hannover Corp. of America v. Beckner, 211 B.R. 849, 854 (M.D. La. 1997); Allard v. Arthur Andersen & Co. (USA), 924 F. Supp. 488, 494, Fed. Sec. L. Rep. (CCH) P 99094, R.I.C.O. Bus. Disp. Guide (CCH) P 9029 (S.D. N.Y. 1996).

33. Florida Dept. of Ins. v. Chase Bank of Texas Nat. Ass'n, 274 F.3d 924, 935-36 (5th Cir. 2001).

34. Del-Met, 322 B.R. at 813.

35. Schact, 711 F.2d 1343.

36. Schact, 711 F.2d at 1350.

37. In re Parmalat, 383 F. Supp. 2d 587 (S.D. N.Y. 2005).

38. Parmalat, 383 F. Supp. 2d at 602.

39. In re Vartec Telecom, Inc., 335 B.R. 631, 45 Bankr. Ct. Dec. (CRR) 205 (Bankr. N.D. Tex. 2005).

40. In re Global Service Group, LLC, 316 B.R. 451, 43 Bankr. Ct. Dec. (CRR) 253, 53 Collier Bankr. Cas. 2d (MB) 57 (Bankr. S.D. N.Y. 2004).

41. See In re Greater Southeast Community Hospital Corp., 333 B.R. 506, 517-18, 45 Bankr. Ct. Dec. (CRR) 179 (Bankr. D. D.C. 2005).

42. Vartec, 335 B.R. at 644.

43. Greater Southeast Community Hospital, 333 B.R. 506.

44. Greater Southeast Community Hospital, 333 B.R. at 517.