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LENDING AND RESTRUCTURING ALERT

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Provisions in Loan Commitment Preclude Borrower's Fraud Claims

Lenders and borrowers alike should take a fresh look at the fine print in their loan commitment letters. The impact of these provisions can be significant, as illustrated recently by a New Jersey federal district court judge presiding over lawsuit for a loan commitment fee.

The case. A disgruntled borrower did not receive a hoped-for $18.2 million loan to finance a real estate transaction, and didn't pay the lender the agreed-upon loan commitment fee. When the lender sued to collect the fee, the borrower counterclaimed, alleging violations of New Jersey's Racketeer Influenced Corrupt Organization Act ("RICO"), breach of contract, breach of the covenant of good faith and fair dealing, fraud, and violation of New Jersey's Consumer Fraud Act (the "Fraud Act").

The allegations. The borrower alleged that the lender did not have sufficient funds, and did not intend, to make the loan, but instead only sought to collect a commitment fee of over $500,000. According to the borrower, in order to avoid closing on the loan, the lender imposed additional conditions, including the requirement that the borrower obtain additional soil samples, before the loan closing date. The borrower based its RICO claim on the assertion that the lender had knowingly made false statements in the parties' loan commitment agreement with the intent of deceiving or injuring it.

The impact of the "boilerplate" in the loan agreement. But the judge found that the borrower's allegations were negated by the loan commitment letter's language, and dismissed the RICO, fraud and Fraud Act claims.

The loan commitment letter included terms requiring the borrower to produce evidence "as the Lender may require" to demonstrate compliance with all applicable zoning, environmental and other laws, and granting the lender or its lawyers "sole discretion" to impose conditions precedent, require representations and warranties, and other conditions for the deal to close. Presented with this language, the court concluded that the borrower's claim that the lender misrepresented the terms and conditions that the borrower would need to satisfy before the lender would extend the loan were without merit. The court also observed that the borrower's counterclaims did not expressly identify any false statement made by the lender or its principals, nor did the borrower state how any such statements had caused it to suffer harm.

The borrower also tried to assert that the entire purpose of the agreement was to ensure that the lender actually had funds on hand or readily available to make the loan. But the loan commitment letter's clear language stating that "[lender] reserves the right to assign or sell participations in all or part of the Loan . . . ." contradicted that assertion.

According to the district court judge, these provisions afforded the lender virtually unlimited discretion in determining whether the borrower had satisfied the terms of the agreement, and thus precluded the borrower's claim that the lender had misrepresented the terms and conditions that the borrower needed to satisfy before the lender would close the loan.

Status of the case. The lender's motion to dismiss did not address every counterclaim the borrower asserted in the case. The court stated that, as the rest of the case proceeded, the borrower would be permitted the opportunity to develop evidence that would provide a basis for one or more of the dismissed claims, and to seek to amend its counterclaim against the lender if such evidence were found.

What this case means for you. The language in the commitment letter, combined with the absence of any provision imposing a reasonableness standard on the lender's conduct, will present a substantial obstacle to any fraud-based claim that this borrower, or any other having agreed to similar language in a loan commitment, might to attempt assert down the road. Lenders and borrowers should bear this issue in mind when negotiating commitment letters of their own.

For further information regarding these or other lending issues, you may **contact Paul Rubin at 212-592-1448 or email prubin@herrick.com.**

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