# LOAN COMMITMENTS
## (How Committed Are You?)

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# LOAN COMMITMENTS

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# LOAN COMMITMENTS
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## I. INTRODUCTION

A. Scope of Article. This Article focuses on providing a legal framework to aid (i) real estate principals, professionals and attorneys in negotiations of a loan commitment that may take place between borrower and lender, (ii) attorneys in construing the rights and obligations of the parties under an executed loan commitment, and (iii) attorneys in determining whether a course of dealing gives rise to an unwritten commitment to lend money.

B. Function of Loan Commitments. The loan commitment functions as a road map for any lending transaction. It is analogous to an earnest money contract in a real estate transaction or a purchase and sale agreement in a business transaction. The loan commitment should adequately describe the parties, the parties' relationship, the loan transaction, the collateral, the performance requirements of each party, the conditions precedent to performance by each party, the due diligence procedure, the loan documentation procedure, the closing procedure, remedies, and boilerplate provisions typical to a business contract.

## II. TYPES OF LOAN COMMITMENTS

A. "Non-binding" Loan Commitment. A non-binding loan commitment is a document, which delineates proposed loan agreement terms, but does not create a contractual relationship. The non-binding loan commitment is short, typically no more than two to four pages, and should expressly state that it does not constitute a legally binding loan commitment. Two loan commitment. Two recent Federal Court cases discuss specific language which the courts held to make documentation between a lender and borrower non-binding.

In *Clardy Manufacturing Co. v. Marine Midland Business Loans, Inc.*, 88 F.3d 347 (5th Cir. 1996), *rehearing and suggestion for rehearing en Banc denied by,* 96 F. 3d 1447 (5th Cir. 1996), and *cert. denied by* 117 S. Ct. 740 (1997), the court construed a letter agreement between an asset-based lender and a borrower as a non-binding loan commitment. The letter contained significant contingent language (i.e., "if" and "would consider") and the following language in bold type: **"Non-Binding Proposal Only: Due Diligence Required"** and

**"THIS PROPOSAL LETTER IS NOT A COMMITMENT TO LEND."**

The district court granted judgment in excess of $8 million in favor of the borrower, based on a breach of contract, reasoning that the loan commitment was a "satisfaction contract," and the lender had an obligation to fund the loan if the borrower reasonably complied with the enumerated requirements of the loan commitment. Applying Texas contract law, the Fifth Circuit rejected that analysis and held the document to be an unambiguous non-binding letter of intent, which simply set forth an agreement by the lender to undertake due diligence. The document did not require the lender to proceed beyond the due diligence phase. *Id.* at 353. In its analysis, the Fifth Circuit was impressed with the repeated use of contingent language.

*Clardy* underscores the need for clear and concise drafting. If a loan commitment is not intended to be a loan commitment, but instead, an agreement to undertake due diligence, with the lender having the sole discretion to determine whether to move forward at the conclusion of the due diligence, it should states as much. Use of language analogous to that in *Clardy* provides a lender a firm foundation to defend against a borrower's claim that a due diligence agreement constituted a loan commitment. *See, John Wood Group USA, Inc. v. Inco, Inc.*, 26 S.W.3d 12, 19 (Tex. App.—Houston [1st Dist.] 2000, writ denied) (discussion of when a commercial letter of intent is binding).

A typical conduit lender application is a non-binding commitment to consider a proposed loan. Upon approval (usually very late in the transaction, the application converts to be a commitment, usually a contingent commitment discussed below. *See, Silver Hill Station Limited Partnership v. HSA/Wexford Bancgroup, LLC*, 158 R. Supp. 2d 631 (D. MD. 2001) for a complete discussion of the conduit loan application process. In *Silver Hill*, the court held the following language sufficient to make a loan application non-binding, despite allegations of negligent loan processing and negligent misrepresentation:

"Applicant acknowledges and agrees that the foregoing terms are **preliminary** and, if lender accepts this Application and thereafter issues to Applicant a Loan Commitment, **the terms and conditions of the Loan set forth therein may vary from those contained in this Application** due to the underwriting due diligence, loan committee requirements and/or market interest rate changes....

**This is a Loan Application, not a Loan Commitment.** Applicant acknowledges and agrees that nothing contained herein, and no prior or subsequent communication from Lender to Applicant, whether written or verbal, shall be deemed or construed to constitute or imply a commitment or offer by Lender to make the Loan, and **no such commitment or offer shall exist unless and until Lender expressly executed a Loan Commitment or offer to the Borrower**." Id. at 633. (emphasis added).

B. "Contingent" Loan Commitment.

1. Inclusion of Contingent Language Many loan commitment forms used in Texas fall into the contingent category, and typically include most material loan provisions. Documentation is usually partially delineated, with the proviso that "loan documentation will be in form and substance acceptable to the lender's counsel," or similar the hallmark of a contingent loan commitment is the inclusion, by the lender, of language intended to give the lender discretion in some or all of the following: loan underwriting, collateral, loan documentation, borrower's and guarantor's financial information, appraisals, "additional" documents and information regarding the borrowers, guarantors or collateral "as required by the lender," and other requirements allowing the lender to withhold its approval, in its sole discretion, and thereby terminate any obligation to fund the loan.

A typical commercial bank loan commitment is usually structured as a contingent loan commitment.

2. Borrower Misunderstandings Conditional loan commitments are often drafted in a manner in which a borrower could assert, "we have a deal." Contingent loan commitments are the source of lawsuits by borrowers who change their position in the belief that the loan will be finally approved, documented, and funded in accordance with the conditional loan commitment for any of the following reasons:

a. the assumption that the lender will act in "good faith" in carrying forward with the conditions to funding set forth in the conditional loan commitment;

b. because the loan meets the requirements for "typical" lenders, it will be approved, documented and funded;

c. the lender will treat the borrower consistently with lender's other borrowers;

d. the lender will treat this deal in accordance with prior transactions between the lender and borrower; or

e. all loan commitments contain "boilerplate" language which is "part of the form" and should be ignored unless specifically brought to the borrower's attention by the lender because "it's only in there to keep the lawyers and regulators happy."

3. Case Law Most cases dealing with contingent loan commitments uphold the lender's right to withhold funding where the lender's conditions are not satisfied. *Maginn v. Norwest Mortgage, Inc.*, 919 S.W.2d 164, 166-167 (Tex. App.— Austin 1996, writ denied), *Henderson v. Texas Commerce Bank-Midland, N.A.*, 837 S.W.2d 778, 781 (Tex. App.– El Paso 1992, writ denied), *Valdina Farms, Inc. v. Brown, Beasley & Assoc., Inc.*, 733 S.W.2d 688, 691-693 (Tex. App.– San Antonio 1987, no writ), *Guaranty Bank v. Lone Star Life Ins. Co.*, 568 S.W.2d 431, 432-433 (Tex. Civ. App.– Dallas 1978, writ ref'd n.r.e.), *First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d 179, 181-183 (Tex. App.— Tyler 1982, no writ), *St. Joseph Professional Bldg. Co. v. New York Life Ins. Co.*, 449 S.W.2d 848, 850 (Tex. Civ. App.— Houston [14th Dist.] 1970, writ ref'd n.r.e.).

4. Risks of Contingent Loan Commitment Conditional loan commitments, together with a course of conduct between the lender and borrower, have given rise to significant litigation and new causes of action, often sounding in tort. *See, Federal Land Bank Ass'n of Tyler v. Sloane*, 793 S.W.2d 692 (Tex. App.— Tyler 1990), *aff'd. in part, rev'd. in part*, 825 S.W.2d 439 (Tex. 1991) (Borrower recovers on negligent misrepresentation theory); *Investors, Inc. v. Hadley*, 738 S.W.2d 737 (Tex. App.— Austin 1987, writ denied) (holding for the borrower based on a DTPA claim); *Island Recreational Dev. Corp. v. Republic of Texas Sav. Ass'n*, 710 S.W.2d 551 (Tex. 1986) (explaining that the lender waived failure to comply with conditions, in the written commitment, by oral statements and course of dealing).

5. Standards for Lender Approval Contingent loan commitments have been used by some lenders with the idea that open-ended contingency language can be used to refuse to fund the loan if the lender gets "cold feet." Lenders and borrowers both have an obligation to exercise diligence in performing their duties under a loan commitment. *Montgomery Ward &Co. v. Scharrenbeck*, 204 S.W.2d 508, 510 (Tex. 1947). It is currently unclear whether the standard is a subjective good faith test or an objective standard. *See First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d 179, 182-183 (Tex. App.— Tyler 1982, no writ)(applying subjective good faith standard; *General Inv. & Dev. Co. v. Guardian Sav. & Loan Ass'n*, 862 F. Supp. 153, 156-158 (S.D. Tex. 1994)(applying Texas law and objective standard). Courts are likely to decide a dispute based on the specific language in question.

Furthermore, Texas courts have applied good faith and reasonableness standards to many contingent phrases typical to loan commitments (although not in the loan commitment context) which lenders have relied upon as the basis to reject borrower performance. *See, Lucas v. Lucas*, 365 S.W.2d 372, 376 (Tex. Civ. App. — Beaumont 1962, no writ), *Davis v. Huey*, 620 S.W.2d 561, 566 (Tex. 1981), *Whiteco MetroCom, Inc. v. Industrial Properties Corp.*, 711 S.W. 2d 81, 82 (Tex. App. – Dallas 1986, no writ), *Texas Indemnity Ins. Co. v. Arant*, 171 S.W.2d 915, 919 (Tex. Civ. App. – Eastland 1943, writ ref'd w.o.m.), *Cowden v. Broderick & Calvert, Inc.*, 114 S.W.2d 1166, 1171 (Tex. 1938), *Riverside Nat'l Bank v. Lewis*, 572 S.W.2d 553, 558 (Tex. Civ. App. – Houston [1st Dist.] 1978), *rev'd on other grounds*, 603 S.W.2d 169 (Tex. 1980), *on remand* 605 S.W. 2d 954 (Tex. Civ. App. – Houston [1st Dist.] 1980, no writ), *Conor v. Buckley*, 380 S.W.2d 722, 724 (Tex. Civ. App. — Waco 1964, no writ).

Borrower's and lender's counsel will disagree on the standards for determining satisfaction of contingent terms in a loan commitment:

a. Lender's Position. So long as the lender acts in subjective good faith (honesty in taking a position which has some rational basis) and, in fact, is dissatisfied with the borrower's performance of the condition, lender counsel asserts that the lender is not obligated to fund a loan.

b. Borrower's Position. In addition to the good faith

faith standard above, borrower counsel would apply an objective reasonable person standard to the lender's decision. If a reasonable lender, under similar circumstances, would discover the borrower's performance was unsatisfactory, then the lender should be obligated to fund the loan.

c. Restatement's Position. Restatement Second of Contracts § 228 (1979) B Adopts the borrower position except in circumstances where it is impracticable (giving the example of a contract for a satisfactory work of art). The Restatement provides that parties may contractually stipulate any other standard, including a standard of absolute, unreasonable discretion.

d. Practical Application. In negotiating a loan commitment, counsel must be aware of nuances of language affecting the standard which is likely to be applied by a court construing determinations by a lender in a contingent loan commitment. Texas cases indicate a desire to apply the concepts of good faith and reasonableness unless the clear language of the contract provides for arbitrary decisions and such language is sufficiently clear that the other party is on notice of the applicable standard. It is clear that the lender may not be arbitrary and, at a minimum, must act in good faith, rejecting borrower performance where it is honestly unsatisfied with some rational basis (even if more strict than industry's standards). Borrower counsel will argue that, unless a reasonable lender standard is applied, a borrower has no notice of the standards to be applied by the lender, resulting in the borrower being at the mercy of the lender with respect to matters not specifically set forth in the loan commitment. This position is supported by Restatement Second of Contracts § 228. Where a lender desires only a good faith standard to apply to its exercise of discretion and establishment of its satisfaction, it should affirmatively state that the good faith standard applies. Where the lender desires to have absolute unfettered discretion, it should state that approvals and consent may be withheld for any reason, whether or not deemed reasonable by borrower or industry standards.

C. "Firm" Loan Commitments.

1. Use of Detail The firm loan commitment is detailed and fully covers all significant loan terms, documentation and conditions precedent. It describes the loan documentation and additional underwriting requirements required by the lender. The firm commitment should be considered analogous to an earnest money contract in a real property setting or a purchase and sale contract in a personal property setting. This document is intended to cover all issues, which arise relating to the relationship between the parties, and is intended to be enforceable without reference to other documents. To the extent that additional approvals or consents are required by the firm loan commitment, those actions must be taken reasonably by the lender, unless otherwise stated. *See First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d 179, 182 (Tex. App. — Tyler 1982, no writ); Mehr & Kilgore, *Enforcement of the Real Estate Loan Commitment: Improvement of the Borrower's Remedies*, 24 WAYNE L. REV. 1011, 1041 (1978). A typical life insurance company permanent loan commitment would be considered a firm loan commitment.

2. Specificity of Conditions Precedent The typical firm loan commitment contains a detailed list of conditions precedent to the lender's obligation to fund. All conditions precedent must be satisfied (some to the lender's satisfaction) before the lender's obligation to fund arises. *Henderson v. Texas Commerce Bank - Midland, N.A.*, 837 S.W.2d 778, 780 (Tex. App. — El Paso 1992, writ denied). Litigation regarding firm loan commitments often involve borrower allegations of a waiver of conditions precedent or lender anticipatory repudiation of its obligation to fund. The major factor differentiating the firm loan commitment from the contingent loan commitment is the use of detailed conditions precedent. Language typical to contingent loan commitments is often seen in a firm loan commitment form, but if borrower's counsel is astute and knowledgeable he or she will resist the use of such language in the final commitment signed by the parties.

3. Contingent vs. Firm Loan Commitments From a legal perspective, the firm loan commitment is recommended over the conditional loan commitment.

loan commitment. *Hillman, supra* at 16. It should be sufficiently detailed to identify all material issues relating to the lender/borrower relationship. If possible, copies of the lender's "form" loan documents (or excerpts of significant portion) should be attached to the commitment. The lender should rely on specific conditions precedent (so stated) to its obligation to fund rather than general "approval" standards typical to conditional loan commitments. However, in practice, many local lenders (particularly smaller financial institutions) decline to use detailed firm loan commitments for reasons such as document length, borrower resistance to "excessive" detail, desire to reduce attorney involvement, or similar considerations.

D. Unilateral/Bilateral Loan Commitments. Some loan commitments are unilateral meaning they do not require the borrower to accept the loan of money, but simply give the borrower the option to do so. A bilateral loan commitment requires acceptance by both parties. *See Valdina Farms v. Brown, Beasley & Assoc., Inc.*, 733 S.W.2d 688, 693 (Tex. App. — San Antonio 1987, no writ). Most banks and savings associations use loan commitments that are unilateral; however, most permanent lender loan commitments are bilateral. Under the bilateral loan commitment, the borrower is contractually obligated to perform and would be liable for a breach. However, most loan commitments provide that breach by a borrower entitles the lender to retain as liquidated damages various fees deposited by the borrower with the lender when the loan commitment was signed.

E. Forms. The only treatise on loan commitments is the *Law of Mortgage Commitments* by Charles D. Katzenstein, published by Clark Boardman Callaghan (1-800-323-1336). The treatise contains an exhaustive list of forms and clauses applicable to loan commitments and related contracts.

## III. CONTRACT LAW ISSUES

### A. Oral Loan Commitments.

#### 1. Statute of Frauds

a. TEX. BUS. & COM. CODE § 26.02. TEX. BUS. & COM. CODE § 26.02 (Vernon 2002) (originally adopted September 1, 1989), limits lender liability for an oral agreement to loan money. Specifically, § 26.02 provides a defense to a breach of contract cause of action by a borrower based on an asserted oral agreement to lend money. Loans of $50,000 or less and agreements relating to a credit card or open-end account (defined by Finance Code § 301.002) intended or used primarily for personal, family or household use, are exempt. The financial institution must conspicuously post in their offices notices promulgated by the Texas Finance Commission, informing borrowers of the provisions of § 26.02. However, a lender's failure to post in their offices the notice regarding applicability of § 26.02 will not preclude the lender from asserting the protection of § 26.02. *Maginn v. Norwest Mortgage, Inc.*, 919 S.W.2d 164, 168 (Tex. App.— Austin 1996, writ denied).

Written loan commitments will not be subject to attack by alleged oral amendments, agreements or discussions which occur before or contemporaneously with the execution of the written loan commitment, provided that the notice required by § 26.02(e) is supplied to the borrower or incorporated in the written loan commitment. The notice must be in **bold-faced**, CAPITALIZED, underlined or otherwise *conspicuously set out* from the surrounding written material. Note that the notice includes a statement that subsequent oral agreements may *not* be used to contradict the written documents.

b. TEX. BUS. & COM. CODE § 26.01. The general provision of the Statute of Frauds contained in TEX. BUS. & COM. CODE § 26.01 (Vernon 1996) may deny enforcement of an oral commitment to lend on real property. *Farah v. Mafrige & Kormanik, P.C.*, 927 S.W.2d 663 (Tex. App. —Houston [1st Dist.] 1996, writ denied); *Edward Scharf Assoc., Inc. v. Skiba*, 538 S.W.2d 501, 502 (Tex. Civ. App. — Waco 1976, no writ) , but *see Maginn v. Norwest Mortgage, Inc.*, 919

S.W.2d 164, 167 (Tex. App. — Austin 1996, writ denied) and *Digby v. Texas Bank*, 943 S.W. 2d 914, 929 (Tex. App. – El Paso 1997, no writ)(agreement may be evidenced by documents other than a loan commitment agreement). In *Skiba*, the court held that a contract to make a loan on real estate falls within the Statute of Frauds, thus oral loan commitments dealing with real estate are unenforceable. *Id.* at 503. However, in *American Bank of Waco v. Thompson*, 660 S.W.2d 831 (Tex. App. — Waco 1983, writ ref'd n.r.e), the court applied Section 26.01 to an alleged real estate loan commitment and held that loan commitments to potential loan participants describing the loan and an internal bank memorandum were sufficient writings to remove the oral loan commitment from the Statute of Frauds. *Id.* at 833. The court affirmed the $150,000 judgment against the bank.

2. Performance Within One Year Another exception to the Statute of Frauds is where the loan commitment is capable of being performed before a year's expiration. This possibility causes an oral loan commitment to fall outside the Statute of Frauds. *FDIC v. Perry Bros., Inc.*, 854 F. Supp. 1248, 1277 (E.D. Tex. 1994), *aff'd in part, reversed in part*, *NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995).

3. Promissory Estoppel Another concern to lenders is the well-settled line of cases in Texas allowing the use of promissory estoppel to enforce an oral agreement to sign a written document, because a written document satisfies the Statute of Frauds. *Moore Burgers, Inc. v. Phillips Petroleum Company*, 492 S.W.2d 934 (Tex. 1972); Maginn v. Norwest Mortgage, Inc., 919 S.W.2d 164, 167 (Tex. App. — Austin 1996, writ denied) (promissory estoppel as an exception to the Statute of Frauds is seeing increasing use). *See also Henderson v. Texas Commerce Bank-Midland, N.A.*, 837 S.W.2d 778, 781 (Tex. App. — El Paso 1992, writ denied); *FDIC v. Perry Bros., Inc.*, 854 F. Supp. 1248, 1267 (E.D. Tex. 1994), *aff'd in part, reversed in part*, *NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995).

4. Independent Tort Causes of Action Not Affected The protection of the Statute of Frauds may be illusory due to the broad definition of a writing sufficient to satisfy the statutes of frauds as outlined in *Thompson* and due to the failure of the statute to preclude oral agreement made subsequently to the written loan commitment. Further, the evolutions of tort theories that are independent of contract law continue to provide a successful basis for litigation of alleged oral agreements to lend money. However, when tort claims have their nucleus in an alleged oral loan commitment unenforceable under the Statute of Frauds, the Statute of Frauds bars the tort claims as well. *Maginn v. Norwest Mortgage, Inc.*, 919 S.W.2d 164, 167 (Tex. App. – Austin 1996, writ denied) (*citing Collins v. Pharmacy Management, Inc.*, 871 S.W.2d 929, 936 (Tex. App. — Houston [14th Dist.] 1994, no writ)). In other words, the tort claims cannot allege the lender contracted to loan money and then breached, but instead, must plead and prove independent tort causes of action like negligent misrepresentation. *Id.* at 169. A summary of the issues in tort/contract classification of "lender liability" claims related to refusal to lend is set out in *Farah v. Mafrige & Kormanik, P.C.*, 927 S.W.2d 663, 673-75 (Tex. App. — Houston [1st Dist.] 1996, writ denied).

Statute of Frauds does not apply where the borrower alleges that the lender negligently misrepresented that it agreed to make a loan as opposed to alleging that the lender breached the agreement to make the loan. *Id.* at 168. *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 441 (Tex. 1991). Certain borrowers also have rights under the Texas Deceptive Trade Practice Act ("DTPA") for misrepresentation and unconscionable conduct. *See* Section IV.A. Statute of Frauds may be used as an affirmative defense to a promissory estoppel cause of action. *Farah*, 927 S.W. at 672.

5. Standards of Certainty Requirement An oral loan commitment is required to meet the same standards of certainty as a written loan commitment. *T.O. Stanley Boot Co., Inc. v. The Bank of El Paso*, 847 S.W.2d 218, 221 (Tex. 1992). In *T.O. Stanley*, the Texas Supreme Court held that an alleged oral loan commitment was unenforceable due to vagueness where the borrowers introduced evidence of only one

material element of the contract to loan money, that being the loan amount. *See America's Favorite Chicken Co. v. Samaras*, 929 S.W. 2d 617, 622 (Tex. App. – San Antonio 1996, n.w.h.); *Valores Corporativos, S.A. de C.V. v. McLane Co. Inc.*, 945 S.W. 2d 160, 166 (Tex. App. — San Antonio 1997, writ denied).

B. Consideration.

1. Commitment Fees

Commitment fees are consideration for the promise to lend money. *Gonzalez County Sav. & Loan Ass'n v. Freeman*, 534 S.W.2d 903, 906 (Tex. 1976); *Bearden v. Tarrant Sav. Ass'n*, 643 S.W. 2d 247, 248 (Tex. App. — Fort Worth 1982, no writ). In a unilateral loan commitment, the commitment fee purchases the option, which permits the borrower to enter into the loan in the future. *Id.* A bona fide commitment fee is not interest. *C. T. Stedman v. Georgetown Sav. & Loan Ass'n*, 595 S.W.2d 486, 488 (Tex. 1979). A commitment fee is not an unenforceable penalty, but is valid consideration for the lender entering into the loan commitment. *B. F. Saul Real Estate Inv. Trust v. McGovern*, 683 S.W.2d 531, 534 (Tex. App. — El Paso 1984, no writ); *First Nat'l Bank of Chicago v. Atlantic Tele-Network Co.*, 946 F.2d 516, 521 (7th Cir. 1991) (applying Illinois law).

2. No Commitment Fee

a. Failure of Consideration. Where no commitment fee has been charged the lender may argue that there is a failure of consideration for its promise to lend money, and without consideration a unilateral commitment is unenforceable. *See* 14 Tex. Jur. 3d Contracts § 103 (1981) (citing numerous cases for this proposition). A bilateral loan commitment has mutuality of obligation and is enforceable.

b. Promissory Estoppel. Promissory estoppel can be a substitute for identifiable consideration. The elements for promissory estoppel are:

(i) an unenforceable promise;

(ii) reasonable expectation that the promise will influence the conduct of the promisee;

(iii) reasonable reliance on the promise by the promisee; and

(iv) detriment to the promisee which would make it unjust that the promise not be enforced. *Wheeler v. White*, 398 S.W.2d 93, 96 (Tex. 1965).

In the context of a written unilateral loan commitment without a commitment fee, promissory estoppel is a consideration substitute in many situations. The key element will be justifiable reliance by the borrower. *See Simpson v. MBank Dallas, N.A.*, 724 S.W.2d 102, 107 (Tex. App. — Dallas 1987, writ ref'd n.r.e.). The borrower must have used due diligence to ascertain the truth of the matters on which it relied to its detriment. *Id.* The question of reliance will be one of fact and likely will be supported by borrower testimony based on oral statements after execution of the written loan commitment.

The lenders will assert that the clauses relating to approval, contingencies and conditions precedent in the loan commitment preclude justifiable reliance.

It is clear that the American legal system is moving toward finding promissory estoppel as a consideration substitute. *See* Gibson, *Promissory Estoppel*, Article 2 of the UCC, 73 IOWA L. REV. 659 (1988); Charny, *Non-Legal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 2, 373, 446 (1990); Annotation, *Promissory Estoppel of Lending Institution Based on Promise to Lend Money*, 18 A.L.R. 5th 307 (1994), Holmes, *Article: Restatement of Promissory Estoppel*, 32 Willamette L. Rev. 263, (1996).

C. Unenforceability for Vagueness. The loan commitment must be sufficiently certain to define the nature and extent of the parties' obligations, or else it is unenforceable. *Henderson v. Texas Commerce Bank-Midland, N.A.*, 837 S.W.2d 778, 781 (Tex. App. — El Paso 1992, writ denied); *T.O. Stanley Boot Co., Inc. v. The Bank of El Paso*, 847 S.W.2d 218, 221 (Tex. 1992); *Willowood Condominium Ass'n, Inc. v. HNC*

*Willowood Condominium Ass'n, Inc. v. HNC Realty Co.*, 531 F.2d 1249-1251 (5th Cir. 1976); *FDIC v. Perry Bros., Inc.*, 854 F. Supp. 1248, 1265 (N.D. Tex. 1994), *aff'd in part, reversed in part, NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995) *citing Bendalin v. Delgado*, 406 S.W.2d 897, 899 (Tex. 1966). There must be a "meeting of the minds" between the necessary parties to form a contract. If essential elements are left open for future negotiation, there is no current binding contract. *See Wheeler v. White*, 385 S.W.2d 619 (Tex. Civ. App. — Beaumont 1964), *rev'd on other grounds*, 398 S.W.2d 93 (Tex. 1965).

An enforceable contract must be sufficiently certain to define the nature and extent of the parties' obligations . . . It is textbook law, as well as clearly the law of Texas that "a court cannot enforce a contract unless it can determine what it is. It is not enough that the parties think that they have a contract; they must have expressed their intentions in a manner that is capable of understanding." 1 Corbin on Contracts, 2nd Ed. 1963, Section 95 quoted in *Bendalin v. Delgado*, *supra*, at 899. "It is said to be fundamental that a person may not be subjected by law to a contractual obligation unless the character of such obligation is fixed with a reasonable degree of definiteness by an express or implied agreement of the parties; that an agreement must not only identify the subject matter, but also must spell out the essential commitments and agreements of the parties with respect thereto; and that the courts cannot specifically enforce contracts or award substantial damages for their breach where they are wanting in reasonable certainty." *Charles v. Charles*, 478 S.W.2d 133 (Tex. Civ. App. — Dallas 1972, writ ref'd n.r.e.). . . . With no delineation of essential elements of the proposed loan--elements we find unexplained and undetermined within the loan commitments reviewed upon by the plaintiffs--there is no evidence of the "mutual assent" or "meeting of the minds" necessary to the formation of a contract. There can be no binding contract between the parties if essential elements are left open for future negotiations between them.

*Willowood*, *supra*. In *Willowood*, the written loan commitment did not specify the amount of monthly installments due, the amount of interest due, when interest was payable and how it was to be computed. Based on these deficiencies, the court held that the loan commitment was unenforceable due to vagueness. *Id.* at 1252.

In *T.O. Stanley Boot Co., Inc.*, 847 S.W.2d at 218 (Tex. 1992), the Texas Supreme Court followed the above-referenced rules for determining whether a meeting of the minds existed between the borrower and lender to create an enforceable loan commitment. The Texas Supreme Court held the following to be material terms of a loan commitment:

1. Loan amount.
2. Maturity date.
3. Interest rate.
4. Repayment terms.

*Id.* at 221. The court specifically held that the borrower's testimony that the lender "always charged" one and one-half percent (1/2%) to two and one-half percent (2 1/2%) over the prime rate was no evidence of the interest. Further, the court held that the borrower's testimony that repayment terms were to be controlled by the pro forma financial statements submitted to the lender, constituted no evidence of repayment terms. The court's position is particularly significant since the court was considering the evidence in the light most favorable to the trial court's verdict in favor of the borrower. *Id.* Apparently, other loan terms can be inferred, such as collateral, timing of loan funding, use of funds and, closing conditions (title, survey, appraisal, environmental, structural, insurance, etc.).

To avoid problems when the lender does not deal with all material issues in a written loan commitment, the loan commitment should expressly state that it is non-binding. Otherwise, a court may exercise its discretion to enforce the loan commitment and infer omitted terms.

D. Contract Construction. A loan commitment is construed like any other contract, and typical contract construction cases are applicable. The following contract construction matters have arisen in loan commitment cases:

1. A contract to loan money will be enforced in the same nature as any other contract. *Pasadena Assoc. v. Connor*, 460 S.W.2d 473, 478 (Tex. Civ. App. — Houston [14th Dist.] 1970, writ ref'd n.r.e.). *See Turboff v. Gerther, Aron & Ledet Investments*, 840 S.W. 2d 603, 607 (Tex. App. — Corpus Christi 1992, no writ).

2. Where the written agreement is unambiguous, the issue presented is a question of law. *Farah v. Mafrige & Kormanik, P.C.*, 927 S.W.2d 678 (Tex. App. — Houston [1st Dist.] 1196, writ denied); *American Nat'l Ins. Co. v. Tri-Cities Constr., Inc.*, 551 S.W.2d 106, 108 (Tex. Civ. App. — Houston [1st Dist.] 1977, no writ); *Clardy Manufacturing Co. v. Marine Midland Business Loans, Inc.*, 88 F.3d 347, 351 (5th Cir. 1996), *rehearing and suggestion for rehearing en Banc denied by* 96 F. 3d 1447 (5th Cir. 1996), and *cert. denied by* 117 S. Ct. 740 (1997), *citing R & P Enters. v. Laguarta Gavrel & Kirk, Inc.*, 596 S.W.2d 517, 519 (Tex. 1980).

3. If the written agreement is ambiguous, the issue should be decided by the jury. *Id.*

4. Whether a written agreement is ambiguous is a decision for the court. *FDIC v. Connecticut Nat'l Bank*, 916 F.2d 997, 1001 (5th Cir. 1990).

5. A loan commitment is ambiguous if after applying established rules of interpretation the document remains reasonably susceptible to more than one meaning. *Clardy*, 88 F.3d at 351, *citing R & P Enters. v. Laguarta Gavrel & Kirk, Inc.*, 596 S.W.2d 517, 519 (Tex. 1980).

6. A loan commitment is enforced as written, based on the "objective intent" evidenced by the language used, rather than the "subjective intent" of the parties. *Id. citing Sun Oil Co. v. Madley*, 626 S.W.2d 726, 711 (Tex. 1981).

7. The entire writing should be examined in an effort to harmonize and give affect to all provisions so that no provision will be rendered meaningless. *Id*; *FDIC v. Connecticut Nat'l Bank*, 916 F.2d 997, 1001 (5th Cir. 1990).

8. No single provision taken alone will be given controlling effect, rather all provisions must be considered with reference to the whole instrument. *Id.* at 1003.

9. Contracts are to be construed against the drafter only as a last resort, used only when doubt persists after applying all of the ordinary processes of interpretation, including all existing usages (general, local, technical, trade and custom), and after having admitted into evidence and duly weighed all of the relevant circumstances and communications between the parties. *Id.* at 1006 *quoting* Corbin on Contracts § 559 (1960); *Clardy*, 88 F.3d at 355.

10. Where a loan commitment contains no time limitation, the court will infer that the parties contemplated performance within a reasonable time. *A.M.R. Enter., Inc. v. United Postal Sav. Ass'n*, 567 F.2d 1277, 1281 (5th Cir. 1978) B applying Florida law.

11. The course of dealings between lender and borrower may modify the written contract. *Morgan v. Young*, 203 S.W.2d 837, 846 (Tex. Civ. App.— Beaumont 1947, writ ref'd n.r.e.).

12. A loan commitment and loan documents drafted to implement the loan commitment are to be harmonized, if possible, because they are part of a single transaction. *5636 Alpha Road v. NCNB Texas Nat'l Bank*, 879 F. Supp. 655, 661 (N.D. Tex. 1995) *citing Meisler v. Republic of Texas Sav. Ass'n*, 758 S.W.2d 878, 884 (Tex. App. — Houston [14th Dist.] 1988, no writ) and *Martin v. First Republic Bank, Fort Worth, N.S.*, 799 S.W.2d 482, 486 (Tex. App. — Fort Worth 1990, writ denied).

13. Conditions precedent, a critical component of loan commitment, are not favorites of the law and must be clearly set forth or else may be construed as covenants instead. *Hohenberg Bros. Co. v. George E. Gibbons & Co.*, 537 S.W.2d 1 (Tex. 1976), *called into doubt by Rincones v. Windberg*, 705 S.W. 2d 846, 848 (Tex. App. — Austin 1986, no writ).

14. No particular terms are necessary but terms such as "if," "provided that," "conditioned that" or other phrases that condition performance should be interpreted as a condition precedent rather than a

covenant or promise. *Id.*, *Henderson v. Texas Commerce Bank-Midland, N.A.*, 837 S.W.2d 778, 781 (Tex. App. — El Paso 1992, writ denied).

15. Where intent is uncertain, or where a condition would impose an absurd or impossible result, a covenant instead of a condition precedent will be inferred. *Hohenberg*, 537 S.W.2d at 3.

16. Conditions precedent should be strictly enforced in loan commitments. *See Colbert v. Dallas Joint Stock Land Bank of Dallas*, 102 S.W.2d 1031, 1034 (Tex. 1937); Norton, *Lender Liability Law and Litigation*, (1991) (hereafter referred to as "Norton").

E. Anticipatory Repudiation. Anticipatory repudiation occurs when a party absolutely repudiates an obligation without right or just excuse and the opposing party is damaged by the repudiation. *Valdina Farms, Inc. v. Brown, Beasley & Assocs., Inc.*, 733 S.W.2d 688, 692 (Tex. App. – San Antonio 1987, no writ). However, the repudiating party may retract their repudiation by notifying the other party that they will perform the contract. *Id.* The retraction may occur until such time as the other party materially changes position in reliance on the repudiation in such a way as to make performance more burdensome or until the other party brings a legal action. *Id.* The borrower must prove it was ready, willing and able to perform its own obligation under the loan commitments.

In *Valdina*, the lender issued a $12 million loan commitment with performance by the borrower secured by $230,000 earnest money. The earnest money was to be refunded upon closing or the borrower's inability to sell certain of its assets, which were conditions to the lender's obligation to fund. If the borrower failed or refused to close the loan, the earnest money was forfeited to the lender. Based on the borrower's inability to satisfy various conditions to the loan, the lender made additional requirements and reduced the loan value to compensate for the problems. The day before closing, the borrower informed the lender in writing that the new requirements were unacceptable and the borrower would not close the loan. The borrower requested return of the earnest money. The following day, the lender waived all conditions to conditions to funding the loan. The borrower refused to close arguing that the lender waived the conditions only after it knew the borrower could not consummate the loan. The lender informed the borrower that lender intended to retain the earnest money. The borrower sued to recover the earnest money. The court reviewed the rules applicable to anticipatory breach but determined, as a matter of law, no anticipatory breach by the lender occurred. This is based upon testimony that the borrower had orally agreed to the additional conditions required by the lender (i.e., those not contained in the written loan commitment), and further, that borrower failed to prove it materially changed its position prior to lender retracting the additional requirements.

Lenders must be careful of anticipatory repudiation. It typically arises when, due to unforeseen circumstances relating to the borrower, changes in the collateral or general economic environment cause the lender to suggest or demand that requirements not contained in the written loan commitment be satisfied prior to funding. In *Valdina*, the lender's actions in requesting that additional conditions be satisfied were deemed reasonable and substantiated by prudent business justifications, and the lender withdrew the additional requirements immediately prior to the deadline for funding. Lenders must be careful in making oral statements that begin with "unless you . . ." and end with "we won't fund the loan." Additional requirements not set forth in the loan commitment should be tied to provisions in the loan commitment providing the lender discretion and should be couched in language which conveys their reasonableness and the good faith of the lender in requiring them. Lenders should refrain from relying upon additional requirements as the primary basis for refusing to fund a loan, but should instead focus on conditional language contained in the loan commitment itself.

Borrowers have a major hurdle in proving anticipatory repudiation in that it is clear that they must be ready, willing, and able to perform their part of the bargain. A borrower should tender signed loan documents, evidence of compliance of conditions precedent, and all required fees on or before the deadline for loan closing in order to ensure that the lender will not later argue that the borrower was not able to perform its

borrower was not able to perform its obligations under the undisputed portions of the loan commitment.

F. Waiver. Waiver is the intentional relinquishment of a known right through words or actions; *Braugh v. Philips*, 557 S.W.2d 155, 158 (Tex. Civ. App. – Corpus Christi 1977, writ ref'd n.r.e.); *Nance v. RTC*, 803 S.W.2d 323, 329 (Tex. App. — San Antonio 1990), *writ denied per curiam*, 813 S.W.2d 154 (Tex. 1991). TEX. BUS. & COM. CODE § 26.02 (Vernon 2002) will not preclude oral testimony from being admitted to evidence a waiver by a lender of written requirements of a loan commitment. If a court determines that the lender has waived conditions precedent, the court may award damages for the lender's failure to fund. *See Island Recreational Dev. Corp. v. Republic of Texas Sav. Ass'n*, 710 S.W.2d 551 (Tex. 1986). In *Island*, the Texas Supreme Court upheld the use by the trial judge of a single broad issue questioning the jury whether the borrower performed the obligations under the commitment. Included within the items the jury could properly consider was the issue of waiver (if properly pled and proved). *Id.* at 555. The history of the *Island* case (including a withdrawn Texas Supreme Court decision which was rescinded after rehearing) gives an interesting background on waiver in a loan commitment setting.

Substantial performance of conditions precedent has been upheld in loan commitment cases, often by the court finding waiver by the lender of full performance. *See Island Recreational Dev. Corp. v. Republic of Texas Sav. Ass'n*, 710 S.W.2d 551 (Tex. 1986).

G. Duty to Perform/Negligent Breach. Lenders have an obligation to exercise diligence in performing their duties under a loan commitment. *See Montgomery Ward & Co. v. Scharrenbeck*, 204 S.W.2d 508, 510 (Tex. 1947). In *Scharrenbeck*, the Texas Supreme Court stated:

> Accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience, and faithfulness that they agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of contract.

*Id.* The violation of that duty does not constitute actionable negligence, only a breach of contract. *Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 495 (Tex. 1991). Rather, *Scharrenbeck* established a standard for performance of contract duties. The tort mentioned in *Scharrenbeck* applies only where there is an independent implied duty which is breached (such as duty of good faith and fair dealing). *Id.*

In *General Inv. & Dev. Co. v. Guardian Savings & Loan Ass'n*, 862 F. Supp. 153, 157 (S.D. Tex. 1994) (applying Texas law), the court held that a lender had an implied duty to diligently pursue compliance with contract requirements. The court further held the lender to an objective reasonableness standard in determining whether lender was proper in claiming that borrower had not complied with conditions which were to be performed "in a matter satisfactory" to lender, rather than the subjective standard asserted by lender. *Id.* at 156.

To the extent that matters are conditions precedent to the lender's obligation to fund, lenders should be careful to exercise diligence in seeking loan committee or director approvals, obtaining SBA guarantees, locating loan participants and similar conditions.

H. Privity/Third-Party Beneficiaries. An interim lender may not enforce the borrower's permanent loan commitment without privity. *Texas Bank & Trust Co. v. Lone Star Life Ins. Co.*, 565 S.W.2d 353, 357 (Tex. Civ. App. — Tyler 1978, no writ). Tri-Party agreements executed by the borrower, the interim lender and the permanent lender provide a contractual basis for an interim lender to enforce a permanent loan commitment. Sellers of property may not enforce a loan commitment issued for the benefit of purchasers of the property. *Payne v. United States*, 336 F. Supp. 1008 (S.D. Tex. 1971). *See* Annotation, *Vendor's Action against Vendee's Prospective Lender for Misrepresentation Respecting or Failure to Complete Loan Application*, 30 A.L.R. 40th (1984). A contractor may recover against a lender for fraud and

for fraud and negligent misrepresentation in connection with the lender's refusal to fund construction loans which it had approved and assured the contractor it would fund as soon as its attorneys completed the loan documents. *Texas Commerce Bank-Reagan v. Lebco Constructors, Inc.*, 865 S.W.2d 68, 73 (Tex. App. — Corpus Christi 1994, writ denied), *disagreed with by Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W. 2d 507, 529 (Tex. 1998). Promissory estoppel will support recovery by a contractor from a lender where the lender agreed to "set aside" and "protect" funds from a loan for the benefit of the contractor. *Fretz Constr. Co. v. Southern Nat'l Bank of Houston*, 626 S.W.2d 478, 482-83 (Tex. 1981).

Lenders must be careful when advising third-parties dealing with a proposed borrower of the lender's intent. Any type of "comfort letter" issued by a lender will be relied upon by the third-party, potentially to their detriment. All comfort letters should contain the statement that any requirement by the lender to fund is conditioned upon full compliance by the borrower with the requirements of the loan commitment and loan documents. The lender should refer the third-party to the borrower for a copy of the loan commitment.

As stated above, common law concepts will provide a third-party the right to recover changes from a lender without having to assert privity of contract. In *Texas Commerce Bank-Reagan*, the lender actually approved the borrower's loan, assured the contractor the loan was funded as soon as the loan documents were finished, and told the contractor it could commence construction prior to loan closing if contractor would send a letter to the bank stating that construction would <u>not</u> begin until the loan closed. Thereafter, the lender (apparently upon advice of counsel) decided not to fund the loans, allegedly due to the early commencement of construction by the contractor. The contractor's suit for fraudulent and negligent misrepresentation was successful, resulting in recovery of lost profits on the job in question, prejudgment interest, and attorneys' fees. The contractor's alleged damages for <u>subsequent</u> lost profits were rejected; since only the actual loss directly resulting and proximately caused by the fraud is recoverable. *Id.* at 73.

## IV. <u>NON-CONTRACT LAW ISSUES</u>

A. <u>Deceptive Trade Practices Act</u>. A consumer may maintain an action against a lender based on either a written or oral loan commitment under the DTPA. *Investors, Inc. v. Hadley*, 738 S.W.2d 737 (Tex. App. — Austin 1987, writ denied). *Also see Herndon v. First National Bank of Tulia*, 802 S.W.2d 396, 399 (Tex. App. — Amarillo 1991, writ denied); *Security Bank v. Dalton*, 803 S.W.2d 443, 452 (Tex. App. – Fort Worth 1991, writ denied).

However, where the sole basis of the borrower's complaint is the refusal to fund a loan, without any connection to the purchase of goods or services, no DTPA action arose since the borrower "was not a consumer" under the DTPA. *Clardy Manufacturing Co. v. Marine Midland Business Loans, Inc.*, 88 F.3d 347 (5th Cir. 1996), *rehearing and suggestion for rehearing en Banc denied by* 96 F. 3d 1447 (5th Cir. 1996), and *cert. denied by* 117 S. Ct. 740 (U.S. 1997); *Maginn v. Norwest Mortgage*, 919 S.W.2d 164, 166 (Tex. App. — Austin 1996, writ denied); *Henderson v. Texas Commerce Bank-Midland, N.A.*, 837 S.W.2d 778, 782 (Tex. App. — El Paso 1992, writ denied). The Houston Fourteenth Court of Appeals held, "to hold a creditor liable in a consumer credit transaction, the creditor must be shown to have some connection, either with the actual sales transaction <u>or</u> with a deceptive act related to financing the transaction." *Brown v. Bank of Galveston, N.A.*, 930 S.W.2d 140 (Tex. App. – Houston [14th Dist.] 1996, writ granted) *judgment affm'd by* 963 S.W. 2d 511(Tex. 1998). However, an allegation of a mere breach of contract, without more does not constitute a DTPA violation. *Crawford v. Ace Sign, Inc.*, 917 S.W.2d 12, 14 (Tex. 1996), *citing Ashford Developments, Inc. v. U.S. Life Real Estate Serv.*, 661 S.W.2d 933 (Tex. 1983).

The DTPA is no longer applicable to transactions exceeding $500,000, thereby significantly limiting its scope in commercial loan transactions. However, for transactions up to $500,000, the DTPA is a nightmare for lenders.

B. Statutory Real Estate Fraud. The Real Estate Fraud Act, Tex. Bus. & Com. Code § 27.01 (Vernon 1996), does not apply to a real estate loan commitment or a standalone real estate loan. *Texas Commerce Bank-Reagan v. Lebco Constructors, Inc.*, 865 S.W.2d 68, 82 (Tex. App. – Corpus Christi 1994, writ denied), *disagreed with by Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W. 2d 507, 529 (Tex. 1998), *citing Greenway Bank & Trust v. Smith*, 679 S.W.2d 592, 596 (Tex. App. — Houston [1st Dist.] 1984, writ ref'd n.r.e.).

C. Negligent Misrepresentation. Commencing with the 1990 decision in *Federal Land Bank Ass'n of Tyler v. Sloane*, 793 S.W.2d 692 (Tex. App. — Tyler 1990), *aff'd in part, rev'd in part*, 825 S.W.2d 439 (Tex. 1991), the tort concept of a negligent misrepresentation by a lender to a borrower became the cause of action of choice of Texas borrowers in the context of loan commitment disputes. However, in the ensuing years, the cause of action has been circumscribed and the damages recoverable have been limited. Negligent misrepresentation is alive and well, but has significantly less concern to lenders today.

The elements of negligent misrepresentation are:

1. representation made in the course of business, or in a transaction with a pecuniary interest,
2. the false information was supplied "for the guidance of others in their business,"
3. failure to exercise reasonable care, or existence of negligence in obtaining or communicating the information, and
4. pecuniary loss by justifiable reliance on the representation. *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 437, 442 (Tex. 1991).

The following rules apply to negligent misrepresentation:

1. Intent is not required, only that the representation was made and it was falsely made. *Federal Land Bank Ass'n of Tyler v. Sloane*, 793 S.W.2d 692, 695 (Tex. App. — Tyler 1992) *aff'd in part, rev'd in part*, 825 S.W.2d 439 (Tex. 1991).
2. Contributory negligence is a defense. *Id.*
3. The fact that there may be no contractual basis to enforce the loan commitment is irrelevant. *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991).
4. The misrepresentation may not be regarding future conduct, only an existing fact. *5636 Alpha Road v. NCNB Texas Nat'l Bank*, 879 F. Supp. 655, 664 (N.D. Tex. 1995).

In *Alpha*, the court distinguished *Federal Land Bank Ass'n of Tyler v. Sloane*, since in that case the lender's officer represented to the borrowers that the loan was approved. Whereas in *Alpha*, the bank officer represented that the current loan would be extended when it matured, stating it was a "done deal" that the loan would be renewed. The court in *Alpha* held, as a matter of law, the type of false information contemplated in a negligent misrepresentation case is a misstatement of existing fact, citing *Airborne Freight Corp. v. C. R. Lee Enter., Inc.*, 847 S.W.2d 289, 294 (Tex. App.— El Paso 1992, writ denied). The *Alpha* decision was followed by *Clardy Manufacturing Co. v. Marine Midland Business Loans, Inc.*, 88 F.3d 347, 357 (5th Cir. 1996), *rehearing and suggestion for rehearing en Banc denied by* 96 F. 3d 1447 (5th Cir. 1996), and *cert. denied by* 117 S. Ct. 740 (1997).

In *Clardy*, the lender stated to the borrower that a loan commitment would be following shortly, because everything "looked good." Negligent misrepresentation cannot be based upon a guess as to a future unknown event. *Id. citing Sergeant Oil & Gas Co. v. National Maintenance & Repair, Inc.*, 861 F. Supp. 1351, 1360 (S.D. Tex. 1994) in distinguishing *Federal Land Bank Ass'n of Tyler v. Sloane*. The Fifth

*Sloane*. The Fifth Circuit went on to state that even if the lender had stated that the loan commitment would (as opposed to "was expected") be issued shortly would not constitute negligent misrepresentation because that would not be a misstatement of an existing fact, but rather of a future action. *Id.* As an alternative basis for denying the negligent misrepresentation claim, the Fifth Circuit found the borrower could not prove justifiable reliance on the misrepresentation. The court held that the reliance requirement (also referred to as a "materiality" element) has two parts: (1) the plaintiff must prove it in fact relied and (2) the reliance must be reasonable. *Id.* The justifiableness of the reliance is judged in light of the plaintiff's intelligence and expertise. *Id.* at 358. Unjustified reliance is, in effect, negligence by the plaintiff, which defeats the negligent misrepresentation claim. *Id.*

Borrowers asserting negligent misrepresentation by lenders must now leap over two major hurdles: (1) that the misrepresentation be related to an existing fact, not a future course of action, and (2) considering the borrower's intelligence and experience, the borrower justifiably relied upon the misrepresentation. Although negligent misrepresentation will continue to be a cause of action of choice for borrowers since intent need not be proven lenders will have greater success because of these hurdles, both at summary judgment and trial, in defeating this cause of action.

D. Negligent Breach. The concept of negligent breach discussed in Part G of Section III cannot be used by the borrower to assert a tort claim against a lender without an independent tort. The cases denying any fiduciary duty, special relationship, or duty of good faith and fair dealing in Texas should be helpful in defending a negligent breach case because with only the loan commitment contract there is no independent implied duty to the borrower.

E. Fraud. Borrowers have asserted causes of action based on fraud in the context of affirmative misrepresentation, as well as the failure to disclose material information.

1. Fraudulent Misrepresentation The elements for fraudulent misrepresentation are:

a. a material misrepresentation;

b. falsely made;

c. made with knowledge of its falsity or made recklessly;

d. made with intent to be relied upon;

e. reliance (actual and reasonable); and

f. damages.

*State Nat'l Bank of El Paso v. Farah Mfg. Co., Inc.*, 678 S.W.2d 661, 682 (Tex. App. — El Paso 1984, writ dism'd by agr.); *T.O. Stanley Boot Co., Inc. v. The Bank of El Paso*, 847 S.W.2d 218, 222 (Tex. 1990).

The difference between negligent misrepresentation and fraudulent misrepresentation is the requirement of intent. *Richter, S.A. v. Bank of America Nat'l Trust & Sav. Ass'n*, 939 F.2d 1176, 1185 (5th Cir. 1991), *rehearing denied by* 96 F. 2d 9 (5th Cir. 1992). The Fifth Circuit set out the following rules for fraudulent misrepresentation actions under Texas law.

a. The misrepresentation must be one concerning a material fact, not an opinion.

b. An opinion may constitute fraud if the speaker knows it is false.

c. An opinion as to the happening of a future event may constitute fraudulent misrepresentation where the speaker purports to have special knowledge of facts that will occur or exist in the future.

d. A promise to do an act in the future is a fraudulent misrepresentation only when made with the intent, design, or purpose of deceiving with no intention of performing.

e. Failure to perform alone, is no evidence of a party's intent not to perform when the promise was made.

f. Reliance on a fraudulent misrepresentation must be actual, as well as justified (but, a lesser burden than the negligence misrepresentation standard where contributory negligence is considered).

g. To determine justifiability, a party's individual characteristics, abilities and appreciation of facts and circumstances at or before the time of the alleged fraudulent misrepresentation are reviewed. *Clardy Manufacturing Co. v. Marine Midland Business Loans, Inc.*, 88 F.3d 347, 359 (5th Cir. 1996), *rehearing and suggestion for rehearing en Banc denied by* 96 F. 3d 1447 (5th Cir. 1996), and *cert. denied by* 117 S. Ct. 740 (1997).

A clever borrower needing to show intent in a fraudulent misrepresentation case alleged that the bank officer's denial of an oral loan commitment existed was sufficient evidence to show that the lender had no intent to perform under the alleged oral loan commitment. *T.O. Stanley Boot Co., Inc. v. The Bank of El Paso*, 847 S.W.2d 218, 222 (Tex. 1992). Although clever, the Texas Supreme Court rejected such argument because, as under negligent misrepresentation, a fraudulent misrepresentation must be a misstatement of a current fact without future action. However, a promise to do an act in the future may be a fraudulent misrepresentation where the party making the promise had no current intent of performing the action. *Id. See Enbley v. Cody Resources, Inc.*, 171 F. 3d 315, 322 (5th Cir. 1999).

Borrowers asserting fraudulent misrepresentation have three major obstacles: (1) reasonable reliance, (2) misrepresentation of an <u>existing fact</u>, and (3) intent. Proving reasonable reliance in the context of a well-drafted loan commitment, particularly if the lender has been careful in documenting its course of dealings with the borrower, is difficult.

Like negligent misrepresentation, fraudulent misrepresentation will continue to be a favorite cause of action and will be pled in most cases where negligent misrepresentation is pled, provided there is some evidence of intent.

2. <u>Duty to Disclose Material Information</u> Borrowers may assert that lenders have a duty to disclose material information. *See Yousef v. Trustbank Sav. FSB*, 81 Md. 527, 568 A.2d 1134 (Md. 1990). However, without a fiduciary relationship or a special relationship (neither of which typically exist in Texas between lenders and borrowers) that cause of action should be unsuccessful. *See Black Canyon Racquetball Club, Inc. v. Idaho First Nat'l Bank, N.A.*, 804 P.2d 900 (Idaho 1990). However, a duty of good faith and fair dealing can arise where there is a "special relationship;" however, the existence of these duties is determined by the court as a question of law. *Cockrell v. Republic Mortgage Ins. Co.*, 817 S.W.2d 106, 116 (Tex. App. — Dallas 1991, no writ); *Manufacturers Hanover Trust Co. v. Kingston Investors Corp.*, 819 S.W.2d 607, 610 (Tex. App. — Houston [1st Dist.] 1991, no writ); *FDIC v. Perry Bros. Inc.*, 854 F. Supp. 1248, 1259 (N.D. Tex. 1994), *aff'd in part, reversed in part, NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995).

Even without a duty to disclose material facts, a party or a party's agent who discloses information <u>thereafter</u> has an obligation to disclose all facts known to them. *Southeastern Fin. Corp. v. United Merchants and Mfr., Inc.*, 701 F.2d 565, 566 (5th Cir., 1983); *Spoljaric v. Percival Toys, Inc.*, 708 S.W.2d 432, 435 (Tex. 1986); *Schindler v. Austwell Farmers Co-Op*, 829 S.W. 2d 283, 286 (Tex. App.— Corpus Christi 1992, no writ). Further, the duty to disclose arises when a party knew or should have known that their prior statement was false. *Ralston Purina Co. v. McKendrick*, 850 S.W.2d 629, 635 (Tex. App. — San Antonio 1993, writ denied).

F. <u>Good Faith and Fair Dealing</u>. The often asserted claim by borrowers that <u>all</u> lenders have a duty of good faith and fair dealing in relationships with borrowers is dead. *Coleman v. FDIC*, 795 S.W.2d 706 (Tex. 1990); *Security Bank v. Dalton*, 803 S.W. 2d 443, 447 (Tex.

803 S.W. 2d 443, 447 (Tex. App. – Fort Worth 1991, writ denied). *See* DiPrinzio, *Good Faith and Fair Dealing in Commercial Agreements*, 11 Probate & Property 31 (January/February 1997). However, in *FDIC v. Perry Bros., Inc.*, 854 F. Supp. 1248 (N.D. Tex. 1994), *aff'd in part, rev'd in part, NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995), the trial court held that a duty of good faith and fair dealing may arise in the following three circumstances:

1. by agreement;

2. by particular circumstances between the parties as a result of a long-standing special relationship of trust and confidence between them (although mere subjective intent alone cannot create the duty of good faith and fair dealing); or

3. where an imbalance of bargaining power exists (at least when the defendant is responsible for the imbalance). *Id.* at 1259.

In *Perry*, the trial court found all three circumstances. The court cited the longstanding special relationship of trust and confidence between the borrower and the lender's predecessor and the lender's embrace of that relationship after taking over the failed predecessor banks, all as reflected in the lender's internal memoranda introduced at trial. The court was persuaded by the borrower's arguments that the lender had a hidden agenda to write down the borrower's loans so they would become "classified credits" eligible to be "put" into a special asset bank which would provide economic benefit to the lender due to its contractual agreement with the FDIC relating to taking over the predecessor's lenders. *Id.* at 1261. However, the Fifth Circuit, in an unreported *per curiam* opinion, stated the Texas Supreme Court has expressed reticence toward implying a duty of good faith and fair dealing into business relationships" warning that such practice "would abolish our system of government according to settled rules of law and let each case be settled rules of law and let each case be decided upon what might seem 'fair and in good faith' by each fact finder, citing *English v. Fisher*, 660 S.W.2d 521, 522 (Tex. 1983).

Referring to the facts that appear very favorable to the holding of a special relationship, the Fifth Circuit stated:

> although, as the relationship progressed NationsBank might have occupied a dominant position to the significant disadvantage of Perry Brothers, it cannot say that any inherent future of this or any other lender/borrower relationship marks it as 'special' as the Texas cases have used this term. In our view, characterizing this particular relationship between NationsBank and Perry Brothers as 'special' such as to impose the duty of good faith and fair dealing, would deprive this narrow doctrine of Texas law of any meaningful limitation and, thus, would invite precisely the abuse that prompted the Texas Supreme Court's earlier expression of concern.

The duty of good faith and fair dealing is a tort concept, and should be distinguished from the covenant of good faith and fair dealing which is a contract concept. There is no implied covenant of good faith and fair dealing in Texas. *Cluck v. First Nat'l Bank of San Antonio*, 714 S.W.2d 408, 410-11 (Tex. App. — San Antonio 1986, no writ). The concept of good faith and fair dealing as it relates to the performance of contract provisions exists in Texas and specifically applies to loan commitments. *See First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d 179, 182 (Tex. App. — Tyler 1982, no writ); *Black Lake Pipeline Co. v. Union Constr. Co.*, 538 S.W.2d 80, 88-89 (Tex. 1976), *overruled on other grounds, Sterner v. Marathon Oil Co.*, 767 S.W.2d 686 (Tex. 1989), *on remand to Marathon Oil Co. v. Sterner*, 777 S.W. 2d 128 (Tex. App. – Houston [14th Dist.] 1989, no writ).

G. Duress. The elements for duress are:

1. a threat to do an act that the threatening party has no legal right to do;

2. the threat must overcome the free agency and will of the threatened party and cause him to do something which he is not legally bound to undertake;

3. the restraint caused by the threat is imminent; and

4. the threatened person must have no present means of protection.

*Simpson v. MBank Dallas, N.A.*, 724 S.W.2d 102, 109 (Tex. Civ. App. — Dallas 1987, writ ref'd n.r.e.); *Nance v. RTC*, 803 S.W.2d 323, 333 (Tex. App. – San Antonio 1990) *writ denied, per curiam* 813 S.W.2d 154 (Tex. 1991).

Duress has been more succinctly defined as "subjecting a person to a pressure which overcomes his will and coerces him to comply with demands to which he would not yield if acting as a free agent." *First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d 179, 182 (Tex. App. — Tyler 1982, no writ). In *Dicker Center*, the borrower signed a release required by the lender for the lender to refund the commitment fee after the lender refused to fund a loan. The borrower sued, asserting that the release was signed under duress because he needed the money. The court held that it is a defense to economic duress that the claimant's financial distress is due to third-party actions. *Id.* at 185-6. The stress of business conditions will not constitute duress unless the defendant was responsible for that condition. *Id.* at 186.

Whether duress actually existed in a particular case, is a question of fact. *FDIC v. Perry Bros., Inc.*, 854 F. Supp. 1248, 1266 (N.D. Tex. 1994), *aff'd in part, rev'd in part, NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995). Enforcing a contractual provision will not support a cause of action of duress. *Nance v. RTC*, 803 S.W.2d 323, 333 (Tex App. — San Antonio 1990), *writ denied, per curiam* 813 S.W.2d 154 (Tex. 1991).

A complete discussion of duress in a lender/borrower setting is contained in *State Nat'l Bank of El Paso v. Farah Mfg. Corp.*, 678 S.W.2d 661, 683-8 (Tex. App. — El Paso 1984, writ dism'd by agr.).

A loan commitment should provide the justification for actions taken by a lender which might otherwise be the basis for a duress claim, such as (i) withholding required approval, (ii) adding requirements due to changing conditions and updated information, and (iii) termination. The lender would point to these provisions as evidence that the lender acted within its legal rights, thereby destroying the first element required for a duress claim. Duress is rarely asserted and even more rarely found in a business setting. Asserting a special relationship, giving rise to an ability of good faith and fair dealing is more likely to be successful.

H. Promissory Estoppel. The elements for promissory estoppel are:

1. a promise;

2. the foreseeability of the promisee's reliance; and

3. actual reasonable substantial reliance by the promisee on the promise to the promisee's detriment.

*Henderson v. Texas Commerce Bank-Midland, N.A.*, 837 S.W.2d 778, 782 (Tex. App. — El Paso 1992, writ denied); *FDIC v. Perry Bros., Inc.*, 854 F. Supp. 1248, 1267 (N.D. Tex. 1994), *aff'd in part, rev'd in part, NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995)(citing *English v. Fischer*, 660 S.W.2d 521 (Tex. 1983)).

Promissory estoppel may be asserted when one party makes a promise which the promissor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee, which does induce such action or forbearance and when an injustice can be avoided only by the enforcement of the promise. *Id.*

Although normally a defensive theory, promissory estoppel has increasingly been pled as an affirmative cause of action. *Farah v. Mafrige & Kormanik, P.C.*, 927 S.W.2d 663, 672 (Tex. App. — Houston [1st Dist.] 1996, writ denied). The Texas Supreme Court stated that promissory estoppel is defensive in nature in that it does not create a contract where none existed before, but only prevents a party from insisting upon strict legal rights when to do so would be unjust. *Wheeler v. White*, 398 S.W.2d 93, 96 (Tex. 1965). In *Wheeler*, the Texas Supreme Court applied promissory estoppel to allow enforcement of an oral agreement to lend money which the Court of Appeals found unenforceable due to vagueness.

The function of waiver or estoppel is to preserve rights, not to create independent causes of action. . . . Waiver and estoppel are defensive in nature and operate to prevent the loss of existing rights. They do not operate to create liability where it does not otherwise exist.

*Hruska, et ux. v. First State Bank of Deanville, et al.*, 747 S.W.2d 783, 785 (Tex. 1988).

Promissory estoppel is also available to third-parties. *Fretz Constr. Co. v. Southern Nat'l Bank of Houston*, 626 S.W.2d 478 (Tex. 1981). In *Fretz*, the lender entered into a construction loan commitment (and subsequently funded a construction loan), and promised the borrower's contractor (in writing) to set aside certain funds, which were to be paid to the contractor under the construction contract to build the office building that were the subject of the loan. The funds were advanced for other purposes and the contractor was not fully paid. The contractor recovered from the lender, based on promissory estoppel.

In *State Nat'l Bank v. Academia, Inc.*, 802 S.W.2d 282 (Tex. App. — Corpus Christi 1990, writ denied), the court held that a contract otherwise unenforceable due to the parol evidence rule could not be enforced under a promissory estoppel cause of action. *Academia* supports a lender's defense that no justifiable reliance is possible on a contract otherwise unenforceable under Tex. Bus. & Com. Code § 26.01 (Vernon 2002). *Also see Farah v. Mafrige & Kormanik, P.C.*, 927 S.W.2d 663, 872 (Tex. App. — Houston [1st Dist.] 1996, writ denied). Further, the affirmative defense of limitations applies to promissory estoppel. *Id.*

## V. DAMAGES

A. Causation. Except under the DTPA, the borrower must prove causation between the damages sought and the lender's actions. *Davis v. Small Business Inv. Co. of Houston*, 535 S.W.2d 740, 743-44 (Tex. Civ. App. – Texarkana 1976, writ ref'd n.r.e.). Causation can sometimes be difficult for borrowers. The alleged loss may be due to the borrower's own poor finances or general economic conditions. *See First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d 179, 182 (Tex. App. — Tyler 1982, no writ).

B. Actual Damages. The typical measure of damages for a lender's failure to fund a loan commitment is the additional interest to be paid on a substitute loan. *Investors Inc. v. Hadley*, 738 S.W.2d 737, 739 (Tex. App. — Austin 1987, writ denied). Additional actual damages recoverable include consequential (sometimes called "special") damages reasonably contemplated by the parties at the time the loan commitment was made. *Id.* The borrower must show the damages sought are the natural, probable, and foreseeable consequence of the lender's conduct or within the parties' contemplation. *City of Dallas v. Villages of Forest Hills, L.P.*, 931 S.W.2d 601, 605 (Tex. App. — Dallas 1996, no writ). Consequential damages include:

1. Costs incurred relating to the failed loan;

2. Costs incurred obtaining a substitute loan;

3. The gross amount of additional interest paid on a substitute loan (even if the substitute loan is larger since the borrower used savings for interest carried during the period between the lender's failure to fund and funding a substitute loan). *Id.* at 741;

4. Lost Equity. *See F. B. Collins Inv. Co. v. Sallas*, 260 S.W. 261 (Tex. Civ. App. – Texarkana 1924, writ ref'd); *Penthouse Int'l Ltd. v. Dominion Fed. Sav. & Loan Ass'n*,

*Sav. & Loan Ass'n*, 655 F. Supp. 301, 311 (S.D. N.Y. 1987), *rev'd on other grounds*, 855 F.2d 963 (2nd Cir. 1988) *cert. denied* 490 U.S. 1005 (1989) for support for lost equity as a consequential charge; and

5. Lost Profits. *Texas Commerce Bank-Reagan v. Lebco Constructors, Inc.*, 865 S.W.2d 68, 74 (Tex. App. — Corpus Christi 1993, writ denied) (awarded lost profits on fraudulent misrepresentation theories, but held *in dicta* that net profits are recoverable under breach of contract); *See Nance v. RTC*, 803 S.W.2d 323, 333 (Tex. App. – San Antonio 1990) *writ denied, per curiam* 813 S.W.2d 154 (Tex. 1991); *First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d 179, 187 (Tex. App. — Tyler 1982, no writ) for additional support for recovery of lost profits.

Lost profits as an element of damages should be the biggest concern for a lender. Lost profits for failure to fund a loan commitment are recoverable (i) for an established business, or (ii) in the event of an unestablished business where there is a prior history of profitable operation for the same business (iii) or when there is proof of actual existence of a future contract from which lost profits can be calculated with reasonable certainty. *See First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc.*, 631 S.W.2d at 187. Recovery of lost profits is denied where they are speculative and determination is uncertain. *Id.* Where a project is new, strict proof is required. *Nance*, 803 S.W.2d at 323. Additionally, House Bill four would require a person seeking lost profits to show a net loss; meaning a person must reduce the amount lost by the taxes that would be owed.

Most Texas courts have denied lost profits in a lender/borrower setting. *See Davis*, 535 S.W.2d at 743-44 ; *Nance*, 803 S.W.2d at 323 ; *First Texas Savings Ass'n of Dallas*, 631 S.W.2d at 187 . A borrower should not be able to recover both lost profits and lost equity, since that would amount to a double recovery. *Penthouse*, 655 F. Supp. at 311.

6. Lost Syndication Fees. In *City of Dallas v. Villages of Forest Hills, L.P.*, 931 S.W.2d 601, 606 (Tex. App. — Dallas 1996, no writ), the court held syndication fees to be earned by the borrower in a low income tax credit apartment rehabilitation project were too speculative to recover because there were no purchasers or potential purchasers lined up and the borrower did not carry forward with the syndication.

7. General Discussion. For a general discussion of damages for breach of a contract to lend money, *see* Annotation, *Measure and Elements of Damages for Breach of Contract to Loan Money*, 4 A.L.R. 4th 682 (1981) and Katzenstein, *The Law of Mortgage Loan Commitments*, Chapter 7 (1996).

C. Punitive Damages. Punitive or exemplary damages are not recoverable for a breach of contract to lend money. *Security Bank v. Dalton*, 803 S.W.2d 443, 454 (Tex. App. – Fort Worth 1991, writ denied); *Dicker Center*, *supra* at 187. However, in a tort cause of action, punitive damages are recoverable, even if the tort cause of action arises out of a contractual relationship. *Texas Nat'l Bank v. Karnes*, 717 S.W.2d 901, 903 (Tex. 1986); *Miles Homes Div., Insilco Corp. v. Smith*, 790 S.W. 2d 382, 387 (Tex. App. — Beaumont 1990, no writ)(*in dissent)*. Only the tort cause of action needs to be sustained to recover punitive damages. *Id.* Tort reform has limited the recovery of punitive damages to the greater of (a) $200,000, or (b) two times the economic damage plus an amount equal to the non-economic damage up to $750,000. TEX. CIV. PRAC. & REM. CODE § 41.008 (Vernon Supp. 2003). Recent tort reform requires that the jury be unanimous in finding liability for exemplary damages, as well as the amount of such damages. TEX. CIV. PRAC. & REM. CODE § 41.003 (revised). Additionally, Plaintiff must prove fraud or actual malice by clear and convincing evidence in order to recover punitive damages. TEX. CIV. PRAC. & REM. CODE § 41.003 (Vernon Supp. 2003).

D. Specific Performance. Generally, specific performance has not been enforced in the context of a loan commitment, since damages are ascertainable in money. *B. F. Saul Real Estate Inv. Trust v. McGovern*,

*Inv. Trust v. McGovern*, 683 S.W.2d 531, 534 (Tex. App. — El Paso 1984, no writ). There are no reported Texas cases where specific performance of a commitment to lend money was enforced. However, where alternative loans are not available specific performance might be granted to a borrower. *See* Annotation, *Specific Performance of Agreement to Lend or Borrow Money*, 82 A.L.R. 3rd 1116 (1978); Groot, *Specific Performance of Contracts to Provide Permanent Financing*, 60 Cornell L. Rev. 718 (1975); Mehr & Kilgore, *"Enforcement of the Real Estate Loan Commitment: Improvement of the Borrower's Remedies*," 24 WAYNE L. REV. 1011 (1978).

E. Borrower's Duty to Mitigate. Borrowers have a duty to mitigate the damages by having diligently looked for other loans in order to operate the business or construct the project in question. *Davis v. Small Business Inv. of Houston*, 535 S.W.2d 740, 743 (Tex. Civ. App. —Texarkana 1976, writ ref'd n.r.e.). This should also apply to lenders.

## VI. NEGOTIATING TIPS FOR BORROWERS

A. Use of Counsel. Attorneys must educate their clients that a loan commitment letter is too important to be signed without negotiation, and should not be negotiated without assistance of legal counsel.

B. Accurately Describing the Business Deal. Confirm that the loan commitment letter accurately sets forth the business deal between the parties. Eliminate all inaccuracies and ambiguities. Include as much detail regarding the business agreement of the parties as possible. Do not let the borrower be railroaded by lender statements that "we don't put those items in our loan commitment letter" or "trust me" types of assurances. Make sure that all business points material to the borrower are included in the loan commitment letter.

C. Arbitration/Jury Waivers/Broad Boilerplate Waivers. Object on behalf of borrower to all boilerplate-type limitations of remedies and waivers. Although success is unlikely, it is appropriate in representing the borrower to object on such provisions on such provisions based on their sometimes onerous and overbearing wording. Success will come sporadically.

D. Borrower Performance. Negotiate for "material" and "reasonable" limitations on borrower performance, and compliance/satisfaction of lender's standards. Although success will be sporadic and uneven, the effort is worthwhile. Generally speaking, a few well-placed changes are more likely to be approved than a deluge of requests.

E. Conditions Precedent. Where possible, eliminate or modify conditions precedent. Form conditions and boilerplate conditions which are not applicable should be eliminated to prevent them from being used later by the lender in an improper context. Sometimes compliance for conditions precedent can be specified to be supplied by a third-party report issued by a specific professional (i.e., appraisals, environmental reports, property condition reports, etc.). To the extent possible, provide for a mechanical procedure to satisfy conditions precedent instead of relying upon lender "satisfaction."

Where third-party reports are available (appraisals, property condition reports, environmental reports, title commitments, survey, etc.) seek lender approval in the loan commitment letter, perhaps subject to a subsequent update without material change. The same applies to important credit leases which should be approved when the loan commitment letter is signed to prevent a lender from requiring the borrower to approach a national credit tenant for significant changes to a fully negotiated loan. Likewise, the agreement to accept a credit tenant's own form of estoppel letter can be important and eliminate significant hassle in the loan closing.

F. Lender Approvals. Request that lender approvals be provided in reasonable good faith (i.e., an objective standard). Eliminate, where possible, phrases such as "sole and unfettered discretion" which would support a subjective standard. Seek a "reasonable lender standard" for approvals.

G. Refund of Commitment/Due Diligence Fee. Particularly for higher quality borrowers with several competing lending sources, negotiate that all or a portion of the fee paid by the borrower to the lender as a condition to issuance of the loan commitment letter be refunded in the event the lender does not approve specified conditions precedent, such as general underwriting, approval of leases/title/survey or approval of third-party reports such as appraisal, environmental and property condition. These matters are, in most cases, beyond the borrower's control. The refund may be subject to lender's reasonable good faith determination that borrower has made no material misrepresentations in its loan application or other underwriting materials supplied to lender.

H. Loan Documents. Material provisions of loan documents should either be negotiated or addressed conceptually in the loan commitment. Examples include prepayment penalties, due on sale and encumbrance clauses, right to use casualty and condemnation proceeds for rebuilding, conditions for assumption upon sale, nonrecourse provisions and related carve-outs, and limitations on guaranties.

I. Attorneys' Fees. Seek a cap or fixed fee for lender's attorneys' fees. Some lenders will allow their attorneys to negotiate fees and others will not. Some lenders will pay the excess over an agreed cap.

J. Description of Project. Where the loan commitment is to fund the construction/acquisition of a new project for the borrower, fully describe the project so that in the event of breach by lender, the borrower can better prove its damages relating to the lost project and, potentially, lost profits. Similar description is applicable for existing projects owned by the borrower which are being refinanced so the borrower may prove-up lost equity in the event of lender breach.

K. Borrower's Counsel Opinion. It may be possible to stipulate in the loan commitment letter that the lender will accept the "Silverado" opinion letter form as adapted by the Committee on Legal Opinions of the Real Estate and Trust Law Section of the State Bar of Texas, or the 1985 "Wallenstein" form opinion letter promulgated previously and approved by that previously and approved by that committee. Both are "fair" opinions which are in common circulation. The Silverado form has seen increasing use in the recent years. Seek to have the lender (particularly a conduit lender) delete any unusual or difficult opinion letter issues such a land use or non-consolidation, particularly if the loan is less than $10,000,000.00

L. Extensions of Funding. Particularly important in a forward permanent loan commitment (i.e., a commitment issued by a permanent lender to take out a construction lender when a project is completed), is that borrowers will want to negotiate the ability to extend the deadline for funding the permanent loan commitment in the event of construction delays.

## VII. SIGNIFICANT RECENT CASES

The following are the most significant cases interpreting Texas law applicable to loan commitments. A review of these cases will provide counsel with an excellent background to draft, negotiate, interpret, or contest a loan commitment.

A. *Beal Bank v. Schleider III*, 124 S.W.3d 640 (Tex. App.-Houston 2003, pet. denied): Borrower Schleider claimed negligent misrepresentation and fraud against Beal Bank for an oral conversation that Schleider had with the Bank's loan officer. Schleider claimed that Dickenson's oral communications indicated an extension on his loan. Dickenson indicated that the extension would not be a problem and used the phrase "we are all set to go" and Schleider testified that he believed that they had reached a deal on an extension. Prior to the conversation Schleider had received a form letter reminding Schleider the date of the maturity of the loan and that he would be required to pay the outstanding indebtedness at that time. The court held that on the fraud claim, there was no evidence on the Bank's part indicating an intent to deceive Schleider. The fact that the Bank never granted the extension is not evidence of intent to deceive. Schleider also failed on the negligent misrepresentation claim. In a negligent misrepresentation case, there must be a misstatement of existing fact, not a promise of future conduct. Such a claim is usually not available where a contract is in

available where a contract is in force. The court held that Schleider was aware that any modifications had to be in writing and that the parties had not agreed on the interest rate and specific due date, Schleider failed to prove that he justifiably relied to his detriment on Dickenson's statements.

B. *In re Absolute Resource Corp.*, 76 F. Supp. 2d 723 (N.D. Tex. 1999), Absolute sought additional financing from Banc One. Absolute claimed that it had a binding contract from Banc One to lend money. This reliance was based on a letter from Robert Keaveny, a Vice-President of Banc One Leasing Corporation. The letter stated an independent investor, who was a customer of Banc One, had "committed to provide a letter of credit to support your loan request." The letter also states: "I expects to close the first transaction in the next week, with your deal to follow." Absolute sued on various causes of action including: fraud, negligent misrepresentation, and promissory estoppel. The court denied recovery, since Keaveny's statements were, at most, predictions or opinions as to the future outcome of the Absolute transaction.

C. *International Bank of Commerce- Brownsville v. International Energy Development Corp.*, 981 S.W. 2d 38 (Tex. App. — Corpus Christi 1998, writ denied), IEDC secured a nine million dollar loan from IBC. When IBC began dishonoring checks written by IEDC, it was discovered that IBC had a lending limit of $1,350,000.00, and IBC had not found participants to take the portion of the loan exceeding IBC's loan limit. IBC contended that the loan agreement was illegal and unenforceable because the amount exceeded IBC's legal lending limits. The court held that an agreement to lend an amount in excess of a regulated financial institution's legal limit is not per se illegal and unenforceable between the parties.

D. *Clardy Manufacturing Co. v. Marine Midland Business Loans, Inc.*, 88 F.3d. 347 (5th Cir. 1996), *rehearing and suggestion for rehearing en Banc denied by* 96 F. 3d 1447 (5th Cir. 1996), and *cert. denied by* 117 S. Ct. 740 (1997), the Fifth Circuit reversed and rendered in favor of the lender a district court judgment for the borrower of $8,100,000.00, based on breach of a written loan commitment. The commitment. The court, on appeal, held that the loan commitment was only a contract to perform due diligence, which did not require the lender to proceed further. The Fifth Circuit addressed the issues of fraudulent misrepresentation, negligent misrepresentation, promissory estoppel, interpretation of a loan commitment under Texas contract law, and deceptive trade practices.

E. *5636 Alpha Road v. NCNB Texas Nat'l Bank*, 879 F. Supp. 655 (N.D. Tex. 1995). The trial court granted the lender's motion for summary judgment holding, as a matter of law, there was no breach of a written loan commitment, no negligent misrepresentation, and no tortuous interference with business relations. The court distinguished *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439 (Tex. 1991), holding that it dealt with false representation of an existing fact (which gives rise to the cause of action for negligent misrepresentation), whereas *Alpha* involved alleged misrepresentation of future action (which does not support a negligent misrepresentation cause of action). In *Alpha*, the loan officer stated that future renewal of the loan was a "done deal."

F. *FDIC v. Perry Bros., Inc.*, 854 F. Supp. 1248 (N.D. Tex. 1994), *aff'd in part, rev'd in part, NationsBank v. Perry Bros., Inc.*, No. 94-40630, *unreported per curiam opinion* (5th Cir. 1995). The trial court entered judgment in favor of the borrower against the lender for actual damages plus attorneys' fees, court costs and interest exceeding $7 million. The lender was "slam dunked" on virtually every conceivable cause of action by the trial court, including special relationship, duty of good faith and fair dealing, duress, promissory estoppel, fraud and breach of an oral loan commitment. The trial court addressed and dismissed virtually all typical lender defenses, including debtor/creditor relationship does not generally impose a duty of good faith and fair dealing, statute of frauds, any alleged oral commitment was unenforceable due to vagueness, parol evidence objections, merger, lack of reasonable reliance, and *D'Oench, Duhme*. However, in an unpublished opinion, the Fifth Circuit affirmed liability only on the wrongful setoff claim and the business disparagement claim. All other trial court findings were either vacated or remanded. This is an excellent case for an outline of

of the elements of the various borrower causes of action and lender defenses, even though the trial court's application of law to the facts has little precedential value.

G. *Texas Commerce Bank-Reagan v. Lebco Constructors, Inc.*, 865 S.W.2d 68 (Tex. App. — Corpus Christi 1993, writ denied). A jury verdict in favor of a contractor for lost profits of $2.5 million when the lender breached a written loan commitment with the contractor's client was upheld on appeal. The court discussed fraudulent and negligent misrepresentation and the damages recoverable. The court references *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439 (Tex. 1991), which denied recovery for loss of profits in the context of negligent misrepresentation. However, in *Lebco*, the court awarded loss of profits based on fraudulent misrepresentation, since lost profits would have been recoverable under a breach of contract analysis.

H. *T.O. Stanley Boot Co., Inc. v. The Bank of El Paso*, 847 S.W.2d 218 (Tex. 1992). Texas Supreme Court held in favor of a lender against a borrower asserting breach of an oral loan commitment. The court outlined the material terms for a contract to lend the money and concluded, that because the borrower did not sufficiently prove those elements, the alleged oral loan commitment failed for indefiniteness. The court also held that the asserted fraudulent misrepresentation failed because the representation involved the promise to do an act in the future, and there was no evidence that the lender had no intention of performing the act it purportedly represented it would do. Based on the foregoing, the Texas Supreme Court upheld the Court of Appeals' reversal of an $8 million judgment against the lender entered by the trial court after jury trial.

I. *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439 (Tex. 1991). Texas Supreme Court held that negligent misrepresentation applies in the context of an oral loan commitment despite the Statute of Frauds. However, damages recoverable did not include loss of profits or mental anguish (reversing the Court of Appeals on this issue). The court adopted the Restatement Second of Torts § 552 definition of negligent misrepresentation and the damages recoverable.

## VIII. CONCLUSION

It has been said that there is more litigation over loan commitments than any other aspect of financing. Loan commitments provide the road map for a lending transaction. An appreciation of the issues in loan commitment disputes will help eliminate the pitfalls caused by poorly drafted and negotiated loan commitments.