

## The return of lender liability (March 13, 2009)

Attorney Barry Cappello may have your bank in his sights

By Steve Cocheo, executive editor, scocheo@sbpublish.com

Barry Cappello's phone has been ringing off the hook these days, and, for bankers, this should be a wakeup call. Cappello is a veteran plaintiff's attorney with a major-league specialization in lender liability cases.

And chances are more than good that Cappello or one of his fellow borrower attorneys could be talking to your customers, or, rather, ex-customers, right now. If not yours, then those of another banker in your state.

### Growing case volume

Not too long ago, Cappello received 10-15 calls a month from borrowers alleging some variation on a lender liability claim against their banks. Now, he's getting that many prospective cases brought to his attention a day. Most concern commercial real estate borrowers, as well as residential real estate borrowers. (Cappello typically takes business cases, rather than consumer suits.)

"And many of them are very good," says Cappello, managing partner of the Cappello & Noël, LLP, law firm, in Santa Barbara, Calif. While many of Cappello's lender liability cases take place in California, a notoriously pro-debtor state, he can pick up cases in virtually any part of the country, attaining standing through local counsel that will sponsor him. Cappello finds state courts friendlier, in general, to borrower suits against lenders, and will generally try to bring them there, rather than in federal court. As it is, unless borrower and lender are headquartered in different states, the cases generally take place in state courts.

Claims can run into multiple millions of dollars, in business cases, which represent Cappello's bread and butter practice.

Years ago, one of the chief causes of lender liability cases was bankers allegedly attempting, or actually succeeding, in effectively taking over the running of a borrower's business. Bankers found that even the semblance of doing so, typically through overzealous offering of advice and such, could trigger a suit.

But that's not driving the growing number of cases today, says Cappello. Much of what he's seeing, on the business lending side, consists of cases of borrowers suing because the bank had allegedly reneged on agreements to provide credit.

## Cost of broken contracts

There is no legal charge called "lender liability," and thus no official numbers on these cases. Lender liability is a potpourri of potential accusations. What is triggering today's cases are failures to perform as promised or implied—breach of contract or breach of good faith and fair dealing.

"Banks are not performing," says Cappello, "because they don't have money to lend. They are pulling the plug on deals they have no right to pull the plug on."

Many banks face a "damned if you do/damned if you don't" choice here. You've heard the stories of banks pulling back due to portfolio troubles, capital issues, or even regulatory orders to reduce credit exposure, concentrations, and such. This is the other side of the matter, the borrower's side. And frustrated borrowers who feel they have been mistreated are calling the plaintiff bar.

Contracts are made to be broken, says Cappello, but if a bank is going to do that, they have to be prepared to face someone like him, who will demand, on behalf of their client, that the bank pay the cost of that breach.

Cappello has different ways of handling today's cases.

Where a lender's action has allegedly put a company out of business, and Cappello finds strong facts, he will generally take on the case on a contingency basis, and seek to take the case to trial.

On the other hand, where the borrower has had trouble, but has been able to keep its doors open, Cappello prefers to reach some out-of-court settlement, on a fee basis. The case becomes more of a workout situation. "I'm a strong believer in there being a business solution," he explains. (Learn more about the ABA Banking Journal Telephone Workshop, Improving Your Bank's Workout Function)

Often, the strategy is dictated as much by the source of the case. Cappello says about one-third of the cases referred to him because of his lender liability specialty arise because a borrower's bankruptcy attorney seeks him out. Another third come from businesses alleging bank misbehavior, directly. And, remarkably, one third of Cappello's caseload comes from bankers. It's not unusual, he claims, for a bank's competitors—"Don't mention my name, but there's a guy you should call"—who hear of a disgruntled borrower.

## The other side of the story

Cappello founded his firm in 1977, and his official biography claims that he's successfully pursued jury trials with total verdicts in excess of \$300 million, and negotiated more than \$1 million in settlements and workouts, as well. You might think he could write a book about lender liability.

Actually, he has. The fourth edition of his *Lender Liability*, came out earlier this year (Juris Publishing, 791 pages).

Cappello has seen a good deal of lenders as well as borrowers, and he is a realist. He knows misunderstandings can arise from both sides of the lender's desk.

"Most borrowers I work with are surprising optimists," says Cappello. "No matter what business they are in, they believe that given more money and a little more time, they will be able to make things work."

Indeed, this colors the types of cases that he will take, to a degree. "I only take cases, for instance, where the facts, as related by the borrower, give him a potential 'A' case, or, at the least, a 'B' case. I'm not interested in iffy cases, not interested in long shots.

And he won't take suits pressed by new businesses, for the most part. "In a 'lost-profits' case, for instance, you have to be able to prove that a business was successful," says Cappello, "and you can't do that without a track record."

He just doesn't see any percentage in most such cases. "Startups are floating like so many fish after a tsunami," he says.

#### How to avoid Cappello

Lender liability cases don't necessarily arrive like a thunderclap. Sometimes they come about after attempts have been made to arrange a workout. In his book, Cappello states that:

"Workouts result in benefits to both lenders and borrowers. More favorable payment terms mean that it is more likely that the borrower will repay the loan, even if it is over a longer period of time or in smaller payments than the original loan documents provided. Lenders may also successfully negotiate releases of claims in exchange for other benefits to the borrower.

"The trick in negotiating a successful workout is to arrive at realistic terms the borrower can meet and the lender can accept. If the workout is not workable, all that is accomplished is a temporary postponement of the day of reckoning."

What can your bank do to ensure that it doesn't meet up with Barry Cappello and his fellow borrower bar members? Cappello gives a few tips:

1. Follow your longstanding procedures to the letter. The cases of today arise because lenders have departed from

behavior and policy patterns that have been well-established with their customers over time. Cappello advises sticking to procedures that the bank can demonstrate have been its standard for a decade or so.

2. When there will be any sort of shift in policy or practice, give the borrower plenty of notice.
3. If you give some ground to a borrower, get them to sign a release.

Cappello gives this advice with some caution. He's of the opinion that a borrower would be "stupid" to sign any release offered by a lender. However, if the borrower does so in exchange for some concession, get the signature and keep it for later difficulties.

The clock may be ticking

One point lenders must be aware of, especially if the thing that has landed their bank in lender liability danger is a regulatorily mandated lending pullback, is that if the borrower and counsel catch even a whiff of trouble about the bank, it can change strategy.

This is because of the status of borrower claims against a bank that has failed. "In the past it was the lenders who worried about whether their borrowers were facing financial failure; now, the reverse is true," says Capello in his book. "Borrowers with viable lender liability claims are, or should be, as concerned about the financial health of the defendant lender as they are about proving liability and damages.

"The reason for this concern is that if the lender is taken over, and federal conservator or receiver is appointed, the borrower's claims may become worthless."

In his Chapter 31, Cappello writes extensively of the statutes and caselaw that can make a post-bank-failure lender liability suit moot.

Bankers need to be aware of Cappello's advice on this score:

"...borrowers considering suing their lenders, and borrowers who are defending against claims by their lenders, should carefully evaluate the financial health of those lenders. If the claim or defense they are raising is one that would be barred, it may make more sense to settle early with a viable lender than to risk later facing the government, with its all but impenetrable array of defenses." BJ

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