Lenders' Liability - The Shift from Contract to Tort Doctrine Deters Banks from Enforcing Unjustified and Detrimental Contract Provisions, 21 J. Marshall L. Rev. 369 (1988)

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LENDERS' LIABILITY—THE SHIFT FROM CONTRACT TO TORT DOCTRINE DETERS BANKS FROM ENFORCING UNJUSTIFIED AND DETRIMENTAL CONTRACT PROVISIONS

INTRODUCTION

A businessman enters into a contract with a bank to borrow money to build a new warehouse. He signs a loan agreement specifying that no one can lease part of the building without the bank's approval. Upon discovering that he has excess capacity in the warehouse, the debtor leases part of the building without the bank's permission. Although the payments and insurance on the building are current, the bank determines that the lessee has breached the contract and accelerates[1] the loan according to the contract provisions. The debt forces the borrower, who is unable to find new financing or payoff the loan, to declare bankruptcy. If the borrower sues the bank for the damage caused to his business, will he prevail?

Courts addressing similar situations have reached conflicting results based upon the degree of importance that the courts have accorded the written document.[2] Where the court looked exclusively at the written document to determine the respective rights of the parties, the creditor prevailed.[3] Where the court also examined the manner in which the creditor exercised its prospective contractual rights,[4] it has awarded judgments to debtors.[5]

The theory of "lender's liability" has attracted multimedia attention due to a $3.6 billion lawsuit that the Hunt brothers of Dallas filed against twenty-three of the nation's largest banks.[6] The phe-

1. An acceleration clause in a credit agreement allows the creditor to call the entire debt due when a default occurs, such as nonpayment of principle or interest. *See* BLACK'S LAW DICTIONARY 12 (5th ed. 1979) [hereinafter BLACK'S]; *see also* Vaughan v. Crown Plumbing and Sewer Serv., Inc., 523 S.W.2d 72, 75 (Tex. Civ. App. 1975) (citing reasons for acceleration as a protection provision).

2. *See infra* notes 31-80 and accompanying text for discussions of contrasting results based upon interpretation of written document.

3. Centerre Bank of Kansas City v. Distribs., Inc., 705 S.W.2d 42 (Mo. Ct. App. 1985).

4. In a debtor-creditor contract, prospective contractual rights allow the creditor to take remedial action if the debtor defaults. Note, *Debtor-Creditor: Estoppel of Creditor Claims for Default for Non-Payment-"Stopping the Bleeding" or "Pulling the Rug Out"?*, 23 WASHBURN L.J. 82, 83 n.8 (1983). The usual prospective rights are acceleration, foreclosure, forfeiture or repossession. *Id.*

5. K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985).

6. The Hunt brothers' suit charges the banks with deliberately delaying the re-

nomenon of debtors suing their bankers has resulted in several multimillion dollar damage awards.[7] The real significance of the debtors' victories, however, lies in the recognition of some courts that they must hold the banking industry to high standards of good faith conduct.[8]

Although banks have contracts allowing them to enforce draconian contract provisions against their debtors, enforcement of such provisions without legitimate business reasons is tortious.[9] To support this contention, this comment discusses why contract law fails to provide debtors with adequate remedies against the egregious conduct of creditors. Next, it focuses on society's perception of banks as places of safety and probity.[10] This comment suggests that although banks are profit-driven organizations, they cannot ignore the reliance that customers place on their integrity and financial advice. Based on this reliance, banks are quasi-fiduciaries[11] which courts must hold to high standards of fair dealing. Finally, this comment suggests a proposal that courts can implement to determine whether a bank has committed a tort against its debtor.

CONTRACT LAW DOES NOT ADEQUATELY ADDRESS DEBTOR-CREDITOR PROBLEMS

A debtor-creditor agreement is a contract whereby one party advances money in return for the other party's promise to repay according to specified terms.[12] Courts, therefore, have traditionally applied the principles of contract law to resolve debtor-creditor conflicts.[13] As long as the parties to an agreement have equal

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structuring of loans "to orchestrate a financial crisis," thus inducing the Hunt brothers to offer their personal assets to avoid bankruptcy. NAT'L L.J., Sept. 1, 1986 at 23, col. 2.

7. *See, e.g., K.M.C. Co.*, 757 F.2d 752 ($7.5 million award for breach of implied covenant of good faith); State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984) ($18.6 million award for fraud, economic duress and business interference).

8. First Nat'l Bank in Libby v. Twombly, 689 P.2d 1226 (Mont. 1984).

9. Legitimate business reasons as used in this comment refers to a creditor's reasonable fear of default on the payment of the loan or the impairment of the security for the loan. *See* U.C.C. § 1-208 (1978) (providing that party may accelerate payment only if he in good faith believes prospect of payment is impaired).

10. *See infra* notes 140-42 and accompanying text for a discussion of society's perception.

11. A fiduciary is a person or institution having a duty to act primarily for another's benefit. BLACK'S, *supra* note 1, at 563. Debtor-creditor agreements may give rise to fiduciary relationships where there ordinarily is no such obligation. *See infra* note 158 for an example of a court finding that a debtor-creditor contract imposed a fiduciary obligation on bank.

12. Symons, *The Bank Customer Relation: Part 1—The Relevance of Contract Doctrine*, 100 BANKING L.J. 220, 232-33 (1983).

13. *See, e.g.*, Iron Mountain Sec. Storage Corp. v. American Specialty Foods, Inc., 457 F. Supp. 1158 (E.D. Pa. 1978) (tort recovery for breach of good faith and fair

knowledge, ability, and power to influence the contract, the principles of contract law offer sufficient protection.[14] If the parties do not have equal bargaining power, however, and one party is able to exert influence and obtain one-sided contract provisions,[15] traditional contract remedies are inadequate to protect the weaker party in the event of breach. This is particularly true when the stronger party is an institution, such as a bank, in which people traditionally place trust and confidence.[16] The failure of contract law to adequately address unequal bargaining power in debtor-creditor relationships lies principally in two areas: interpretation and remedies.

Many courts are reluctant to look outside the four corners of a written contract to interpret its meaning.[17] Considering the adhesive nature of loan agreements, courts must overcome this reluctance in the case of debtor-creditor contracts.[18] Loan agreements often contain insecurity clauses[19] allowing creditors to make aggressive and

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dealing not recognized in debtor-creditor contract); Midlantic Nat'l Bank v. Commonwealth Gen., 386 So. 2d 31 (Fla. Dist. Ct. App. 1980) (absent some other contractual arrangement, bank within rights in terminating financing); Rigby Corp. v. Boatman's Bank and Trust Co., 713 S.W.2d 517 (Mo. Ct. App. 1986) (refusing to find tort cause of action for breach of good faith because U.C.C. does not provide such a remedy).

14. This is the classic exchange transaction between parties of relatively equal bargaining power, arising in a functioning market where it is assumed there is a dollar price for everything and, given their way, the parties will reach an efficient agreement. Speidel, *The Borderland of Contract*, 10 N. KY. L. REV. 163, 192 (1983).

15. Unequal bargaining situations often result in adhesion contracts. *See infra* note 18 for a discussion of adhesion contracts.

16. For the past 25 years, courts have recognized that contract law is inadequate to protect the public against egregious conduct by insurance companies. *See generally* Diamond, *The Tort of Bad Faith Breach of Contract: When, If At All, Should It Be Extended Beyond Insurance Transactions?*, 64 MARQ. L. REV. 425 (1981). There are many similarities between the banking and the insurance industries justifying extension of the tort to banking. *See infra* notes 92-97 and accompanying text for a discussion of these similarities.

17. This view is supported by both the U.C.C. and the *Restatement (Second) of Contracts*. U.C.C. § 2-202 (1978) provides that writings intended as the final expression of the parties' agreement may not be contradicted by evidence of any prior or contemporaneous agreement. *Id.* RESTATEMENT (SECOND) OF CONTRACTS § 215 states: "Where there is a binding agreement either completely or partially integrated, evidence of prior or contemporaneous agreements or negotiations is not admissable in evidence to contradict a term of the writing." *Id.*

18. One commentator has implied that the stronger party has duties beyond the contract when it is one of adhesion, due to the duty of good faith and fair dealing. J. MCCARTHY, PUNITIVE DAMAGES IN BAD FAITH CASES § 6.1, at 336-37 (2d ed. 1978). McCarthy states:

> Contracts of adhesion give no opportunity for bargaining between parties, but enable one party to wield such power over the other as to require the ordinary arms length principle of laissez faire to be reexamined . . . . Good faith and fair dealing means one thing in ordinary contracts where profit is the motivation of both parties. It takes on another meaning in contracts of adhesion . . . .

Id. at 336-37.

19. An insecurity clause is a provision in a contract allowing a creditor to call the entire debt due if there is a good reason to believe that a debtor cannot or will

unilateral decisions concerning continued funding. As a condition of the loan, many banks also insist that debtors maintain deposit accounts at the lenders' institutions.[20] The banks, at their discretion, can then offset the debtors' loan balances against the deposit accounts.[21] If a bank does this without sufficient justification, the bank will leave the debtor without adequate operating capital, forcing him into bankruptcy.[22] Consequently, courts that refuse to look beyond the four corners of the contract will leave the debtor without a remedy. This serious injustice illustrates the need for courts to require creditors to justify, with legitimate business reasons, their enforcement of harsh contract provisions.

Although a court may force creditors to justify their actions, the court will not adequately compensate debtors if it adheres to traditional contract remedies.[23] The usual remedies for unconscionable contract provisions[24] are rescission of the contract, severance of the provision, or damages.[25] These are unsatisfactory solutions when creditors unreasonably injure their debtors.

Rescission of the contract will require the debtor to return the loan proceeds to the bank. Because the borrower probably spent or invested the cash, rescission will force the debtor to liquidate the assets purchased with the funds. Thus, rescission is an inadequate remedy leaving the borrower in the same position that he was in when the bank unjustifiably called the loan.[26]

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not pay. BLACK'S, *supra* note 1, at 715.

20. *See, e.g.*, K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 759 (6th Cir. 1985) (financing agreement stipulated that debtor must deposit all receipts into account to which bank would have sole access).

21. Offset, sometimes called the "banker's lien," allows the bank to withdraw from the debtors' deposit account funds needed to cover a debt owed to the bank. The bank requires no court order and need not inform the depositor that it has this right or that it is making use of it. 1976 U.S. NEWS AND WORLD REPORT MONEY MANAGEMENT 39 [hereinafter MONEY MANAGEMENT]. *See, e.g.*, *K.M.C.*, 757 F.2d at 754 (bank used company's deposit account to payoff loan without company's knowledge); First Nat'l Bank in Libby v. Twombly, 689 P.2d 1226, 1228-29 (Mont. 1984) (bank used debtors' checking account to payoff debtors' loan without debtors' knowledge).

22. *See infra* note 55 and accompanying text for an example of a bank's action forcing debtor into bankruptcy.

23. For a discussion of the limitation of contract remedies, see *infra* notes 28-29 and accompanying text.

24. The basic test of unconscionability is whether, in light of the general commercial background and the commercial needs of the trade or case, the clauses involved are so one-sided that they are unconscionable under the circumstances existing at the time of making of the contract. U.C.C. § 2-302 comment 1 (1978).

25. U.C.C. § 2-302 (1) (1978) states:

> If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract or it may enforce the remainder of the contract without the unconscionable clause or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

Id.

26. One can contrast this situation to the retail sales agreement where rescission

Severance of the offensive contractual provision is feasible only if the bank has not enforced the provision.[27] Where the bank offset deposit accounts or refused to advance funds pursuant to the loan agreement, the bank may have irreparably harmed the borrower's business. If a business has lost contracts or has declared bankruptcy, returning deposit accounts or forcing the bank to honor its loan commitment will not adequately compensate the borrower for the harm already inflicted.

In contract law, economic policies limit the award of money damages.[28] Recovery is allowed only for economic injuries that were foreseeable consequences of the breach at the time the contract was made.[29] In a debtor-creditor contract, this means that a creditor's liability is limited to damages that were foreseeable when the loan was made, rather than those that were foreseeable when the creditor unjustifiably called the loan. Courts, therefore, will more likely measure damages according to the amount of the loan rather than the actual fiscal impact that the creditor's conduct had on the debtor.

Creditors facing only limited damages for their unreasonable conduct will continue to act unjustifiably whenever it is in their self-interest. Consequently, courts seeking to adequately compensate

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of the contract means that the debtor returns the merchandise in exchange for any consideration paid to the retailer. Under these circumstances, rescission is an adequate remedy.

27. Where a debtor has notice that the bank is planning enforcement of a harsh contract provision, he may be able to get an injunction preventing the bank's enforcement. *See, e.g.*, Vaughan v. Crown Plumbing and Sewer Serv., Inc., 523 S.W.2d 72 (Tex. Civ. App. 1975) (court issued injunction enjoining creditor from accelerating loan and foreclosing on property). This equitable remedy is not always available, particularly where the bank has acted without notice. *See infra* note 54 and accompanying text for an example of a bank acting without notice.

28. Contract law has two underlying purposes: protecting the reasonable expectations of the parties and promoting an efficient, reliable economic system. Diamond, *supra* note 16, at 437. Contract law is designed to promote a market economy by affording parties maximum flexibility in the performance and termination of contracts. Speidel, *supra* note 14, at 166. Remedies in contract law promote the parties' reasonable expectations by awarding the injured party the value of the breaching party's promised performance—the benefit of the bargain. *Id.*

Damages are limited to economic losses foreseeable at the time the contract was executed. Diamond, *supra* note 16, at 433-34. This limitation reduces uncertainty for the contracting parties and encourages them to enter into commercial transactions. *Id.* at 437. The limitation also encourages efficient resource allocation. *Id.* at 435.

A breaching party who knows in advance the cost of its breach can assess when the gain from the breach exceeds compensating the aggrieved party. Speidel, *supra* note 14, at 173. When the gain from the breach exceeds the value of performing the contract, economic efficiency is achieved. Diamond, *supra* note 16, at 435. This theory, known as "efficient breach," downplays the wrongfulness of the breaching party's conduct. *Id.* at 438. It emphasizes the economic reasons permitting reinvestment of the net gain into other economic opportunities and assumes that the injured party can recover full compensation from the breaching party in a relatively quick and costless litigation. *Id.* at 441.

29. Diamond, *supra* note 16, at 433-34.

debtors for injuries inflicted by unreasonable creditors should look beyond contract law to fashion remedies discouraging unjustifiable conduct. Two recent decisions[30] illustrate the contrast between strict adherence to the written document and a more liberal approach, where the court examines the creditor's justification for enforcing offensive provisions. These cases demonstrate that courts considering the reasonableness of the creditor's conduct, in addition to the written agreement, will arrive at more equitable results than courts limiting their inquiries to the written document.

ANALYSIS OF RECENT COURT DECISIONS

In *Centerre Bank of Kansas City v. Distributors, Inc.*,[31] the debtors purchased a business after the company's bank assured them that it would continue the company's line of credit.[32] The bank's loan officer told the debtors that the bank would continue financing if they were willing to personally guarantee the loan.[33] The loan officer, however, failed to disclose that the bank considered the loan a risk and was, in fact, preparing to demand full payment of all funds previously disbursed.[34] Relying on the loan officer's promise,[35] the debtors purchased the business and gave the bank their personal guarantees.[36] Three days after the debtors delivered their personal guarantees, the bank proceeded with its plan and demanded full payment on the loan.[37] The debtors, unable to find other financing, surrendered the business' assets to the bank.[38] After liquidating the business' assets, the bank sued to collect an additional $400,000 on the debtors' guarantees.[39] The debtors countersued, contending that the bank had made a fraudulent and material misrepresentation.[40]

30. Centerre Bank of Kansas City v. Distribs., Inc., 705 S.W.2d 42 (Mo. Ct. App. 1985) (demonstrating strict adherence to written document); K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (demonstrating more liberal interpretation).

31. 705 S.W.2d 42 (Mo. Ct. App. 1985).

32. A line of credit is "an agreement between a bank and a customer whereby the bank agrees, over a future period, to lend the customer funds up to an agreed maximum amount." Midlantic Nat'l Bank v. Commonwealth Gen., Ltd., 386 So. 2d 31, 33 n.1 (Fla. Dist. Ct. App. 1980). "The bank has the option to withdraw from the agreement if the financial status of the borrower changes, or if the borrower fails to use the line of credit for its intended use as per the agreement." *Id.*

33. *Centerre Bank*, 705 S.W.2d at 48-49.

34. *Id.* at 47.

35. *Id.* at 45.

36. *Id.*

37. *Id.* at 47.

38. *Id.* at 46.

39. *Id.*

40. A misrepresentation is material if it either induces a reasonable person to act or the maker of the misrepresentation knows that it is likely to induce a reasonable person to act. A misrepresentation is fraudulent if it is intended to mislead another. *See* RESTATEMENT (SECOND) OF CONTRACTS § 162 (1979). In contract law, a mis-

They also contended that the bank breached the covenant of good faith and fair dealing, which is implied in every contract.[41] Following a jury verdict for the debtors, the bank appealed.[42]

The Missouri appellate court held that the written contract was a completely integrated agreement.[43] Therefore, the parol evidence rule[44] prohibited the introduction of any evidence regarding the loan officer's verbal representations.[45] The court then found that the written agreement gave the bank the right to demand payment at anytime. As a result, the bank's actions were justified.[46] In addition, the court noted that the debtors' relationship with the bank was one of borrower and lender and that the bank did not owe the debtors a fiduciary obligation.[47] Consequently, the bank's failure to disclose its intentions regarding the loan did not constitute fraud.[48] The court stated that the bank's conduct was not unfair or morally offensive.[49] The debtors, therefore, could not avoid liability on their personal guarantees.

Conversely, in *K.M.C. Co. v. Irving Trust Co.*,[50] the company had a $3.5 million line of credit with the bank that was secured with assets.[51] When the company requested a disbursement against the credit line, the bank refused to advance the funds.[52] At the same

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representation which is either material or fraudulent may have three distinct effects: it may prevent contract formation; it may make the contract voidable; or it may provide grounds for a decree of reformation. *Id.* § 159, at 424 (introductory note). Misrepresentation in a contract does not give rise to a claim for damages. *Id.* In tort law, a misrepresentation that is both material and fraudulent may be the basis for a damage claim. *Id.*

41. *See infra* notes 83-91 and accompanying text for a discussion of the convenant of good faith and fair dealing.

42. *Centerre Bank*, 705 S.W.2d at 44.

43. An integrated agreement is a writing or writings constituting a final expression of one or more terms of agreement. RESTATEMENT (SECOND) OF CONTRACTS § 209 (1) (1979). A completely integrated agreement is an integrated agreement adopted by the parties as a complete and exclusive statement of the terms of the agreement. *Id.* § 210 (1).

44. The parol evidence rule prohibits the introduction of any evidence contradicting integrated agreements. *See supra* note 17 for a discussion of the parole evidence rule.

45. *Centerre Bank*, 705 S.W.2d at 51.

46. *Id.* at 48.

47. *Id.* at 53. *See supra* note 11 for a discussion of fiduciary duties.

48. The *Centerre* court stated: "In order that supression of the truth may constitute fraud, there must be a suppression of facts which one party is under a legal or equitable obligation to communicate to the other and which the other party is entitled to have communicated." *Centerre Bank*, 705 S.W.2d at 53. The court found that absent some fiduciary or confidential relationship, banks have no duty to disclose the status of loans to prospective debtors. *Id.*

49. *Id.* at 54.

50. 757 F.2d 752 (6th Cir. 1985).

51. The bank held a security interest in the debtors' accounts receivable and inventory. *Id.* at 754. An audit conducted by the bank concluded that in the event of the company's liquidation, no loss would be sustained by the bank. *Id.* at 762.

52. *Id.* at 754.

time, the bank used the company's deposit accounts to offset funds previously advanced under the credit line.[53] Because the bank did not give the company notice prior to acting,[54] the company did not have an opportunity to secure alternate financing. The bank's actions deprived the company of working capital and forced it to declare bankruptcy.[55] The company subsequently filed suit against the bank contending that the bank should have given advance notice that it was about to terminate the credit line and that failure to do so was a breach of good faith by the bank.[56] Further, the company alleged that the bank's misconduct directly caused the company's business failure.[57] The bank maintained that the company was already on the verge of financial collapse. Therefore, the bank's conduct was not only reasonable but specifically permitted under the loan document.[58] Following a $7.5 million jury verdict for the company, the bank appealed.[59]

On appeal, the bank raised several issues. First, the bank argued that the trial court erred in permitting a jury trial because the company waived that right as a provision of the loan.[60] Second, the bank argued that it did not, in fact, breach the financing agreement.[61] Third, the bank argued that the amount awarded was excessive.[62] The Court of Appeals for the Sixth Circuit affirmed the jury verdict.[63]

The court first held that the trial judge properly admitted parol evidence regarding the intent of the parties with respect to the waiver of a jury trial in the parties' agreement.[64] Next, the court addressed the breach of contract issue. The court recognized that

53. *See id.* at 759.

54. Although the bank's loan agreement stated that advances under the line were payable on demand, the court implied that the bank had to give reasonable notice. *Id.* Because the bank controlled all of the company's demand deposits, the court stated that "literal interpretation of the financing agreement . . . would leave K.M.C.'s continued existence entirely at the whim or mercy of Irving." *Id.*

55. The bank's unexpected action deprived the company of all its cash. *Id.* at 763. As a result, over $800,000 worth of checks written to suppliers were dishonored. *See id.* at 762. The court stated that the bank's action resulted in "a unilateral decision on [its] part to wind up the company." *Id.* at 763.

56. *Id.* at 754.

57. *Id.*

58. The bank argued that the court should not imply any notice requirement because such an implication would be inconsistent with the express provisions of the contract. *Id.* at 759.

59. *Id.* at 754-55.

60. *Id.* at 755.

61. *Id.*

62. *Id.* at 766.

63. *Id.*

64. The court stated that a party may waive its right to a jury trial only if done knowingly, voluntarily and intentionally. Therefore, more than " 'mere contract law . . . is involved' in determining whether waiver was effective under the applicable standard." *Id.* at 755-56 (citations omitted).

the written agreement entitled the bank to refuse further disbursements under the credit line.[65] The court stated, however, that the bank abused its discretion because a reasonable bank, that was fully secured, would have advanced the funds rather than cause irreparable harm to its borrower.[66] The court stated that the bank acted unreasonably, thereby breaching the covenant of good faith and fair dealing that is implied in every contract.[67] The bank was, therefore, liable for the actual damage that it caused the company.[68] The court stated that the correct measure of damages was based in part on the value that an acquiring firm would have been willing to pay for the company prior to insolvency.[69] The correct measure was not, as the bank argued, the company's value as an ongoing business.[70]

In both *Centerre Bank*[71] and *K.M.C.*,[72] the courts had to address the harsh results that occur when banks enforce draconian contract provisions against their debtors. The courts reached strikingly different conclusions based upon the varying degree of importance that each accorded the written document. Consequently, these courts sent conflicting messages to the banking industry regarding a bank's obligation of good faith and fair dealing towards its debtors.

The *Centerre Bank* message emphasized that there is no fiduciary obligation in a debtor-creditor relationship.[73] The implication is that banks can limit their duty to deal fairly and in good faith by the written contract.[74] The court's rigid adherence to the loan agree-

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65. *Id.* at 759.

66. *Id.* at 761.

67. *See infra* notes 83-91 and accompanying text for a discussion of the implied convenant of good faith and fair dealing.

68. K.M.C. Co. v. Irving Trust Co., 757 F.2d at 752, 766 (6th Cir. 1985).

69. *Id.* at 764. The Court stated that damages amounted to the difference in value of K.M.C. before and after insolvency. *Id.* The amount a willing buyer would pay and the amount a willing seller would accept would determine those values. *Id.*

70. The company had at least one prospective buyer prior to its insolvency. *Id.* at 762. This buyer had made its interest in the company known to the bank the day before the bank refused its advances. *Id.*

71. Centerre Bank of Kansas City v. Distribs., Inc., 705 S.W.2d 42 (Mo. Ct. App. 1985).

72. *K.M.C. Co.*, 757 F.2d 752.

73. *Centerre Bank*, 705 S.W.2d at 53.

74. U.C.C. § 1-203 (1978) states: "Every contract or duty within this act imposes an obligation of good faith in its performance or enforcement." The court stated that this provision was not applicable to demand loans because:

> [E]xecution of a demand note constitutes an agreement between the borrower and the lender that the note may be called for payment at any time . . . . The imposition of a good faith defense to the call for payment of a demand note transcends the performance or enforcement of a contract and in fact adds a term to the agreement which the parties had not included. The additional term would be that the note is not payable at any time demand is made but only payable when demand is made if such demand is made in good faith. The parties by the demand note did not agree that payment would be made only when demand was made in good faith but agreed that payment would be made whenever demand was made.

ment allowed the bank to purposefully mislead unsuspecting debtors. Centerre Bank knew that the debtors would not purchase the business without the bank's assurance of continued financing.[75] Despite this knowledge, the court stated that the bank had no duty to disclose its intention to demand payment on the credit line.[76] The court's refusal to consider parole evidence implies that as long as banks do not reduce their promises to writing, they can mislead potential debtors or guarantors by making verbal promises that they have no intention of keeping. Ethical considerations should preclude banks from deliberately misleading prospective guarantors merely to find a "deep pocket" to assume the risk of a potentially bad loan. Unless courts discourage such practices, however, banks will engage in such conduct whenever it is in their economic self-interest to do so.

In contrast, the *K.M.C.*[77] court sent a message to banks that contractual rights and privileges will not protect a lender who engages in unreasonable conduct from liability to its debtors. The court clearly stated that a bank's obligation of good faith did not end merely because the agreement allowed the enforcement of harsh contract provisions "at the bank's discretion."[78] The court refused to rigidly adhere to the rules of contract law. Instead, it considered the circumstances surrounding the enforcement of the provision and thereby reached an equitable result.[79] The *K.M.C.* court's decision shows judicial recognition that overreaching is a potentially serious problem which courts must not condone.[80] Several courts[81] have reached similar conclusions when dealing with issues of insurance industry overreaching. These courts have found that an insurance company commits a tort when it breaches a contract in bad faith.[82]

BREACH OF GOOD FAITH AND FAIR DEALING AS A TORT

A covenant of good faith and fair dealing is implied in every contract.[83] This covenant requires that neither party do anything

Centerre Bank, 705 S.W.2d at 47-48.

75. *Id.* at 49.
76. *Id.* at 53.
77. *K.M.C. Co.*, 757 F.2d 752.
78. *Id.* at 760-61.
79. *Id.* at 759-61.
80. *See infra* notes 90-97 and accompanying text for a discussion of banks' impact on society.
81. *See* Louderback & Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F.L. REV. 187, 196-202 (1982) (discussing courts that have applied tort to insurance industry).
82. *Id.*
83. *See* U.C.C. § 1-203 (1978); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979). *See generally* Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963).

that will injure the right of the other to receive the benefits of the agreement.[84] When this duty is breached, a cause of action arises.[85] As a general rule, breach of this covenant results in a breach of contract.[86] In recent years, however, several jurisdictions have recognized a cause of action in tort for breach of good faith and fair dealing.[87] This provides the injured party with remedial relief that is not available in an action founded in contract, including damages for mental suffering,[88] for economic losses not foreseeable at the time of contracting,[89] and for punitive damages.[90] To date, courts have limited this tort almost exclusively to the insurance industry.[91]

While many courts have recognized that there is a "special relationship" between an insurance company and its insured,[92] few have recognized that this same relationship exists between the banking industry and its customers.[93] This relationship, characterized by elements of adhesion, fiduciary responsibility and public interest, justifies imposition of the duty to act in good faith as a matter of law. There are many similarities between the banking and the insurance industries. In both industries, the relationship of the institution with its customers is primarily unbalanced: both banks and insurance companies enjoy superior bargaining positions allowing them to

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84. Diamond, *supra* note 16, at 425.

85. Louderbach & Jurika, *supra* note 81, at 187.

86. *Id.*

87. *See* S. Ashley, Bad Faith Actions: Liability and Damages § 2.05, at 9, 10 n.1 (citing cases).

88. Diamond, *supra* note 16, at 426. "Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the breach is of such a kind that serious emotional disturbance was a particularly likely result." Restatement (Second) of Contracts § 353 (1979).

Professor Corbin explains that breaches of contract, in general, do not cause as much resentment or other mental anguish as do wrongs labeled "torts." *See* 5 A. Corbin, Corbin On Contracts § 1076 (1964).

89. Diamond, *supra* note 16, at 427.

90. *Id.*

91. *See* Kornblum, *Recent Cases Interpreting the Implied Covenant of Good Faith and Fair Dealing*, 30 Def. L.J. 411, 431 n.50 (1981) (listing 17 states that have adopted a tort cause of action in the insurance context).

92. The tort of bad faith breach of contract originally arose from the insurers' refusal to settle within policy limits. Louderback & Jurika, *supra* note 81, at 199. The tort has developed so that many other acts now give rise to liability. *Id.* For example, an insurer may breach the covenant if it fails to properly investigate the insured's claim, construes an ambiguity in its policy to the severe detriment of its insured or cancels a policy for unjustifiable reasons. *Id.*

93. Three courts have recognized that breach of the implied covenant by a financial institution may give rise to a tort cause of action. *See* Skeels v. Universal C.I.T. Credit Corp., 335 F.2d 846 (3d Cir. 1964) (assurance by company's manager that credit union would extend loan made; otherwise proper action of foreclosure tortious); First Nat'l Bank in Libby v. Twombly, 689 P.2d 1226 (Mont. 1984) (recognizing bank's breach of covenant may be tortious and subject to punitive damages); McKay v. Farmers' and Stockmens' Bank of Clayton, 92 N.M. 181, 585 P.2d 325 (1978) (refusing to recognize that bank had right as matter of law to accelerate debtors' loan).

dictate the terms of their agreements.[94] In both industries, the weaker party reasonably and justifiably places its trust and confidence in the larger entity.[95] Finally, both industries provide services that are essential to the functioning of society.[96] Therefore, legitimate public policy concerns justify extending the breach of good faith tort from the insurance industry to the banking industry.

The legitimacy of this extension was recognized by the Montana Supreme Court in *First National Bank in Libby v. Twombly*.[97] The *Twombly* court addressed the issue of whether the breach of good faith tort should be applied to the banking industry.[98] In *Twombly*, the bank accelerated the debtors' loan and exercised an offset against the debtors' checking account.[99] The bank did not notify the debtors of the offset.[100] Consequently, the debtors continued to write checks on the account until several of the checks were returned for insufficient funds.[101] The loan officer who had initiated the action[102] refused to discuss the matter with the debtors.[103] The

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94. Contracts in both industries are adhesional. While the customer may be able to find a variance in premium cost or interest notes, most other terms are usually not subject to negotiation. *See* Purdue v. Crocker Nat'l Bank, 38 Cal. 3d 913, 702 P.2d 503, 216 Cal. Rptr. 345 (1985) (discussing adhesion contracts in banking industry). Schmidt v. Pacific Mut. Life Ins., 268 Cal. App. 2d 735, 74 Cal. Rptr. 367 (1969) (discussing adhesion contracts in insurance industry); *see also* MONEY MANAGEMENT, *supra* note 21, at 95-117 (discussing which terms in loan agreement parties may negotiate).

95. An insurance transaction does not involve parties dealing at arms-length with one another. Louderbach & Jurika, *supra* note 81, at 220. The contract is personal in nature and involves parties in a quasi-fiduciary relationship. *Id.* "There is a special relationship between banks and their customers that is based on confidence and trust in the bank itself . . . . If a bank does not maintain the highest standards of integrity in its dealings that confidence and trust will be eroded." Symons, *The Bank-Customer Relation: Part II-The Judicial Decisions*, 100 BANKING L.J. 325, 329 (1983) (quoting *Corporate Takeovers: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong. 2d Sess. 103 (1976) (statement of Richard A. Debs, First Vice President and Chief Administrative Officer, Federal Reserve Bank of New York)).

96. "In summary, the individual consumer in a highly organized and integrated society must necessarily rely upon institutions devoted to the public service to perform the basic functions which they undertake." Gray v. Zurich Ins., 65 Cal. 2d 263, 280, 419 P.2d 168, 54 Cal. Rptr. 104 (1977) (discussing importance of insurance companies to society). Another court discussed the role of banks in society:

> Banks are necessary concomitants of civilization. To them are intrusted the earnings of honest toil, the accumulations of intelligent enterprise; the trust funds of charity, orphanage, and helpless old age; and, as managers of such institutions, bank presidents, cashiers and directors cannot be too strongly impressed with the responsibility of their official positions.

State v. Commercial & Savings Bank of Kearey, 37 Neb. 174, 55 N.W. 640 (1893).

97. 689 P.2d 1226 (Mont. 1984).

98. *Id.* at 1230.

99. *Id.* at 1228.

100. *Id.* at 1229.

101. *Id.*

102. The debtors' loan became due while their normal loan officer was on vacation. *Id.* at 1228. Although the debtors had re-negotiated the loan, the loan officer in

debtors sued the bank for breach of its duty of good faith.[104] The trial court granted the bank's motion to exclude evidence of punitive damages because contract actions generally exclude such damages.[105]

In reversing the trial court, the supreme court stated that the duty to exercise good faith is imposed by law and breach of that duty is a tort.[106] The court stated that "given a bank's relationship to its debtor, punitive damages could be justified as an exemplary imposition for oppression."[107] Thus, the court implied that a "special relationship" between a bank and its debtor exists which prohibits the bank from acting in reckless disregard of the debtor's rights.[108] The court stated that such enforcement equals an abuse of power[109] that courts can discourage by awarding punitive damages.[110] Other courts, which have recognized this principle,[111] have applied traditional tort doctrines to debtor-creditor contracts.

THE USE OF OTHER TORTS IN DEBTOR CREDITOR RELATIONS

Although *Twombly* is the only court to clearly hold that a breach of good faith is a tort in the banking industry,[112] several courts have held that the unjustified enforcement of detrimental contract provisions creates a separate and distinct tort.[113] For example, in *Van Bibber v. Norris*,[114] a bank repossessed a borrower's mobile home.[115] Although the borrower's payment was overdue, the bank often accepted late payments from the debtor.[116] Because it

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charge was not informed. *Id.* He did not believe the debtors when they informed him of the re-negotiation and took action without further investigation. *Id.*

103. *Id.*

104. *Id.* at 1227.

105. *Id.*

106. *Id.* at 1230.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *See, e.g.*, Van Biever v. Morris, 404 N.E.2d 1365 (Ind. Ct. App. 1980) (holding bank liable for conversion); State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984) (holding bank liable for fraud, economic duress, and business interference).

112. First Nat'l Bank in Libby v. Twombly, 686 P.2d 1226, 1230 (Mont. 1984).

113. Torts such as fraud, negligence or intentional infliction of emotional distress may stem from breach of contract. Diamond, *supra* note 16, at 431 n.23. Their commission does not depend on any fiduciary relationship. *Id.* Several jurisdictions, unwilling to impose tort liability for breach of the implied covenant of good faith, have held that any contracting party may be liable for the tort of intentional infliction of emotional distress if the breach is sufficiently willful and odious. *Id.*

114. 404 N.E.2d 1365 (Ind. Ct. App. 1980).

115. *Id.* at 1371.

116. If a bank has consistently acquiesced in a customer's failure to abide by the terms of the loan agreement, the bank has established a "course of dealing." This requires that the bank give the customer reasonable notice before enforcing any insecurity clauses in the contract. *Id.* at 1373.

appeared that the bank repossessed the home for reasons unrelated to the delinquency, the Indiana Court of Appeals held that the bank did not act in good faith, and, therefore, committed a tort of conversion.[117] The debtor was awarded punitive damages in addition to recovering the value of his home and furnishings.[118]

The Texas Court of Appeals expanded this concept of tort liability to deter banks from unreasonably enforcing detrimental contract provisions[119] in *State National Bank v. Farah Mfg. Co.*[120] The *Farah* court found the lenders liable for fraud,[121] economic duress,[122] and business interference[123] because they failed to exercise good faith in dealing with the debtor company.[124] The case was based on a management change provision[125] contained in a $22 million loan agreement.[126] When the company attempted to make a change in its executive management, the participating banks[127] threatened to treat the change as a default that would trigger the acceleration of the loan.[128] The company's board of directors, fearing that the banks would force the company into bankruptcy, proceeded to elect less qualified officers who were chosen by the lenders.[129] Under this management, the company's position in the market place deteriorated.[130] The banks then insisted that the company sell some of its assets to

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117. The intentional tort of conversion is any unauthorized act of dominion or ownership exercised by one person over personal property belonging to another, in denial of or inconsistent with his right. *Id.* at 1380.

118. *Id.* at 1385.

119. State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984) (bank did not actually enforce provision, but court found bank's threat to do so was tortious).

120. *Id.*

121. The basic element of actionable fraud is material misrepresentation which, when made, the speaker knows is false and which results in damage to another. *Id.* at 682.

122. "Economic duress . . . may be evidenced by forcing a victim to choose between distasteful and costly situations, *i.e.*, bow to duress or face bankruptcy." Economic duress may be claimed only when the party against whom it is claimed was responsible for the claimant's financial distress. *Id.* at 686-87.

123. The tort of interference with business relations embraces within its scope all intentional invasions of contractual relations, including any act injuring or destroying property and thus interfering with performance of the contract itself, regardless of whether breach of contract is induced. It presupposes knowledge of the plaintiff's interests or, at least, of facts that would lead a reasonable man to believe in their existence.

Id. at 689.

124. *Id.* at 685.

125. The clause gave any two banks veto power over any change in the company's management if the banks considered the change "for any reason whatsoever, to be adverse to the interests of the bank." *Id.* at 667. The banks could treat any change occurring, despite the company's objections, as default. *Id.*

126. *Id.* at 666.

127. Five banks participated in making the loan. *Id.* at 667.

128. *Id.* at 668.

129. *Id.* at 676-77.

130. *Id.* at 679-80.

reduce its loan obligations.[131] The directors subsequently elected management that was unacceptable to the banks and sued.[132] After a jury verdict for the company, the banks appealed.[133]

The appellate court held that the banks acted fraudulently because despite numerous threats made to the company, the banks had not decided to declare the loan in default.[134] The court upheld a duress claim based on the banks' threats that they would "bankrupt [the company] and padlock it the next day."[135] The court noted that banks cannot use acceleration clauses offensively to the commercial advantage of the creditor.[136] Such provisions do not permit banks to accelerate loans when the facts make such acceleration unjust or oppressive.[137] The court stated that the banks went too far in controlling the company's management and affirmed a jury award of $18.6 million.[138] The court did not specifically address the applicability of the breach of good faith tort to banking. It is evident from the court's opinion, however, that the court was concerned about the impact that the banking industry has on the general public.[139]

Tort Recovery Should Be Allowed Against Banks

Banks are one of the mainstays of American industrial society.[140] Customers believe that bankers will give advice in good faith.[141] Furthermore, customers expect that their relationship with a bank, in contrast to other commercial transactors, will involve a higher degree of confidence and a greater reliance on the bank's judgment.[142]

A debtor-creditor relationship usually is not fiduciary in nature,[143] and in such relationships, banks have no duty to favor their

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131. *Id.* at 678.
132. *Id.* at 678-79.
133. *Id.* at 667.
134. *Id.* at 671.
135. *Id.* at 673.
136. *Id.* at 685.
137. *Id.*
138. *Id.* at 691-99.
139. Among the concerns that the court expressed were the bank's power to harm its debtors, and the social utility of the bank's actions. *Id.* at 684, 690.
140. *See generally* P. Trescott, Financing American Enterprise: The Story Of Commercial Banking (1963).
141. "Advice and money are the two commodities banks have to sell. We don't need their money, but we do need, and do get excellent advisory service from them." G. Katona, Business Looks at Banks 53 (1957).
142. Banks encourage this view with their advertising. Symons, *supra* note 12, at 327-28.
143. A fiduciary relationship may arise when a debtor places faith, confidence and trust in the judgment or advice of the bank. *See, e.g.*, Williams v. Griffin, 35 Mich. App. 179, 192 N.W.2d 283, 285 (1971) (fiduciary relationship exists when there is reposing of faith, confidence and trust, and the placing of reliance by one upon

customers' well-being. The banking industry, however, interacts with the vast majority of the public,[144] supplies vital services[145] and enjoys a superior bargaining position.[146] Courts, therefore, must hold banks to a standard of fairness and reasonableness.

In contract law, the parties' agreement defines their duties.[147] Consequently, by their agreement, parties can limit the scope and content of their duties. Accordingly, courts rarely use public policy considerations to interfere with obligations and duties that the parties negotiated.[148] In adhesion contracts, however, the larger entity dictates the terms of the agreement.[149] There is no bargaining. If the larger entity is also part of an industry interacting with the general public, courts should assure that the entity conducts its business dealings fairly and reasonably. This inquiry is necessary to protect the general public, as well as the weaker party to the contract.[150]

Tort law protects members of society from the unreasonable actions of others by requiring certain minimal standards of conduct.[151] Public policy plays a major role in determining what particular acts constitute a tort.[152] Tort law also recognizes that lawful acts can be tortious if done for a wrongful purpose.[153] Furthermore, when necessary to serve the public interest, tort law punishes egregious conduct to deter others from performing similar acts in the future.[154] Where a creditor's egregious conduct injures its debtor, courts should strive

judgment and advice of the other). *See infra* note 158 for an example of a fiduciary relationship in debtor-creditor contract.

144. "It is almost inconceivable that any man should engage in financial transactions of any magnitude in the modern time without having recourse to some bank not only as a place of safety to keep his money, but as a place to secure loans to conduct his business." *See* Symons, *supra* note 95, at 327 (quoting Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101 (1937)).

145. The modern commercial bank is a multiservice organization. It obtains funds by offering checking, savings and time deposit accounts. SIMPSON, MONEY, BANKING AND ECONOMIC ANALYSIS 52 (2d ed. 1981). It then uses these funds to make loans to businesses, farmers and households. *Id.* To these regular banking functions, one must add such diverse functions as servicing credit cards, trust operations, safe deposit box rental, equipment leasing and dealership in government securities and foreign exchange. *Id.*

146. *See supra* note 94 and accompanying text for a discussion of a bank's bargaining position.

147. Louderbach & Jurika, *supra* note 81, at 191.

148. *Id.*

149. *Id.* at 220.

150. *Id.* at 220-22.

151. W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 92, at 613 (4th ed. 1971).

152. Wagner v. Benson, 101 Cal. App. 3d 27, 34, 161 Cal. Rptr. 516, 520 (1980).

153. This concept, known as the prima facie tort, is defined as "infliction of intentional harm, resulting in damages, without excuse or justification, by an act or series of acts which would otherwise be lawful." *See generally* Note, *The Prima Facie Tort Doctrine: Acknowledging the Need for Judicial Scrutiny of Malice*, 63 B.U.L. REV. 1101 (1981) (quoting A.T.I., Inc. v. Ruder & Finn, Inc., 42 N.Y.2d 454, 458, 368 N.E.2d 1230, 1232, 398 N.Y.S.2d 864, 866 (1977)).

154. Diamond, *supra* note 16, at 427 n.7.

to compensate the debtor and to discourage the creditor from performing such acts in the future. Therefore, tort law, which is intended to achieve desirable social conduct, is preferred over contract law, to enjoin unjustifiable creditor conduct.

Suggested Guidelines for the Use of Tort Law in Debtor-Creditor Contracts

Although tort remedies are more favorable to debtors than contract remedies, courts should apply them only in limited circumstances. When banks *legitimately* fear default[155] or impairment of security,[156] courts should allow them to invoke the protection of their contracts. However, if banks enforce harsh contract provisions for reasons other than protection of their property interests, courts should impose tort remedies.

When dealing with debtor-creditor documents, courts should not limit their inquiry to the four corners of the document. Courts must consider the totality of circumstances. Some of the basic factors courts must consider include the following: the history of the banking relationship; verbal agreements outside the written contract; the motive of the bank in claiming default; and public policy.

The History of the Banking Relationship

The customer's prior associations and dealings with the bank are important considerations in determining whether there was an arms-length transaction.[157] Courts should examine the length of the banking relationship and investigate whether the customer has previously sought and relied upon the bank's financial advice. The court should also determine whether the bank knew or should have known of the customer's reliance on its advice. Where the customer has had a long association with the bank and has previously acted upon its financial advice, a fiduciary relationship may have developed.[158] In such cases, courts should preclude the bank from taking

155. Sheppard Fed. Credit Union v. Palmer, 408 F.2d 1369, 1371 (5th Cir. 1969); *see also* U.C.C. § 1-208 (1978) (providing that party may accelerate payment only if believes in good faith that the prospect of payment is impaired).

156. *Sheppard*, 408 F.2d at 1371.

157. *See* Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101 (1937).

158. In *Stewart*, the debtor was a customer of the bank for 23 years. *Id.* at 104. During that time, the debtor often sought and relied on the bank's financial advice. *Id.* The debtor gave the bank a mortgage on real estate to secure a loan. *Id.* When the loan was due, the debtor informed the bank that he would not be able to pay on time. *Id.* The bank assured the debtor that it would not foreclose. *Id.* Nevertheless, the bank did foreclose. *Id.* at 105. At that time, the bank promised the debtor that if he could secure funds to repay the bank, it would reconvey the property. *Id.* When the debtor acquired the necessary funds, the bank refused to reconvey the property. *Id.*

The Arizona Supreme Court concluded that the bank had a fiduciary relation-harsh measures against the debtor unless it has attempted to reach a mutually satisfactory agreement regarding the dispute.[159]

Verbal Agreements Outside the Written Contract

The parties' conduct during the formation of the loan should be examined. The court should determine whether the loan was actually an arms-length transaction or whether the bank had a motive for encouraging or inducing the debtor to make the loan.[160] The court should also consider whether the bank made any statements which justified the debtor's belief that the bank would not enforce certain provisions in the written contract.[161] It is also necessary to determine whether both parties fully disclosed all pertinent information regarding the purpose and terms of the loan.

The Motive of the Bank in Claiming Default

Whether the bank claimed default for reasons other than protecting its property interest is relevant to determining whether the bank acted in good faith.[162] Fair dealing should preclude attempts to coerce a debtor for reasons unrelated to protecting the bank's rights and expectations. The court should also examine whether the bank acquiesed in the borrower's breach of contract without objection.[163]

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ship to the debtor. *Id.* at 106. It stated that although there is ordinarily no fiduciary duty in a debtor-creditor relationship, the bank had acted as the debtor's financial advisor for many years. *Id.* The bank, having assumed that role, was subject to the duties imposed on one in that position. The bank, therefore, had a duty to act with the debtor's best interest in mind. *Id.* at 105.

159. *See, e.g.*, McKay v. Farmers & Stockmen's Bank of Clayton, 92 N.M. 101, 585 P.2d 325, 327 (1978) (court found that bank's refusal to assist debtors seeking alternative financing raised questions about the reasonableness of the bank's conduct).

160. *See, e.g.*, Stenberg v. Northwestern Nat'l Bank of Rochester, 238 N.W.2d 218 (Minn. 1976). In *Stenberg*, the bank convinced the debtors to convert their unsecured loan to a loan guaranteed by the Small Business Administration (S.B.A.). *Id.* The debtors alleged that the bank knew that the debtors would have difficulty making the payments on the new loan because the term was reduced from twelve years to six years. *Id.* at 219. The court ruled, however, even if there was a fiduciary relationship between the bank and the debtors, the bank would never intentionally imperil its own funds through a bad loan. *Id.*

161. *See, e.g.*, K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 755 (6th Cir. 1985) (bank told debtors that it would not enforce jury waiver unless the debtors had committed fraud).

162. *See, e.g.*, Brown v. Avemco Inv. Corp., 603 F.2d 1367 (9th Cir. 1979). In *Brown*, the debtors financed an airplane through the creditor. *Id.* at 1369. The contract stated that the plane could not be leased without the creditor's approval. *Id.* The debtors leased the airplane and informed the creditors of their actions, but the creditors never formally approved the lease. *Id.* Two years later, the debtors offered what they believed was full payment of the debt. *Id.* The creditors refused the offer, accelerated the loan and repossessed the airplane, which was sold for almost twice the payoff value of the loan. *Id.*

163. *See, e.g.*, First Nat'l Bank in Libby v. Twombly, 689 P.2d 1226 (Mont.

If so, courts should require the bank to continue its financing unless it gave the debtor adequate notice that noncompliance with the terms of the agreement would no longer be tolerated.[164]

Public Policy

The court should consider whether it should discourage the bank's conduct because it was overreaching, capricious or improperly motivated. To aid in this determination, the court should examine whether the bank acted in its own self-interest by misrepresenting facts during the formation of the loan.[165] The court should also seek to determine whether the bank acted recklessly by creating a high degree of risk to the debtor's interest when there was little danger of impairment to the bank's interest.[166] The court should not look at the contract in isolation. Instead, it should consider the consequences to the public if the bank continues engaging in the conduct that the debtor complained of.

Courts should attempt to balance the respective rights and interests of the parties. They should consider the extent of harm to the debtor if the creditor claims default and enforces harsh contract provisions. They should also consider the extent of harm to the creditor if the debtor is allowed to continue performance contrary to the written contract. If, after considering all the relevant facts, the court concludes that the bank enforced offensive contract provisions without serious threat to its property interest, the court should compensate the debtor for all injuries caused by the creditor's unreasonable conduct. Where contract remedies do not adequately compensate the debtor, the court should award tort damages. Where the bank's conduct was outrageous, courts should allow tort recovery to discourage similar behavior in the future.

CONCLUSION

The banking industry affects almost every member of our society. Its customers range from elderly widows to large, publicly traded corporations. As a matter of public policy, therefore, courts should not treat banks' acts of unfairness or bad faith as mere breaches of contract. Courts also should not condone bad faith by allowing banks to enforce draconian contract provisions without le-

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1984) (bank often accepted late payments, thereby establishing course of dealing).

164. *Id.*

165. *See, e.g.*, Centerre Bank of Kansas City v. Distribs., Inc., 705 S.W.2d 42 (Mo. Ct. App. 1985) (bank told potential buyers it would continue financing business though it had no intention of doing so).

166. *See, e.g.*, K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (bank refused to advance money on line of credit although bank was fully secured).

gitimate business reasons. In order to protect the public from egregious conduct by members of the banking industry, courts must adopt tort remedies. Only by doing so will courts assure that the banking industry deals fairly and reasonably with its customers.

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