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Limits on lender's "Sole Discretion"

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While loan agreements notoriously grant broad discretion to lenders, there are limits under N.Y. law including the covenant of good faith and fair dealing implied in all contracts. The First Department in the Solow opinion described below stated that "even an explicitly discretionary contract right may not be exercised in bad faith." And in 2011, a trial court held in *55 Eckford Realty LLC v. Bank of East Asia (U.S.A.) N.A.* that, despite a lender's contractual right of "sole and absolute discretion," the implied covenant prevented it from imposing requirements on borrowers not expressed in the contract. Lenders have wide latitude, however. For example, in *State St. Bank & Trust Co. v. Inversiones Errazuriz Limitada*, the Second Circuit held under N.Y. law that, "[w]here a contract allows a bank to withhold consent for particular conduct and sets no express restrictions on the bank's right to do so, the bank is not prohibited from unreasonably or arbitrarily withholding such consent." There, credit agreements prohibited the borrower from selling its assets without the lender's consent while a default existed, and there were no express restrictions on the bank's right to refuse consent to any such sale; accordingly, the bank had the right to "withhold consent for any reason or no reason." Many cases have held that the duty of good faith and fair dealing does not preclude lenders from exercising a right to terminate or refuse to extend a loan, regardless of the reason, and particularly where the borrower has defaulted. In *Hudson Valley Bank, N.A. v. Banxcorp*, a N.Y. trial court went so far as to hold that a borrower had "no enforceable expectation that plaintiff would use good faith in deciding whether to terminate financing." To preclude enforcement of provisions limiting borrower remedies, lender misconduct must be intentional and unrelated to any legitimate economic self-interest. In a landlord/tenant matter, *Banc of Am. Sec. LLC v. Solow Bldg. Co. II*, the First Department made clear that enforcement of common exculpatory provisions (that may limit a tenant's or borrower's remedies) is precluded when it offends public policy, meaning "the [landlord or lender] misconduct for which it would grant immunity smacks of intentional wrongdoing," whether willful - fraudulent, malicious or in bad faith - or grossly negligent. The Court of Appeals in *Metro. Life Ins. Co. v. Noble Lowndes Int'l, Inc.* held that intentional conduct which merely capitalizes on economically advantageous contract terms will not suffice; instead, according to the First Department in *Devash LLC v. German Am. Capital Corp.*, the intentional wrongdoing must be "unrelated to any legitimate economic self-interest." The Solow defendant's conduct - repeatedly refusing to approve its tenant's proposed alterations while demanding additional exorbitant payment for services it was obligated to provide - was held to be the type of intentional wrongdoing that would render a limitation of remedies provision unenforceable. In *Devash*, however, a lender's failure to approve proposed leases, intended to maximize its available options and the value of both the property and the loan, was found to be related to a legitimate economic self-interest and therefore permitted. Tom Kearns is a partner at Olshan Frome Wolosky, New York, N.Y. Katelyn Patton, summer associate, contributed to this article.

