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Farm and Ranch Credit: Duty-based Theories of Lender Liability

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FARM AND RANCH CREDIT: DUTY-BASED THEORIES OF LENDER LIABILITY

STEVEN C. BAHLS†

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I. INTRODUCTION

In the past several years, private lenders and lenders within

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the Farm Credit System successfully argued against claims by farmers and ranchers who allege wrongful termination of credit. This trend has discounted the theories successfully developed and used by farmers and ranchers in the mid-eighties to recover from lenders when credit was unexpectedly terminated. Courts and legislators appear to be narrowing many of those theories. However, despite these new efforts to narrow lender liability suits, farmers are sure to continue asserting lender liability claims.

This Article examines the courts' growing tendency to reject lender liability claims and the remaining viability of duty-based tort claims against agricultural lenders. This Article first identifies the differences between agricultural loans and other types


3. See supra note 1.


5. According to a 1992 second quarter survey conducted by the Federal Reserve Bank of Minneapolis, 5.3% of Ninth Federal Reserve District farmers have gone out of business or partially liquidated within the last twelve months because of financial distress. Stanley L. Graham, Rural Banks Enjoy Health Loan Portfolios, But Farm Profits Fall and Land Prices Improve Only Slightly, FEDGAZETTE, Oct. 1992, at 7. Many farmers negotiated loan workout agreements in response to the agricultural credit crisis of the late 1980s. As those agreements mature (many had a five-year agricultural bankruptcy and lender liability claims become more likely.
of commercial loans and then analyzes the courts’ treatment of commonly asserted lender liability claims and legislative responses. Ultimately, the Article proposes that courts should evaluate claims on a case by case basis. Where agricultural lenders assume a duty to act as farm financial advisors, agricultural lenders must be accountable for the negligent discharge of any duties they assume by virtue of their special relationships.

II. LENDER LIABILITY FOR AGRICULTURAL LOANS

The hurdles faced by farmers and ranchers in winning lender liability suits are part of an apparent growing hostility toward all lender liability claims. Several leading cases clearly illustrate this judicial change in attitude.6

In 1985, the Sixth Circuit Court of Appeals decided *K.M.C. Co. v. Irving Trust Co.*7 Writing for the court, Judge Cornelia Kennedy developed a standard to scrutinize credit decisions by loan officers. The standard required the loan officers’ decisions to be measured against those of reasonable loan officers.8 Judge Kennedy stated that, in order for a lender to avoid liability, “there must be *some* objective basis upon which a reasonable loan officer in the exercise of his discretion would have acted in that manner.”9 Evidence of bad faith, the court found, included personality conflicts between a loan officer and the borrower,10 a loan officer’s conduct that violated bank policy,11 and the bank officer’s knowledge that failure to give reasonable notice of credit would destroy the borrower financially.12

Since the *K.M.C. Co.* decision in 1985, courts have hesitated to second guess the credit decisions of loan officers. Instead, the courts have demonstrated an increased willingness to respect the sanctity of loan documents. Because loan documents are almost always drafted by lenders, with the lender’s protec-

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8. *Id.*
9. *Id.* at 761 (emphasis in original).
10. *Id.*
11. *Id.*
tion in mind, this new attitude creates formidable obstacles for borrowers. The judicial attitude protecting the sanctity of loan documents is perhaps best exemplified by the Seventh Circuit Court of Appeals decision in *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting.* Judge Frank Easterbrook, articulating what lenders consider a compelling repudiation of *K.M.C., Inc.*, wrote: "Firms that have negotiated contracts are entitled to enforce them to the letter, even to the great discomfort of their trading partners, without being mulcted for lack of 'good faith.'" Easterbrook reasoned that lenders do not have a "general duty of 'kindness' in performance" and courts should not engage in "judicial oversight into whether a party had 'good cause' to act as it did." A lender is neither an "el-eemosynary institution" nor "bound to treat customers with the same consideration reserved for their families." Lenders, according to Judge Easterbrook, are "entitled to advance [their] own interests" and need not put the borrowers' interest first. Judge Easterbrook declined to follow *K.M.C., Inc.* and concluded that "[a]ny attempt to add an overlay of 'just cause' . . . to the exercise of contractual privileges would reduce commercial certainty and breed costly litigation."  

Another case emphasizing the sanctity of agricultural loan contracts is *Kruse v. Bank of America.* In *Kruse,* a jury awarded $20 million in compensatory damages and $26.7 million in punitive damages against the lender and in favor of California apple farmers. The farmers contended that the lender induced them to bor-

13. 908 F.2d 1351 (7th Cir. 1990).
14. 757 F.2d at 752.
15. *Kahm,* 908 F.2d at 1357.
16. *Id.*
17. *Id.* at 1357-58.
18. *Id.* at 1358.
22. *Id.* at 219.
23. *Id.* at 235.
row heavily.\textsuperscript{24} Once the farmers became hopelessly overex- tended, the lender allegedly reneged on its promise to provide long-term financing.\textsuperscript{25} As to the borrowers' bad faith tort claim, the court held that borrowers may not successfully as- sert a claim for bad faith unless the borrowers assert "the exist- ence and breach of an enforceable contract."\textsuperscript{26} The court found no contract between the parties providing for long-term financing.\textsuperscript{27} The borrowers had merely a "hopeful expecta- tion" of long-term financing.\textsuperscript{28} Hopeful expectations are not enough to create a contract, and existence of a contract is a necessary element of a bad faith claim.\textsuperscript{29} Specifically, the court stated:

Here, the entire subject matter under consideration—the long-term loan—was at best left open to future negotiations and agreement. . . . The [borrowers'] hopeful expectation that a loan agreement would eventually be reached was sim- ply that: an expectation. The Bank's manifestation of assent never materialized; and no agreement was ever formed. Under such circumstances, the Bank was under no legal ob- ligation or commitment to make a long-term loan.\textsuperscript{30}

Prior to the \textit{Kruse} decision, successful lender liability claims relied on courts' less restrictive view of the sanctity of con- tracts.\textsuperscript{31} Courts in the mid-eighties examined how a reason- able lender might act.\textsuperscript{32} Presently, courts are increasingly unwilling to examine anything outside the four corners of the contract\textsuperscript{33} and thus stricter views of lender liability claims evolved rapidly.\textsuperscript{34} As the sands of lender liability continue to shift, courts face the critical question of whether the rules designed for nonagricultural commercial borrowers should be applied to farmers and ranchers.

\textsuperscript{24.} \textit{Id.} at 220-23.
\textsuperscript{25.} \textit{Id.} at 223-24.
\textsuperscript{27.} \textit{Id.}
\textsuperscript{28.} \textit{Id.} at 229.
\textsuperscript{29.} \textit{Id.} at 230.
\textsuperscript{30.} \textit{Id.} at 229.
\textsuperscript{31.} \textit{Weissman}, \textit{supra} note 4, at 136.
\textsuperscript{32.} See, \textit{e.g.}, \textit{K.M.C.}, 757 F.2d at 761.
\textsuperscript{33.} \textit{Weissman}, \textit{supra} note 4, at 136-37. \textit{See also Pearson}, \textit{supra} note 4, at 296-97; \textit{Rose}, \textit{supra} note 4, at 634.
\textsuperscript{34.} \textit{Supra} note 1.
III. THEORIES OF LENDER LIABILITY

A. The Farmer-Lender Relationship

Farmers and ranchers argue that five attributes of the farmer-lender relationship distinguish it from a typical borrower-lender relationship. Borrowers argue these unique attributes thus merit different treatment by the court. First, farm lenders often specialize in agricultural lending, leading farmers to expect lenders to have special expertise in structuring successful farm loans. Second, farm lenders inject themselves too intimately into the operation of the farm. Third, lenders often serve as trusted financial advisers. As a result, borrowers often experience a paternalistic approach on the part of lenders. Fourth, the legal rights and obligations of farm borrowers are complex and farmers often avoid legal advice, thereby leaving farmers particularly vulnerable to lenders. Fifth, farm borrowers frequently prefer informal agreements, which are common in rural communities. Because of lenders' paternalistic approach and borrowers' lack of expertise, borrowers argue the farmer-lender relationship transcends a simple debtor-creditor relationship. Instead, farm lenders not only provide credit but also become trusted financial advisers to farmers. Having assumed this special relationship, farmers often argue that lenders have additional duties to their borrowers.

First, most lenders providing credit to farmers and ranchers specialize in agricultural lending. The Farm Credit System, for example, is the largest single source of credit for farmers and ranchers. The entities of the federal Farm Credit System were created to provide for both long-term and short-term

35. See, e.g., Production Credit Ass'n v. Croft, 423 N.W.2d 544, 546 (Wis. Ct. App. 1988).
37. One group of farm borrowers went so far as to allege that the lender served as a “father figure” to them. Mantooth v. Federal Land Bank, 528 N.E.2d 1132, 1138 (Ind. Ct. App. 1988).
38. See, e.g., Production Credit Ass'n, 423 N.W.2d at 546; Mantooth, 528 N.E.2d at 1138. See also, Randy Rogers, COLLIER FARM BANKRUPTCY GUIDE § 1.01 (Lawrence P. King 1992).
39. Rogers, supra note 38, at 1-2. Farmers creditor groups typically include one or more governmental or quasi-governmental entities.
credit needs of farmers.\textsuperscript{41} Likewise, the Farmers Home Administration (FmHA) was created by Congress to provide credit on reasonable rates and terms to farmers who could not obtain sufficient credit elsewhere.\textsuperscript{42} Major insurance companies and banks often have subsidiaries or units specializing in agricultural lending. Rural bankers also tout their knowledge of agriculture.\textsuperscript{43}

Second, farmers argue that a disparity exists in bargaining power between the farmer and the lender. This disparity may allow lenders to inject themselves into decisions about farm operations.\textsuperscript{44} Disparities can result from a farmer's poor health, inexperience, lax farm accounting practices or lack of education.\textsuperscript{45} One trial court judge aptly noted that "some people who [are] excellent farmers [are] not particularly good at figures or at making business decisions."\textsuperscript{46} Another court correctly observed that the "farm crisis of the 1980s produced cash-strapped and financially unsophisticated farmers who claimed reliance upon their bank officers' oral promises to renew their loans..."\textsuperscript{47} Many farmers contend that, while they may be experts at crop production or animal husbandry, they are not experts in farm finance.\textsuperscript{48}

Third, agricultural lenders frequently become much more involved in the day-to-day operations of the farmer borrower than other commercial lenders. Federal law specifically authorizes federal land bank associations and production credit associations to provide "technical assistance" to borrowers as well as "financially related services appropriate to [borrowers]


\textsuperscript{42} \textit{Id.} at 60.

\textsuperscript{43} \textit{See infra} note 65, for an example of an advertisement.

\textsuperscript{44} \textit{See infra} notes 50-54 and accompanying text.


\textsuperscript{46} Production Credit Ass'n v. Vodak, 441 N.W.2d 338, 345 n.3 (Wis. Ct. App. 1989).


\textsuperscript{48} \textit{See, e.g.,} Production Credit Ass'n v. Croft, 423 N.W.2d 544, 546 (Wis. Ct. App. 1988). It has been noted "... farmers have sometimes been at a disadvantage in dealing with creditors because of their lack of financial sophistication. There is a perceived unequal relationship between farm debtors and creditors which allegedly may cause some unfairness in the relationship." LOONEY, \textit{supra} note 41, at 55.
Agricultural lenders often require farm borrowers to submit extensive farm plans detailing a farmer's expected operations. Sometimes lenders require borrowers to follow their advice as a condition of receiving a loan. In addition, lenders may give both financial advice and farming advice. Frequently, lenders will put substantial limitations on the ability of farmers to make management decisions such as when to buy and sell equipment or when to make other large expenditures. Financial advice is not necessarily unwelcome to farmers. Because of complex government regulation of farm credit and federal farm benefit programs, farmers usually welcome advice about farm finance. The 1989 Department of Agriculture's Yearbook of Agriculture, for example, advises farmers to select lenders who demonstrate "up-to-date knowledge of problems, trends and modern agricultural practices."

52. Nelson v. Production Credit Ass'n, 930 F.2d 599, 606-607 (8th Cir. 1991) (Heaney, J., dissenting) (president of the PCA advised farmer to sell unrelated piece of land and to purchase 625 feeder pigs); Idaho First Nat'l Bank v. Bliss Valley Foods, Inc., 824 P.2d 841, 853 (Idaho 1991) (vice-president of bank advised farmer to form a limited partnership to raise capital); Mantooth v. Federal Land Bank, 528 N.E.2d 1132, 1138 (Ind. Ct. App. 1988) (PCA allegedly advised borrowers to start, then later liquidate a hog operation); Yoest v. Farm Credit Bank, 832 S.W.2d 325, 327 (Mo. Ct. App. 1992) (Farm Credit Bank allegedly forced the borrower to sign 132 acres into the Conservation Reserve Program); Lachenmaier v. First Bank Sys., Inc., 803 P.2d 614, 616 (Mont. 1990) (banker allegedly advised borrower to switch from a small cow-calf operation to a feeder cattle operation); Production Credit Ass'n v. Vodak, 441 N.W.2d 338, 345 (Wis. Ct. App. 1989) ("PCA set the farm goals, the herd size, insisted on construction of the entire barn at once, did their accounting, and told them which bills they could pay and when to pay them."). See also Burman, supra note 38, at 721.
53. See, e.g., Production Credit Ass'n v. Croft, 423 N.W.2d 544, 546 (Wis. Ct. App. 1988) (supplementary loan agreement provided that machinery and equipment could not be sold without written consent of the PCA).
including the lenders' knowledge of government programs. 55

Fourth, farmers often do not have the benefit of legal counsel. Professors Juergensmeyer and Wadley have accurately observed that "farmers, unlike most businessmen" do not have automatic access to legal advice. 56 Rather than consulting lawyers for preventative purposes during the decision making process, farmers often consult lawyers once a transaction has unraveled. 57 Even when farmers have access to attorneys, self-reliant and cost-conscious farmers underuse their services. Ironically, thousands of increasingly complex laws and regulations exist to confound farmers. The federal regulations governing the Farm Credit System alone span 242 pages in the Code of Federal Regulations. 58

Fifth, because rural American business often relies on a "handshake," rural business differs greatly from business in more urban settings. When given a choice, many farmers prefer oral agreements to written agreements, even in credit transactions. 59 Farmers and ranchers have relied upon oral agreements and representations since the homesteading of agricultural America. 60 Statements made by agricultural bankers

55. U.S. DEP'T OF AGRICULTURE, 1989 YEARBOOK OF AGRICULTURE: FARM MANAGEMENT 177 (1989). Nonfarm borrowers also welcome business suggestions. According to a survey conducted by the National Federation of Independent Businesses conducted in 1982, 95% of small businesses believe that it is important or very important for their banks to give helpful business suggestions. Similarly, 55% of the owners of small businesses believe it is important or very important that their banks know both the borrower and the borrower's business. William C. Dunkelberg et al., SMALL BUSINESS AND THE VALUE OF BANK-CUSTOMER RELATIONSHIPS, 14 J. BANK RESEARCH 248, 253 (1984).

56. JULIAN C. JUERGENSMEYER & JAMES B. WADLEY, AGRICULTURAL LAW § 1.2, at 8 (1982). A recent survey of agricultural attorneys conducted by the American Bar Association confirms Professors Juergens-Meyer's and Wadley's conclusions. Agricultural attorneys estimate that only 38% of farmers in their commodities "have an adequate knowledge of their rights when dealing with bankers and other creditors. American Bar Association Agricultural Law Committee, Survey, December 1, 1992, at 1 (copy on file with author and WILLIAM MITCHELL LAW REVIEW). The same survey reveals 34% of farmers have adequate knowledge of their legal rights when dealing with the Farm Credit System, the Farmers Home Administration or the Agricultural Conservation and Stabilization Service. Id.


58. See generally Farm Credit Administration, 12 C.F.R. Chapter VI (1992).

59. ROGERS, supra note 38, § 1.02, at 1-3 ("Individual credit transactions are often oral rather than written and are typically satisfied in an informal manner.").

60. For example, an estimated 50% of farm leases in Iowa are oral leases. Jane Easter Bahls, DON'T YOU TRUST ME? AVOIDING PROBLEMS WITH FARM LEASES, FARM FUTURES 24N (April 1987).
such as "we're with you" or "not to worry" often create legitimate expectations in the agricultural community that inconsistent banker action will not occur. Similarly, because farming is a cyclical business with good years and bad years, guarantees of staying with the borrower in the "long haul" often create significant expectations.

The five attributes of the farmer-lender relationship demonstrate the paternalistic approach many farm lenders take toward farm borrowers. While paternalistic guidance may not be welcomed by unsophisticated farm borrowers, one commentator has suggested that agricultural lenders have a duty "to abide by generally accepted standards for agricultural lenders—standards which impose duties beyond those of 'normal' lenders."

Because agricultural lenders hold themselves out as possessing a special knowledge of agriculture, farmers often believe agricultural lenders owe them additional or higher duties than those owed by nonagricultural lenders to their commercial borrowers. Agricultural lenders often advertise or make oral statements designed to create an impression of special expertise. As a result, agricultural borrowers often reasonably expect that agricultural lenders have specific expertise in

61. See, e.g., State Bank v. Curry, 476 N.W.2d 635, 637 (Mich. Ct. App. 1991) (dairy farmers expected bank to support them after loan officer said "we're with you"); Interstate Prod. Credit v. MacHugh, 810 P.2d 535, 537 (Wash. Ct. App. 1991) (farmers expected not to repay one year loans right away after PCA official told them not to worry). See also testimony of Joe Nelson, supra note 50, at 56 ("They all have the same story—[the PCA officer says] bring in extra money, your mortgages and we'll stay with you. So the trusting farmer takes in his assets, and with his trust—and shortly thereafter the Farm Credit System pulls the plug and down he goes.").


63. Burman, supra note 36, at 721-22.


65. See Siegner, 820 P.2d at 23 (advertising by lender stated that it would provide financing for the "long haul.").
agriculture and agricultural finance.\textsuperscript{66} In light of these attributes of the farmer-creditor relationship, courts should examine whether lenders impliedly assumed additional duties and whether those duties were breached.

B. Judicial Treatment of Duties to Agricultural Borrowers

Whether agricultural lenders owe a higher duty to their borrowers varies from jurisdiction to jurisdiction. Courts have addressed four commonly asserted duties: fiduciary duty, the duty of good faith and fair dealing, the duty to avoid negligent misrepresentations, and the duty of care in structuring a loan and rendering advice. Each of these duties is often alleged to arise outside the four corners of a contract.

1. Breach of Fiduciary Duty

Farmer borrowers frequently assert that farm lenders have breached their fiduciary duty by giving bad advice upon which the borrower, in turn, relies.\textsuperscript{67} If borrowers successfully con-

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One Farm Credit Service advertisement circulating in Montana made the following representations:

\textbf{The wrong lender can leave you with more chaff than wheat.}

\begin{itemize}
  \item The standard lender's approach to financing doesn't always work for the wheat farming business. And it can leave you with a lot of chaff on the bottom line. Farm Credit understands. We offer loan packages and financial services designed for you. We have more than 70 years of experience with wheat farmers. And our loans are designed with built in flexibility. With our fixed, adjustable and variable rate loans, and the ability to convert from one to the other, you can plan your strategy to meet your current and projected financial needs. And with our many payback options, you have true flexibility. So call the lender who knows the whole wheat business. Call Farm Credit.
\end{itemize}

\textsuperscript{66} See, e.g., Siegner, 820 P.2d at 22 (loan officer told the farmer that the lender "was the premier agricultural lender in the region, that its rates were competitive, that defendant understood the ups and downs of the cattle market"); accord Production Credit Ass'n v. Vodak, 441 N.W.2d 338, 345 (Wis. Ct. App. 1989) (lender allegedly held itself out as able to give the "skillful financial advice to assist [the borrowers] in getting the cash needed to make the operation function.").

vince a court that lenders should be classified as fiduciaries, additional obligations are imposed upon lenders outside of those found in typical credit contracts. In other words, once a fiduciary duty is established, "the party in whom confidence is thus reposed must 'lay his cards on the table.'" 68

A. Case law

A survey of recent cases involving farm credit shows farmers have argued for the imposition of six different obligations stemming from the existence of a fiduciary relationship between the lender and the agricultural borrower. Most of these claims have failed. First, farmers argue fiduciary duty obligates the lender to disclose fully actions it takes or contemplates to take regarding the borrowers' loans. 69 For example, in Waddell v. Dewey County Bank, 70 the farmer alleged that the Bank had a fiduciary duty to disclose the risk involved with the participation agreement. 71 The agreement provided that the participating banks could reject the farmer's subsequent loan applications by changing their credit requirements. 72 The court held the lead bank did not have to disclose the possibility of such rejection to the borrower. 73

Second, farmers argue lenders are obligated to approve conveyance of the collateral supporting the loan when the conveyance is in the best interest of the borrowers. 74 In Williams v. Federal Land Bank, 75 the court found that the bank did not have a fiduciary duty to accept the borrowers' proposal to sell his

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70. Waddell, 471 N.W.2d at 595.
71. Id.
72. Id.
73. Id.
75. Id. at 774.
mortgaged farm land. Even though the farmer allegedly suffered injury from the bank's refusal, the court rejected the farmer's claim.

Third, farmers suggest lenders must inform financially distressed borrowers of all available financial options including bankruptcy. An example of this circumstance is Boatmen's National Bank v. Ward. In Boatmen's the farmer's financial situation disintegrated to the point where the farmer could no longer afford the credit extended to him by the Bank. The Bank, however, failed to disclose any options to the farmer to remedy the situation, including the possibility of filing for bankruptcy. The jury determined that, even though the Bank would have incurred a substantial loss on the transaction, the Bank's failure to suggest bankruptcy as an option was a violation of fiduciary duty. The Illinois Appellate Court sustained the jury's determination.

Fourth, farmers argue that lenders must ensure that all steps are taken to protect and preserve their collateral. For example, in Production Credit Association v. Ista, the court rejected the farmer's claim that the bank owed the farmer a fiduciary duty to ensure that the borrower obtained crop insurance. The court found that, within the relationship between a director and a corporation, a duty exists to "act wholly for the benefit of the corporation." However, no similar duty extended to transactions between corporations and individual stockholder-borrowers. Thus, the court held the bank had no fiduciary duty to inform the farmer of the risk of failure to

76. Id.
77. Id.
79. Id. at 626.
80. Id.
81. Id.
82. Id.
83. Boatmen's Nat'l Bank v. Ward, 595 N.E.2d 622, 626 (Ill. Ct. App. 1992). Ultimately, the farmer did not consider the bankruptcy option because he was unaware of how to proceed with a bankruptcy transaction. Id.
84. Production Credit Ass'n v. Ista, 451 N.W.2d 118, 121-25 (N.D. 1990) (failure to ensure that borrower obtained crop insurance).
85. Id. at 121.
86. Id.
87. Id.
88. Id.
obtain insurance. 89

Fifth, farmers argue that lenders have a duty to notify borrowers when farm plans are unsound. 90 In Production Credit Association v. Vodak, 91 the farmers relied on the bank’s representations regarding their farm plan. 92 The farmers followed the bank’s advice to increase their herd size but were unable to afford or maintain the costs associated with the increased herd. 93 Later the farmers discovered that the farm plan was unsound because it lacked sufficient capital to pay the required debt. 94 The court held that the factfinder could have concluded the bank had violated its duty. 95

Sixth, farmers argue banks are obligated to continue loaning money to borrowers. 96 In Yoest v. Farm Credit Bank, 97 the farmers alleged that they entered into a contract with a bank and relied on the bank’s promise to roll the short-term notes from one bank into long-term notes at another. 98 The court, however, held that neither bank had a fiduciary duty. 99 Further, the court found the Yoests were experienced borrowers who managed their own property and were thus not subservient to the requests of the bank. 100

The facts in agricultural lender liability cases commonly alleged to support farmers’ arguments that the bank has an obligation to continue loaning money to borrowers fall into a pattern. Lenders are alleged to have required a detailed farm financial plan that sometimes specifies the degree of participa-

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89. Production Credit Ass’n v. Ista, 451 N.W.2d 118, 121 (N.D. 1990).
91. Vodak, 441 N.W.2d at 344-45.
92. Id.
93. Id. at 345.
94. Id.
95. Id.
97. Yoest, 832 S.W.2d at 327.
98. Id.
99. Id.
100. Id. at 328.
tion in federal farm programs, the crops the farmer will plant, or the number of animals the farm will maintain in the herd. Though the farmer or rancher generally develops these plans, lenders often require material changes prior to accepting plans. Lenders often require that the borrower may neither make major expenditures nor use cash proceeds from collateral without lender approval. Even though lenders may exercise pervasive control in the agricultural lender-borrower relationship, applying traditional fiduciary relationship analysis is problematic.

b. Analysis

Fiduciary duties arise primarily in agency relationships. In a true agency relationship, one person—the agent—consents to act on behalf of another person, the principal, in conducting the principal's affairs. The agent is subject to the principal's control. Presumably in lender liability cases, then, the borrowers are the putative agents, subject to control of the putative principals, the lenders. In borrower and lender relationships, it usually requires a stretch of imagination when borrowers argue that they are somehow acting for lenders. Rather, courts usually find that both parties are acting in their own interest on opposite sides of a contract.

The fiduciary relationship commonly alleged by borrowers is probably best described as a quasi-fiduciary relationship or a "fiduciary-type" relationship. A quasi-fiduciary relationship

101. See supra text accompanying note 50.
102. See supra text accompanying notes 39-62.
103. See supra text accompanying notes 40-62.
105. Reformation (Second) of Agency §§ 1, 140 (1958).
106. Reformation (Second) of Agency § 1 (1958).
109. See Fischel, supra note 104, at 147.
110. Several authors have noted this distinction between a fiduciary relationship and a quasi-fiduciary (or special) relationship. See Burman, supra note 36, at 713-18; Fischel, supra note 104 at 146-47; Neils B. Schaumann, The Lender As Unconventional Fiduciary, 23 Seton Hall L. Rev. 21, 39 (1992). Several courts have classified certain debtor-creditor relationships as quasi-fiduciary or "special relationships." See, e.g., High v. McLean Fin. Corp., 659 F. Supp. 1561 (D.D.C. 1987), aff'd sub nom., Hill v. Equitable Trust Co., 851 F.2d 691 (3rd cir. 1988), cert. denied, 488 U.S. 1008 (1989);
is not a true agency relationship but is a relationship which arises from special circumstances between the parties. A quasi-fiduciary relationship creates certain fiduciary duties, including duties for the lender to "lay the cards on the table" and to administer the loan in a non-negligent way. Typically, these special circumstances involve subservient borrowers entrusting their financial and business affairs to a lender in which they have confidence.

Courts have generally found that the relationship between lenders and borrowers is not a fiduciary-type relationship. Perhaps Judge Friendly said it best in Weinberger v. Kendrick:

"[L]ending relations between banks and large corporations are the product of arm's-length bargaining, and it would be anomalous to require a lender to act as a fiduciary for interests on the opposite side of the negotiating table." Instead, courts hold that the lender-borrower relationship is a contractual debtor-creditor relationship where the parties deal at arms length.

When a fiduciary relationship is created, the lender must avoid making misleading statements, concealing facts, or giving negligent advice. The essence of a fiduciary duty is the creation of an obligation to give sound and complete information for the benefit of another. Silence about material facts necessary for informed decisionmaking is unacceptable in a fiduciary relationship. An example of unacceptable silence in


111. See Favors v. Matzke, 770 P.2d at 690 (quasi-fiduciary relationship exists where "a special relationship of trust and confidence has been developed between the parties.").


115. Weinberger, 698 F.2d at 61.

116. See id.


118. See RESTATEMENT (SECOND) OF TORTS § 874 cmt. a (1979).

119. See First Nat'l Bank v. Brown, 181 N.W.2d 178, 182 (Iowa 1970); Nie v. Ga-
a fiduciary type relationship includes failure to inform a borrower of the lender’s plans for imminent foreclosure at the same time the lender is seeking additional collateral. Other examples of unacceptable conduct include failing to explain the advantages or disadvantages of bankruptcy or federally mandated debt restructuring programs.

As a general rule, a fiduciary duty does not require a lender to continue loaning money indefinitely or to act only in the best interest of the borrower.¹²⁰ Lenders have the fundamental right to enforce their contracts. In doing so, however, a lender must be candid with a borrower about its actions and the alternatives available to the borrower, including bankruptcy.¹²¹ In addition, as a part of the duty of candor in a fiduciary relationship, the lender should give the borrower sufficient notice of its adverse actions. This notice will give creditworthy borrowers the opportunity to obtain credit elsewhere. Even a lender with a fiduciary relationship to the borrower need not act forever in the best interests of a borrower. It is not reasonable to expect a lender to perpetually extend credit in the face of inadequate collateral or inadequate cash flow.¹²²

2. Tortious Breach of Implied Covenant of Good Faith and Fair Dealing

In addition to fiduciary duties, courts must often determine whether farm lenders have breached a duty of good faith and fair dealing. Borrowers often assert these claims when lenders terminate credit without a seemingly logical basis.¹²³ Parties to a contract must act in good faith according to contract principles.¹²⁴

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¹²⁰ Theodore H. Helmeter, Lender Liability and Fiduciary Obligation: Dentures for a “Toothless Lion”, 6 PROB. & PROP., July-Aug. 1989, at 22. Those who suggest that finding a fiduciary relationship means that lender “is liable for almost anything” recklessly overstate their case. Id.
¹²³ In an odd twist, a federal district court recently allowed a lender’s bad faith claim against a borrower to proceed. Riveredge Assoc. v. Metropolitan Life Ins. Co., 774 F. Supp. 897 (D.N.J. 1991). In Riveredge, the lender’s claim was based on the borrower’s lawsuit against the lender alleging facts inconsistent with loan documents. Id.
ples.  However, agricultural borrowers argue that a breach of the duty of good faith should result in tort damages in addition to contract damages. Thus, plaintiffs are able to recover tort damages for emotional distress, punitive damages, and lost profits.

**a. Case law**

Claims asserting a breach of a duty of good faith and fair dealing are often very general and, therefore, not successful. In *Garrett v. Bank West, Inc.*,  the court held that the borrowers failed to show that the lender had a "duty to refrain from doing anything that [would] injure the rights of the [borrowers] to receive the benefits of the agreement." Other claims for tortious breach of the implied covenant have attacked the following lender conduct: a breach of an obligation to offer administrative loan forbearance under federal regulations; a breach of an obligation not to force liquidation of collateral at an inopportune time; and a breach of a duty of the lender's regional office to act consistently with the local loan officers.

124. U.C.C. § 1-203 (1977) provides that "every contract or duty within this code imposes an obligation of good faith in its performance or enforcement." More specifically, U.C.C. § 1-208 (1977) states that a lender may not "accelerate payment or performance or require collateral or additional collateral 'at will' or 'when he deems himself insecure' " unless the lender "in good faith believes that the prospect of payment or performance is impaired."  


127. *Id.* at 552-53.

128. *See, e.g.*, R.E.T. Corp. v. Frank Paxton, 329 N.W.2d 416 (Iowa 1983). Lost profits are more difficult to recover in breach of contract claims because of the notion that damages must be reasonably foreseeable. *Id.*


130. *Id.* at 841.


Although some courts recognize the tort of bad faith when insurance companies reject the claims of the insured party arising under insurance contracts, the great weight of authority denies the imposition of tort damages for a breach of the implied covenant of good faith and fair dealing in agricultural and nonagricultural debtor-creditor relationships. In fact, in Montana and California, the two leading states in developing theories of tortious breach of the covenant of good faith and fair dealing in banking relationships, courts have recently rejected claims for tort damages.\footnote{137}

\paragraph{b. Analysis}

Courts should deny recovery of tort damages for a breach of the implied covenant of good faith and fair dealing in debtor-creditor relationships. Good faith obligations should arise only from the terms of the contract. Parties ought to be able to bar- gain for contract terms and engage in an efficient breach of the contract without courts imposing tort damages thus depriving the parties of the benefits of their bargains.\footnote{138} As the court accurately noted in \textit{State National Bank v. Academia, Inc.},\footnote{139} the

\begin{itemize}
  \item \footnote{134} See generally William M. Shernoff, Sanford M. Gage & Harvey R. Levine, \textit{Insurance Bad Faith Litigation} (1992).
  \item \footnote{136} See also Betterton v. First Interstate Bank, 800 F.2d 732, 733 (8th Cir. 1986); Rodgers v. Tecumseh Bank, 756 P.2d 1223 (Okla. 1988); Keeton v. Bank of Red Bay, 466 So. 2d 937, 938 ( Ala. 1985); State Nat'l Bank v. Academia, Inc., 802 S.W.2d 282, 284 (Tex. Ct. App. 1990).
\end{itemize}
obligation of good faith "is a derivative principle and does not create an independent [tort] cause of action." 140

Allowing courts to impose tort damages for unfair conduct between contracting parties allows a court to second guess the parties' contract terms and results in the creation of good faith responsibilities outside the four corners of the contract. 141 As Judge Frank Easterbrook succinctly stated: "Any attempt to add an overlay of 'just cause' ... to the exercise of contractual privileges would reduce commercial certainty and breed costly litigation. . . . " 142 The circumstances of the agricultural debtor-creditor relationship are not sufficiently distinct from other debtor-creditor relationships to justify tort damages for all unfair conduct.

3. Negligent Misrepresentation

Borrowers' claims of negligent misrepresentation have met with greater success. Borrowers can claim the tort of negligent misrepresentation by demonstrating that the lenders supplied them with false information for their business use. 143 The claim of negligent misrepresentation has been frequently litigated in agricultural lender liability cases. 144 Most courts recognize that the parties to a contract have a duty to take

140. Id.
141. A California Court of Appeals noted that hopeful expectations of continued credit should not be protected: "Here, the entire subject matter under consideration—the long term loan—was at best left open to future negotiations and agreement .... Under such circumstances, the Bank was under no legal obligation or commitment to make a long-term loan." Kruse v. Bank of America, 248 Cal. Rptr. 217, 229 (Cal. Ct. App. 1988), cert. denied, 488 U.S. 1045 (1989).
142. Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351, 1357 (7th Cir. 1990).
143. RESTATEMENT (SECOND) OF TORTS § 552 cmt. a (1965).

reasonable steps to supply accurate and straightforward information. Section 552 of the Restatement (Second) of Torts ("Section 552") states:

One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.145

The comments to Section 552 provide that the obligation to supply accurate information exists "only when the defendant has a pecuniary interest in the transaction in which the information is given."146 Clearly, lenders have a pecuniary interest in transactions with their borrowers. As a result, lenders making statements for the benefit of agricultural borrowers must comply with Section 552's requirements and must refrain from giving false information.147

Unlike actions for fraud or deceit, in negligent misrepresentation actions the borrower need not plead and prove that the lender intentionally misstated the facts.148 Instead, the borrower must simply prove the lender acted negligently.149 Furthermore, the lender's liability extends only to those circumstances in which the lender is aware of how the borrower will use the information and intends to supply the information for that purpose.150 The prohibition against negligent misrepresentation furthers the social policy "of encouraging the flow of commercial information upon which the operation of the economy rests."151

a. Case law

Borrowers have asserted negligent misrepresentation claims in three types of lender liability cases. First, borrowers claim

146. Id. cmt. c, at 129.
147. See supra text accompanying note 117.
148. See supra text accompanying notes 64-66.
149. RESTATEMENT (SECOND) OF TORTS § 552(1) (1965).
150. Id. § 552 cmt. a (1965).
151. Id.
that lenders have given them operational advice and falsely represented their expertise. In *Production Credit Association v. Vodak*, the lenders advised the borrowers to expand a farm operation. The lender refused to finance construction of half a barn to house a small increase in herd size. Instead, the lender required construction of a full barn and a sizable expansion in herd size prior to approving a loan for the borrower. The borrower argued that the plan was developed by the lender, and implementation of the plan was carefully supervised by the lender. The borrower claimed the expansion plan was unworkable because it failed to provide for maintenance of the expanded herd. The court held that the borrower's claim survived a motion for summary judgment because the lender held itself out as having expertise to advise the borrower.

Second, borrowers claim negligent misrepresentation where lenders allegedly promised to extend or continue extending credit. In *Gilmore v. Ute City Mortgage Co.*, the United States District Court in Colorado sustained a claim for negligent misrepresentation based on an alleged promise by the loan officer that loan committee approval would be forthcoming. Likewise, in *Bottrell v. American Bank*, the Montana Supreme Court recognized a claim for negligent misrepresentation where a lender promised to assist the borrower in obtaining long term financing from another source. The same court noted in an earlier case that a lender's insertion of an amount in a corporate borrowing resolution may be sufficient to give


154. *Id.* at 345.

155. *Id.*

156. *Id.*

157. *Id.*


159. *Id.* See also *Frame v. Boatmen's Bank*, 824 S.W.2d 491, 492 (Mo. Ct. App. 1992) (noting that borrower's reliance on officer's statement that bank would lend money presents an issue of fact that cannot be disposed of in summary nature).

160. *Bottrell v. American Bank*, 773 P.2d 694, 706 (Mont. 1989) (recognizing negligent misrepresentation where lender promised to assist SBA in obtaining long term financing while the bank was obtaining additional collateral to accomplish a set-off).

161. *Id.*
rise to an expectation that the funds will be provided.\textsuperscript{162} In \textit{State Bank v. Maryann's, Inc.},\textsuperscript{163} the Montana court acknowledged that the borrower's action would create a claim for negligent misrepresentation.\textsuperscript{164} Borrowers may also claim that a lender has promised to continue extending credit to the borrower.\textsuperscript{165} In \textit{Hill v. Equitable Bank},\textsuperscript{166} the United States District Court, applying Maryland law, noted that lenders have a duty to avoid misrepresentation concerning the safety of an investment under certain circumstances.\textsuperscript{167}

\textbf{b. Analysis}

Negligent misrepresentation claims against agricultural lenders are sometimes appropriate, since agricultural lenders frequently purport to specialize in agricultural lending and exalt their knowledge of agricultural finance and credit to attract borrowers.\textsuperscript{168} Lenders inject themselves into agricultural operations by providing financial and business advice.\textsuperscript{169} As a result, farmers rely on statements made by lenders about farm finance.\textsuperscript{170} Just as customers of other professionals can pursue claims against professional "advice givers" using negligent misrepresentation theories,\textsuperscript{171} agricultural lenders should be held to the same standard. Lenders should be responsible for their own advice when they hold themselves out as having special expertise in farm finance.

Where borrowers claim that lenders negligently misrepre-
sented that credit would be extended or continued, courts must carefully analyze whether lenders gave any false information. Clearly, inaccurate or misleading statements which legitimately and actually create expectations should be considered false information. On the other hand, predictions of future conduct expressed by the lenders should not always be grounds for negligent misrepresentation. 172

Even if statements made about extension of credit are more akin to opinions, courts should not rule out claims of negligent misrepresentation:

The rule stated in [Restatement (Second) of Torts § 552] applies not only to information given as to the existence of facts but also to an opinion given upon facts equally well known to both the supplier and the recipient. Such an opinion is often given by one whose only knowledge of the facts is derived from the person who asks it. 173

Of course, courts should not hold lenders responsible for all representations that are inaccurate. Rather, lenders should only be held responsible for those misstatements which result from the lender’s failure “to exercise reasonable care or competence in obtaining or communicating the information.” 174 Borrowers should be entitled to expect that lenders will exercise care and competence when making statements. Specifically, borrowers are entitled to expect that lenders have done a reasonable and adequate investigation of the validity of material statements likely to cause reliance. Borrowers are also entitled to expect agricultural lenders to have business and professional competence typically possessed by lenders. 175 If the information given by lenders expresses an opinion, borrowers should be entitled “to expect a careful consideration of the facts and competence in arriving at an intelligent

172. Lenders often state that given the information they have, credit should be forthcoming. Some courts have categorically stated that promises of future conduct (including promises to continue credit) are not actionable negligent misrepresentations. See McAlister v. Citibank, 829 P.2d 1253, 1261 (Ariz. Ct. App. 1992); Bank of Shaw v. Posey, 573 So. 2d 1355, 1360 (Miss. 1990).


175. Id. cmt. e (recipients of information not currently known to them in the course of a transaction are entitled to expect that the supplier will exercise the care and competence required by the business or profession in acquiring the information).
4. Negligent Breach of Duty of Care

Borrowers cannot prevail on claims of negligent misrepresentation in agricultural lender liability suits if borrowers cannot specifically identify the false statements made by the lenders. Further, borrowers must demonstrate reliance on the lender's false statement. However, the borrowers can still allege that the lenders were negligent either in the evaluation or administration of loans or in giving advice to borrowers in conjunction with loans. These claims, similar to professional malpractice claims, assert that lenders have undertaken a special duty to act in a nonnegligent fashion.

Courts have not been consistent in their reasoning and conclusions when deciding whether lenders have duties to avoid negligent administration of loans and loan applications. Some courts find that lenders owe a duty of care to borrowers in processing loans. Other courts reject that position. Some courts indicate a willingness to find duties of care only in fiduciary-type relationships.

a. Duty of Care

Whether a claim of negligence succeeds usually depends upon whether the court finds a duty to provide the service or whether the lender failed to take the action. Prosser and Keeton properly recognize the difficulty in determining when a duty exists. Prosser and Keeton conclude that "[n]o better general statement can be made than that the courts will find a duty where, in general, reasonable persons would recognize it and agree that it exists." Despite some uncertainty, it is well established that a person undertaking a business or profession

176. Id.
177. See infra text accompanying notes 187-199.
178. See infra text accompanying notes 199-204.
182. Keeton, supra note 145, § 53.
"is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities."

183 As a result, highly skilled individuals, such as attorneys, physicians, architects, and public accountants face exposure to liability if they fail to exercise the level of skill common to those active in the profession. 184 These duties also apply to less skilled persons engaging in trades such as electricians, carpenters, and plumbers. 185 Similar duties have been imposed upon lenders whom borrowers rely on for their expertise. 186

b. Negligent Evaluation or Administration of a Loan

Borrowers commonly claim that lenders negligently evaluated and administered their loan, despite the lenders' special skills and knowledge. Claims for negligent loan evaluation and administration fall into four categories. First, borrowers often allege that lenders have breached a duty to evaluate a loan, loan application, or a loan modification request in accordance with prudent and reasonable lending procedures. 187 Second, borrowers claim that lenders have a duty not to approve a loan application where proceeds of the loan would be invested in a high-risk venture. 188 The borrowers maintain that approving such loans, in the face of high risk, constitutes negligence on

183. Restatement (Second) of Torts § 299A (1965).
185. Restatement (Second) of Torts § 299A cmt. b (1965).
188. See, e.g., Wagner v. Benson, 161 Cal. Rptr. 516, 521 (Cal. Ct. App. 1980) (borrowers alleged bank was negligent in failing to inform borrowers that borrowers were about to invest loan proceeds in a risky venture).
the part of lenders. 189 Third, some borrowers contend that lenders act negligently by making or structuring loans which borrowers are unable to repay. 190 Finally, borrowers assert negligence when lenders fail to take reasonable steps to protect the value of the collateral. 191 Several courts have hesitated to accept these negligence theories because such acceptance could permit recovery of tort damages for a breach of the debtor-creditor contract.

Courts ought to reject negligence claims where the claim, in effect, creates duties which extend beyond the debtor-creditor contract and for which the parties to the contract have not bargained. 192 When a borrower's claim that a lender breached its duty of care is really a claim for negligent breach of contract, courts properly reject the borrower's claim. 193 Courts are wise to avoid converting breach of contract claims into tort actions. As Prosser and Keeton correctly argue, duties created by contract ought to be governed by the law of contract and not be convertible into tort claims. 194

In debtor-creditor relationships, the risk of inadequate cash flow or inadequate collateral to satisfy a loan falls first and foremost on borrowers. Accepting the argument that lenders have a duty to make only those loans that borrowers will repay would efficiently eliminate the borrower's contractual duty to repay the loan. Likewise, the duty to preserve the value of collateral and insure adequate cash flow is not that of the lender. Rather, the obligation to preserve the value of business assets, as well as maximize profits and cash flow, is that of the borrower. Transferring the obligation to operate as responsible business persons from borrowers to lenders could encourage borrowers to engage in sloppy business practices. Borrowers, armed with the knowledge that courts might later force lenders

189. Id.
191. See, e.g., Production Credit Ass'n v. Ista, 451 N.W.2d 118, 125 (N.D. 1990) (failure to acquire crop insurance).
193. See infra text accompanying notes 205-218.
194. KEETON, supra note 145, § 92.
to make them whole, might be inclined to take undue risks. Courts should avoid creating duties that allocate risks inconsistent with the terms of contracts and general commercial practices.

In the absence of a fiduciary duty, courts examining agricultural debtor-credit relationships have rejected claims that lenders have a duty to make loan decisions consistent with their internal loan policies. Courts have also refused to find agricultural lenders governed by the Farm Credit System liable under state law for failure to follow the policies of the federal Farm Credit Act.

The analysis and reasoning of these courts is sound for three reasons. First, the decision to terminate credit is best governed by contract law. One of the most fundamental terms of a credit contract is the date on which the credit is due. Courts should not supplement the terms of credit contracts to create a duty contained in the contract, unless the contracts expressly provide that credit determinations will be made in accordance with reasonable or identifiable standards.

Second, courts should not require lenders to continue lending money indefinitely, even if borrowers meet the loan standards in effect at the time of the original loan. Banks and other lenders periodically react to the changing economy by modifying loan policies, in accordance with the changing requirements of regulators and the changing priorities of individual lenders.

Third, even if a lender has specific lending standards, application of the standards to a borrower’s situation is highly subjective. For example, empirical studies show that the quality of the farm’s management, measured by the farmer’s character and ability, is the most important factor in making credit deci-


sions. Courts should neither second guess the contract terms negotiated by the parties nor second guess the credit decisions made by the lender pursuant to those terms. In the interest of protecting the parties' right to bargain, borrowers' claims based solely on the lenders' alleged negligent evaluation or administration of a loan should generally fail.

c. Breach of Duty to Provide Competent Financial Advice Concerning Agricultural Finance

In general, the relative duties of lenders and borrowers should be ascertained by the law of contracts. However, courts may call for additional duties on the part of lenders in special circumstances. The nature of the relationship between an agricultural borrower and agricultural lender may create special circumstances, since the agricultural debtor-creditor relationship is built on a degree of trust not found in many commercial contracts. These relationships occur when the lender acts not only as a commercial creditor but also serves as a business or financial advisor. When lenders assume a professional advisory relationship, borrowers are apt to look to the lenders' expertise regarding matters affecting the borrowers' livelihood.

An agricultural lender, however, may assume the role of a professional advisor in matters of farm finance without additionally assuming a fiduciary role. Much less is required for the bank to assume the role of a professional advisor. If a lender holds itself out as an expert and as a result the borrower reposes faith, confidence, and trust in the lender, the lender becomes an advisor and is responsible for its negligent conduct. As the drafters of the Restatement (Second) of Torts state:

Unless he represents that he has greater or less skill or knowledge, one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.

198. Id. at 517-18.
199. See supra text and accompanying notes 49-55.
200. In a fiduciary relationship, a substantial power disparity exists, and the lender asserts its power to exercise dominion over the borrower. See supra text accompanying notes 44-45.
201. RESTATMENT (SECOND) OF TORTS § 299A (1965).
The obligation to exercise skill and knowledge described in the Restatement sometimes applies to agricultural lenders. Lenders in rural America frequently hold themselves out as having special expertise in agricultural finance or other aspects of agricultural business. Even if that expertise is offered gratuitously and is not explicitly part of the debtor-creditor contract, lenders have a responsibility to use the skill and knowledge ordinarily possessed by agricultural lenders. When the lender has voluntarily undertaken to provide special advice, imposition of liability for negligently given advice is justified. To discourage negligent performance of lender duties, lenders assuming advisory roles should be held responsible for the “professional” advice given.

Before holding a lender responsible for the “professional advice” negligently given, the court must determine whether a particular lender has represented itself as possessing special knowledge. The duty of a lender to avoid negligence in providing business and financial advice arises only when the lender assumes the role of financial advisor. To ascertain whether a lender holds itself out in this role, courts should examine statements made in advertisements and oral statements which may suggest expertise in a certain area. Courts should also examine the history of the relationship between the lender and borrower to ascertain whether the borrower frequently sought advice, whether the lender gave frequent advice, and whether the borrowers were unsophisticated in matters relating to the advice given.

202. The duties described in § 299A of the Restatement (Second) of Torts do not “depend upon the existence of an enforceable contract between the parties.” Id. cmt. c, at 74. Likewise, these duties apply to service rendered gratuitously. Id.

203. Id. (“The basis of the rule is the undertaking of the defendant, which may arise apart from contract.”)

204. See Production Credit Ass’n v. Vodak, 441 N.W.2d 338, 345 (Wis. Ct. App. 1989). In Vodak, the court stated:

We conclude that the factfinder could infer that PCA adopted a role respecting the Vodaks’ farm operation and the financial repayment plan which went beyond the role of a lender. Whether PCA was negligent in performing the additional responsibilities which it assumed is for the factfinder to determine.

The factfinder could also infer that the farm plan was a representation to the Vodaks that if it was followed, they would have a successful operation. The factfinder could find that the plan was flawed in that its objectives could not be accomplished.

the borrower reasonably relied on the advice, then the lender should be held liable.

IV. Written Credit Agreement Statutes

In recent years, a majority of states have enacted legislation to curtail lender liability claims. Some states enacted statutes to protect lenders from "having to litigate claims of oral promises to renew agricultural credit." Backed by banking interests, these statutes are designed to protect lenders from liability for oral comments, thereby increasing commercial certainty.

States have enacted two primary types of legislation limiting lender liability claims—statute of fraud legislation and credit agreement legislation. The former provides that certain contracts to extend credit are invalid unless the contracts are in writing. Credit agreement statutes are much broader in scope. Not only do these statutes require a writing, but they also prohibit courts from implying the existence of credit agreements from fiduciary relationships or by promissory estoppel. Some credit agreement statutes go so far as to provide that "the rendering of financial advice by a creditor to a debtor" shall not "give rise to a claim that a new credit agreement is created." While many states use a statute of fraud to create a defense to contract actions, the statutes do not create a defense to breach of fiduciary duty, negligent misrepresentation, or other negligence claims. The effect of credit agree-

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205. See supra note 4.
   The farm credit crisis of the 1980s produced cash-strapped and financially unsophisticated farmers who claimed reliance upon their bank officers' alleged oral promises to renew their loans. Numerous lawsuits arose over the bankers' alleged oral promises. The credit agreement statute was passed to prevent the litigation of such difficult claims.

Id.

207. See, e.g., Pearson, supra note 4, at 297 n.11.
211. Weissmann, supra note 4, at 138-39.
ment statutes on these claims is less certain.

Because of the diversity of the credit agreement statutes, it is difficult to summarize the effect of state statutes on duty-based lender liability tort claims. Generally, credit agreement statutes serve to limit some of these claims. States enacting legislation most favorable to lenders require that credit agreements arising from fiduciary duties or from lenders rendering financial advice must be in writing. As a result, if a borrower claims that a fiduciary relationship creates an obligation to forebear on collection, the claim is barred by statute unless a written agreement to forebear exists. Similarly, courts have rejected claims that a lender must continue to loan money if the borrower follows the oral advice of the lender.

Borrowers in states with credit agreement statutes who seek to hold lenders liable for fiduciary responsibilities, such as the obligation to inform them of all available options or the obligation to refrain from giving negligent financial and business advice, should not ask the courts to enforce oral credit agreements. Borrowers should seek neither to modify credit terms nor to modify other accommodation terms. Instead, borrowers should seek damages for breach of a fiduciary duty to provide sound guidance to the borrower.

Credit agreement statutes may also provide a defense to some negligent misrepresentation claims. While some courts have recognized that credit agreement statutes permit some types of fraud claims, it is less clear how credit agreement statutes affect negligent misrepresentation claims. Most state statutes do not expressly preclude actions based on negligent misrepresentations. Those statutes that limit claims for negligent misrepresentation apply only if the effect of the tort...
would be to establish an oral agreement to provide credit or accommodation. Since many negligent misrepresentation claims do not seek to establish or to modify a credit agreement, the statutes may not apply. Instead, borrowers seek damages for lost profits due to reliance on the lender’s negligent business or financial advice, and the statutes do not bar such a claim.

Credit agreement statutes, however, often preclude some claims alleging negligence. If a claim for negligent administration of a loan has the effect of creating an obligation to extend credit or provide a financial accommodation under a credit agreement, the claim may be barred by credit agreement statutes. Therefore, a claim that a bank failed to follow its internal policies and refused to extend the due date of the loan may be precluded by the broadest of the credit agreement statutes. A claim that the lender held itself out as having special expertise as a financial advisor and was negligent in rendering advice should not be precluded by credit agreement statutes. In these instances, the borrower is not seeking to establish a credit agreement but instead is simply attempting to recover damages for negligently rendered professional advice.

The purpose of credit agreement statutes is to add certainty to loan contracts. The statutes are not intended to allow lenders to breach duties arising from special circumstances of the relationship between two parties. As a result, courts should construe credit agreement statutes narrowly. Tort actions that have the effect of alleging an agreement to extend, continue or modify a credit agreement should be barred by these statutes. Tort actions should be allowed if they allege a breach of duties arising separately from the contractual relationship.

V. IDENTIFICATION OF THE APPROPRIATE DUTIES BETWEEN FARMER AND LENDER

Because of the complexity of many farmer/lender relationships and the special circumstances surrounding agricultural

\[217. \textit{Id.}\]

\[218. \textit{See, e.g., Iowa Code § 535.17 (b) (West Supp. 1991). The purpose of the Iowa statute is clearly stated: “To ensure that contract actions and defenses on credit agreements are supported by clear and certain written proof of the terms of such agreements to protect against fraud and to enhance the clear and predictable understanding of rights and duties under credit agreements.” \textit{Id.}\]
credit, courts have had difficulty categorizing the appropriate types of relationships between farmer and lender. While courts should avoid categorical rules to classify farmer-lender relationships, it is clear that most farmer-lender relationships are not fiduciary relationships. Even when the relationship between a farmer and lender falls short of a fiduciary relationship, the special circumstances of the relationship might still create a duty to avoid negligent misrepresentations or provide competent credit advice.

A. Farmer Lender Relationships Are Not Usually Fiduciary Relationships

Courts should find a fiduciary relationship rather than a contractual one in an agricultural debtor-creditor relationship only when each of the following three conditions exists: First, the borrower must actually repose faith, confidence and trust in the lender.\(^\text{219}\) Second, a substantial power disparity must exist between the borrower and the lender due to the borrower's age, mental capacity, mental or economic duress, health, education, and degree of business experience.\(^\text{220}\) Third, the lender must use its power to exercise dominion over the borrower in a way not reasonably necessary to protect the lender's loan.\(^\text{221}\)

The facts in the typical agricultural debtor-creditor dispute generally do not satisfy these conditions. While the first condition is often satisfied because members of the agricultural


community generally have a stronger trust and faith in one another than they do in nonagricultural commercial communities, the second and third conditions are not satisfied. As to the second condition, courts should not presume that a substantial disparity of power exists between agricultural borrowers and lenders. Lenders may be more knowledgeable about farm finance, but borrowers are usually more knowledgeable about the business of crop production and animal husbandry. In analyzing whether farmers are subservient to lenders, courts must recognize that financially stable farmers usually have many financing alternatives, perhaps more than many non-farm commercial borrowers. Federal agencies such as the Farmers Home Administration and Farm Credit System provide farmers with numerous credit alternatives. Likewise, farming is a capital intensive business and is usually attractive to collateral conscious banks and insurance company lenders.

Finally, the third condition necessary to find a fiduciary relationship is usually not satisfied. Despite power disparity, courts should look carefully at the particular facts and circumstances before concluding that the lender exercises unnecessary dominion over the borrower. Courts should permit lenders to protect their interests in collateral and the borrower’s creditworthiness. Such a presumption that the lender exercised dominion should not be created where the lender merely gives optional business advice. This presumption would discourage lenders from fully discussing issues such as extent of enrollment in federal farm programs, expected trends in production, new farming techniques, the desirability of various types of leases, and other business arrangements. These discussions are mutually beneficial and provide an education for both lender and borrower. Only when a lender has assumed a specific duty to provide competent advice should public policy encourage farmers to sue if the advice was inappropriate. Borrowers should be encouraged to reasonably investigate and consider all of their borrowing alternatives.

Where a lender imposes requirements on a borrower and the borrower becomes subservient, courts should ask whether the requirements were reasonably necessary to protect the lender’s interest. A lender has a legitimate interest in conditioning credit on acceptance of covenants restricting certain

222. See supra text accompanying notes 59-62.
actions that could negatively affect the borrower's creditworthiness. Acceptable conditions include compliance with a farm business plan, limitations on the ability to make major expenditures, or, in some cases, downsizing of the farm or ranch. Such loan covenants are commonly regarded as reasonably necessary to protect collateral.\(^{223}\)

Courts should also remember that special circumstances surrounding certain types of farm loans require that the lender be more involved in the borrower’s finances. For example, agricultural lenders have special problems in monitoring certain types of loans, such as those made for crop production. When lenders make crop production loans in the spring, borrowers often cannot pay off the loan until the crop is harvested in the fall. In the interim, wind, hail, insects, drought, and disease create significant risks. As a result, lenders must be allowed to monitor the production loans. Since the collateral (i.e., the crop) has little value until harvest, lenders often properly mitigate their risks by closely monitoring the farmers’ operation and by requiring approval of major expenses.\(^{224}\)

Lenders, however, should not be allowed to exercise more control than necessary to protect the collateral. Without established boundaries, a lender’s conduct may cross the line and extend into actual control of the day-to-day operations of the farm. For example, a lender should not be allowed to impose limitations on the borrower regarding who is permitted to serve as management personnel for the farm. This decision goes to the heart of farm business. Lenders can protect the farm collateral and income stream in less intrusive ways. Likewise, lenders may not control day-to-day decisionmaking, including decisions concerning routine expenditures unless that control is necessary to protect collateral.

Control over daily operation decisions is evidence of impermissible domination.\(^{225}\) For example, in *A. Gay Jenson Farms Co.*

\(^{223}\) See Richard T. Nassberg, The Lender's Handbook 16 (1986). See also Wagner v. Benson, 161 Cal. Rptr. 516, 521 (Cal. Ct. App. 1980) (“Normal supervision of the enterprise by the lender for the protection of its security interest in loan collateral is not ‘active participation’”); Production Credit Ass'n v. Croft, 423 N.W.2d 544, 547 (Wis. Ct. App. 1988) (“The loan provisions appellants rely on were to protect the PCA’s security interests and did not vest in the PCA control of appellant's property.”).


v. Cargill, Inc., the Minnesota Supreme Court found Cargill, a major grain dealer, liable as a principal through an agency relationship created as a result of Cargill's exercise of financial and managerial control over a grain elevator operator. Thus, lenders should use veto power over major expenditures. Veto power is a more reasonable method and less intrusive of the farmer's control of his or her business.

B. Special Circumstances in the Farmer-Lender Relationship May Result in Other Duties

Even when the relationship between a farmer and a lender falls short of a fiduciary relationship, special circumstances may result in other tort-based duties. The special circumstances that may create a duty between a farmer and a lender include faith, trust, and confidence the farmer often reposes in other grounds.

227. Id. at 294. Factors indicating control included:
(1) Cargill's constant recommendations to Warren [the grain elevator operator] by telephone;
(2) Cargill's right of refusal on grain;
(3) Warren's inability to enter into mortgages, to purchase stock or to pay dividends without Cargill's approval;
(4) Cargill's right of entry onto Warren's premises to carry on periodic checks and audits;
(5) Cargill's correspondence and criticism regarding Warren's finances, officers salaries and inventory;
(6) Cargill's determination that Warren needed "strong paternal guidance";
(7) Provision of drafts and forms to Warren upon which Cargill's name was imprinted;
(8) Financing of all Warren's purchases of grain and operating expenses; and
(9) Cargill's power to discontinue the financing of Warren's operation.

Id. at 291. The court noted that some of these factors are ordinarily found in a debtor-creditor relationship, but the factors "must be viewed in light of all the circumstances surrounding Cargill's aggressive financing of Warren." Id.

228. Comment a to § 140 of the Restatement of Agency (1958) states:

A security holder who merely exercises a veto power over the business acts of his debtor by preventing purchases or sales above specified amounts does not thereby become a principal. However, if he takes over the management of the debtor's business either in person or through an agent, and directs what contracts may or may not be made, he becomes a principal, liable as any principal for the obligations incurred thereafter in the normal course of business by the debtor who has now become his general agent. The point at which the creditor becomes a principal is that at which he assumes de facto control over the conduct of his debtor, whatever the terms of the formal contract with his debtor may be.
While reposing faith, trust in confidence alone is not enough to create a fiduciary relationship, it may be enough to create the duty to avoid making negligent misrepresentations and the duty to give competent advice.

Many agricultural lenders do hold themselves out as specializing in agricultural lending and as experts in agricultural finance. When a borrower selects a lender or continues to deal with a lender on the basis of the lender’s stated expertise, it is reasonable to hold the lender to the role of financial advisor. Just as lawyers, accountants, and others have a duty to provide sound advice to clients, agricultural lenders who render such advice may have similar duties.

Farm borrowers should consider alleging violations of specific duties undertaken by the lender. Simply asserting a generalized claim of breach of fiduciary duty often requires proof that the farm borrowers are unable to provide. Compounding this problem are the difficulties farmers have establishing the scope of the duties arising from the fiduciary relationship. Instead, farm borrowers should consider asserting that the unique relationship between farmers and lenders creates specific duties on the part of lenders to avoid giving negligent advice and making misleading statements.

VI. CONCLUSION

Both courts and legislatures have been increasingly hostile to lender liability actions. Much of this hostility results from the well-founded desire to protect the sanctity of contract and to add certainty to the debtor-creditor relationship. In some cases, however, the relationship between the lender and borrower is broader than the typical debtor-creditor relationship. Broad relationships may be more common between agricultural borrowers and lenders because of the very nature of the agricultural community.

Where the lender assumes duties outside the four corners of the typical debtor-creditor contract, courts should carefully an-
alyze the circumstances to ascertain whether breaches of those duties are actionable. If, for example, a lender assumes the role of trusted financial advisor, courts should examine whether the bank’s statements and advice were negligently given. Though most courts have been hesitant to permit tort remedies, courts should carefully examine the relationship of the lender and borrowers. Because these relationships differ, courts should avoid inappropriate categorical rules and examine the facts on a case-by-case basis before allowing recovery of tort damages.