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North Carolina Supreme Court Issues a Reminder on the Scope of a Lender's Duty to a Borrower

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February 19, 2016

Recently, in Arnesen v. Rivers Edge Golf Club & Plantation, Inc., the North Carolina Supreme Court issued a welcome opinion for lenders that reaffirmed the limited scope of a lender's duties to a borrower. In Arnesen, the Court held that in an ordinary lender-borrower relationship, the lender's duties are defined by the written loan agreement and do not extend beyond its terms. In so holding, the Court affirmed the trial court, which had dismissed the borrowers' claims against the lender at an early stage of the case. The decision is a welcome reminder that a loan is an arm's-length transaction and lenders generally do not have open-ended obligations to their borrowers if an investment or business venture turns sour.

In Arnesen, the borrowers bought lots in a new residential real estate development. When the development failed during the collapse of the real estate market, the borrowers sued the developer, the bank (the primary lender on the project), and certain appraisers. The borrowers claimed that the developer and appraisers artificially inflated property values, that the borrowers would not have purchased their lots but for the faulty appraisal information, and that the bank should have discovered and disclosed the inflated appraised property values to the borrowers.
The bank moved to dismiss the complaint for failure to state a claim under Rule 12(b)(6) of the North Carolina Rules of Civil Procedure. This remedy is available to a party in the early stages of a case if when it can show the court that the complaint, on its face, states no law to support the claim, has an absence of facts to constitute a valid claim, or discloses facts that necessarily defeat the claim.

In granting the motion to dismiss, the trial court determined that the borrowers premised their claim upon alleged wrongful omissions by the lender regarding the loan and appraisal process. In essence, the claim was that the borrowers would not have purchased the properties but for the faulty appraisal information. Unfortunately for the borrowers, they had decided to purchase the properties without consulting an appraisal. They did not order, view, or request appraisal information at any time, nor were they prevented from doing so. The borrowers dealt with the developer on their purchases, not with the bank.

A tort claim, such as borrower's claim that the bank was negligent in failing to tell the borrowers of the appraisal values, requires three elements: a duty, a breach of that duty, and damages. Absent a legal duty, there can be no breach of duty.

The trial court found that under both state and federal law, the lender did not owe any duty to disclose the details of its internal loan and appraisal process to the borrowers. More importantly, the terms of the loan agreements did not require the bank to disclose the appraisal value.

The Supreme Court affirmed the trial court's decision. The Court held that the borrowers alleged nothing more than a typical debtor-creditor relationship and the bank's only duty was created by contract through the

loan agreement. The borrowers failed to allege any special circumstances that would create a heightened fiduciary relationship between the parties. The Supreme Court specifically noted that “the law does not typically impose on lenders a duty to put borrowers’ interests ahead of their own.”

Most lenders obtain appraisals of collateral for their own internal underwriting purposes. One takeaway from Arnesen is that, as a general rule, a borrower cannot delve into a lender’s underwriting file and use internal appraisals or appraisal review documents to manufacture a claim against the lender. Collateral valuation is for the lender’s benefit -- it is not a service meant to protect the borrower.

Arnesen is also a reminder that lenders should still proceed with caution when it comes to “investment” loans. Lenders should avoid statements and activity that could be construed as going beyond the traditional lender role. For instance, they should avoid the appearance of being engaged in a joint venture with a developer. Lenders also should avoid promoting investments and certainly should never guarantee the success of an investment to a borrower. Finally, regardless of what an appraisal says, a lender should never promise a borrower that a loan is risk-free because of the value of the collateral.

Ward and Smith's Creditors' Rights Practice Group is available to provide you with additional information and answer any questions you have about the Arnesen decision and how it may affect you.

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