



Successor Banks of FDIC assets Not so Jolly after Jolley - A New Duty to Investigate?

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A recent California case appears to contradict the general rule holding that a successor bank that has acquired a commercial loan through an FDIC receivership may owe a duty to a commercial borrower to reasonably investigate the pre-acquisition loan history. Failure to investigate the loan's *pre-acquisition history* may give possible rise to liability for the successor bank. *Jolley v. Chase Home Finance, LLC*, 213 Cal. App. 4th 872, --- Cal. Rptr. 3d ---, 2013 WL 494022 (Cal. App. 1st Dist., February 11, 2013).

Successor banks may not be so jolly under *Jolley*. The case may increase the potential liability under the general rule that successor banks typically have "no duty" to review pre-acquisition loan histories for failed bank assets. Generally, liability to a successor bank is limited under a Purchase and Assumption Agreement between the FDIC and successor bank, coupled with the general "no duty" rule that banks do not owe a duty of care to a borrower when the institution's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender. The FDIC as receiver of a failed bank often sells the assets of the failed bank, which typically include loan portfolios (performing or not), to successor banks. Successor banks usually have no knowledge of or interest in the pre-receivership history of each acquired loan because the Purchase and Assumption Agreement ("P&A Agreement") typically absolves the successor bank from any liabilities at the failed bank level and the "no duty" rule.

Jolley is also significant since it may impact the quick disposition of lender liability cases against successor institutions should courts find that a successor institution owes a duty of care to the borrowers it inherited from the failed institution.

In *Jolley*, the Plaintiff, an owner of rental property, entered into a construction loan agreement with Washington Mutual Bank ("WaMu") to renovate a house. Plaintiff alleged that WaMu improperly delayed loan disbursements, lost documents, and made bookkeeping errors, which forced Plaintiff to personally incur significant expenses associated with the renovation. Plaintiff and WaMu eventually agreed to a loan

modification, which involved additional disbursements.

On September 25, 2008, WaMu collapsed and the FDIC was appointed receiver. On the same date, Chase acquired WaMu's loans and loan commitments pursuant to a P&A Agreement between the FDIC as receiver and Chase. The P&A Agreement contained a clause stating that Chase would not assume any liabilities connected with WaMu's loan modification activities.

Plaintiff thereafter attempted to secure a loan modification from Chase and outlined in detail the prior problems with WaMu's handling of the loan. In response, Chase's representative represented that there was a "high probability" that Chase "would be able to modify the loan so as to avoid foreclosure." As a result, Plaintiff borrowed heavily to complete the construction.

Contrary to its representations, Chase commenced nonjudicial foreclosure proceedings, and Plaintiff filed suit alleging causes of actions based on WaMu's pre-acquisition conduct and Chase's post-acquisition conduct. The trial court (in California?) granted summary judgment for Chase, holding that the P&A Agreement barred any liability for the pre-acquisition wrongdoing of WaMu and that the loan officer's representation that a loan modification was "highly probable" was merely an expression of opinion, rather than an actionable misrepresentation.

The California Court of Appeals reversed after finding that there were triable issues of fact as to Chase's duties and liabilities to Plaintiff.

Reasoning

Notwithstanding the general rule that a financial institution owes no duty of care to a borrower when the institution's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender of money, the court concluded that there were triable issues of fact of whether Chase owed a duty of care to the Plaintiff for its *post-acquisition* conduct. The court held that the successor lender had a duty to administer the loan modification process in a reasonable manner in order to prevent future harm even if the bank is not liable for breaches, fraud, or negligence under the P&A agreement. Thus, an acquiring institution has a duty to investigate the history of the loan and take that into account in negotiating with the borrower for a loan modification.

The court expressly rejected Chase's assertions that it was entitled to pursue its own economic interests in its dealings with a borrower:

We live, however, in a world dramatically rocked in the past few years by lending practices perhaps too much colored by shortsighted self-interest. We have experienced not only an alarming surge in the number of bank failures, but the collapse of the housing market, an avalanche of foreclosures, and related costs borne by all of society. There is, to be sure, blame enough to go around. And banks are hardly to be excluded.

Focusing on the fact that there was an ongoing dispute about WaMu's performance of the loan contract, that the dispute bridged the FDIC's receivership and Chase's acquisition of the construction loan, and that specific representations were made by Chase's representative as to the likelihood of a loan modification, the court found that a cause of action for negligence had been stated that could not be properly resolved based on a lack of duty alone.

Conclusion

Although the court did not hold that Chase owed a duty of care to Plaintiff as a matter of law, the rejection of

the general "no duty" rule and finding that a triable issue of fact existed as to Chase's duty to Plaintiff, could significantly alter the duties of successor bank to borrowers. *Jolley* is on appeal with the California Supreme Court. The Petition for Review was filed on March 26, 2013. The California Supreme Court has not yet determined whether it will grant or deny the petition.