[Blogs]
September 02, 2015
Asset Management ADVocate

Can a Lender Be a Fiduciary to a Borrower?

I've cherished a belief that certain relationships can never be characterized as "fiduciary." The clearest example I can give is boxers. The point of a boxing match is to do things that are decidedly against the interest of your opponent. Categorically excluding boxers from being fiduciaries is best for all concerned. If a boxer is certain that his opponent will try to inflict maximum harm, the boxer will not hesitate to defend himself. Uncertainty as to whether an opponent may be obligated to pull his punches may lead a boxer to let down his guard. I'm regularly looking for other relationships which should never be classified as fiduciary. Debtor/creditor relationships might be a candidate for exclusion. People generally borrow money to serve their own interest, not the lender's. The lender's paramount concern is getting its money back from the borrower. Both parties look for the most advantageous terms for themselves, which would be the least advantageous terms for the other party. **Consolidation Loans and Fiduciary Duties** So I was surprised to find Professor Frankel citing the case of *Lash v. Cheshire County Savings* as an example of a bank violating fiduciary duties to its borrower. (Fiduciary Law at 10 (2010)). This is indeed what the case holds; but it illustrates the problem with indiscriminate application of the term "fiduciary." The Lashes were a couple who owed money to Pappas. Pappas owed money to the bank. Pappas suggested the Lashes consolidate their debts by borrowing money from the bank. The Lashes borrowed $35,000 from the bank, directly receiving more than $10,000 in proceeds from the loan. The bank applied the balance to Pappas's obligations to the bank. "It was understood by plaintiffs that part of the loan proceeds would be used to reduce the plaintiff's debt [to Pappas]," but "plaintiffs never provided written authorization to the bank to make this disbursement …." The jury found that the bank did not breach its contract to make the loan, but breached its fiduciary duty to the Lashes. The jury awarded the Lashes $45,000 for the breach of fiduciary duty and $15,000 for emotional distress (the bank made Mrs. Lash cry). The New Hampshire Supreme Court affirmed the verdict for breach of fiduciary duty but vacated the award for emotional distress. Aside from the satisfaction of seeing a bank hoisted by its own petard, this is surely the wrong result. The court treated the existence of a fiduciary relationship as a question of fact for the jury to decide, but did not cite any evidence from the trial supporting the jury's finding. Instead, the court noted the "trend is toward liberalizing the term [fiduciary] in order to prevent unjust enrichment." But it was the Lashes, not the bank, who were unjustly enriched by the verdict. **Borrowers' Unjust Enrichment** The essence of debt consolidation is that the loan is applied to the borrower's obligations to other creditors. The repayment of other creditors offsets the liability resulting from the consolidation loan, leaving the borrower with the same net worth. Repayment of amounts owed to Pappas did not unjustly enrich Pappas or harm the Lashes, and application of this payment to amounts Pappas owed the bank did not unjustly enrich the bank. The jury's verdict, however, resulted in the Lashes receiving over $10,000 in loan proceeds from the bank plus an additional $45,000 in damages. Assuming the bank set off the $35,000 loan against the damages, the Lashes would still net $10,000. When added to the reduction in the debt to Pappas, the jury verdict created a $45,000 windfall for the Lashes. Mistaken treatment of a lender as a fiduciary led the jury to compensate the Lashes for damages they never suffered. This case illustrates the risk of allowing a jury to believe that a lender might ever act as a fiduciary when making a loan.

Explore more in

Investment Management
Blog series

Asset Management ADVocate

The Asset Management ADVocate provides unique analysis and insight into legal developments affecting asset managers in the United States.

View the blog