The Importance of Liability Waivers in

Commercial Loan Workouts

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Due to the lender liability litigation fad of the late 1980s and early 1990s, most institutional lenders significantly tightened their documentation, particularly in workouts and restructurings. Various provisions such as pre-negotiation agreements, reaffirmations of security and waivers of lender liability claims became common. While lender's counsel have generally believed these provisions are enforceable in a commercial loan context, it is always interesting to see a court agree.

IN THE RECENT CASE OF INTERPHARM, INC. V. WELLS FARGO BANK, NATIONAL ASSOCIATION, THE U.S. SECOND CIRCUIT COURT OF APPEALS UPHELD A LOWER court decision dismissing various claims made by a defaulted borrower against Wells Fargo. The facts of the case are relatively straightforward and not unusual. Interpharm was a commercial borrower with a revolving credit facility secured by accounts receivable and inventory. As Interpharm's business deteriorated, there were various defaults on the loan agreement that resulted in workout negotiations and increasingly restrictive credit terms. Throughout the workout, Wells Fargo and Interpharm entered into a series of forbearance agreements, each of which, in addition to other terms, included a waiver by the borrower of any claims against Wells Fargo. Ultimately, Interpharm paid off the debt through the sale of assets, but sued Wells Fargo alleging breach of contract, breach of the duty of good faith and fair dealing, tortuous interference with business expectations, unjust enrichment and breach of fiduciary duty - all common lender liability claims.

Wells Fargo sought to dismiss these claims based on the releases of lender liability contained in each of the forbearance agreements. Interpharm, in turn, tried to argue that dismissal was not appropriate because the waivers were a product of "economic duress." Essentially, Interpharm argued that it had no choice but to agree to the terms of the forbearance agreements and waivers or file for bankruptcy that would have made it impossible to continue its business.

The court pointed out that in order to avoid a contract on the ground of economic duress, the borrower would have to show that the agreement was procured by means of (i) a wrongful threat that (ii) precluded the exercise of its free will. After a lengthy analysis, the court concluded that a threat to exercise a legal right could not be the basis for a claim of economic duress. In other words, as long as the lender had no duty to continue to provide credit as a result of the borrower's default, the fact that the lender may have engaged in aggressive workout tactics did not make its actions wrongful. The case was dismissed since the borrower could not overcome the waivers in the forbearance agreements.

A few observations:

- The lender's position was strengthened by having a clearly drafted waiver of claims in each of the forbearance agreements (note that this case was decided under New York laws - individual state laws may vary on the enforceability and requirements for a valid waiver of claims).
- Although the lender aggressively pursued its rights, it always had a definite material default to point to.
- The lender appears to have only proceeded to grant concessions when there was a written forbearance agreement - in other words, the process remained formal rather than relying on verbal agreements and understandings.
- The Court noted several times that the forbearance agreement expressly stated that it superseded all other negotiations and was unambiguous - both of which are crucial in keeping out evidence of contrary negotiations.

In short, this case demonstrates the benefits of a tightly run workout process with well-documented forbearance agreements. Whether or not the lender would have prevailed on the lender liability claims, it saved significant time and expenses by having those claims dismissed based on the waivers.

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