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# Eastern District of North Carolina (E.D.N.C.) Bankruptcy Court Rules that Borrower Can Raise Unfair and Deceptive Trade Practices Claims Against Lender Based on Refusal to Modify Loan

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Does a lender have a duty to act in good faith when negotiating with a borrower during a commercial loan modification? In an order issued recently by the United States Bankruptcy Court for the Eastern District of North Carolina, in ***In re: Burcam Capital II, LLC***, the court denied a lender's motion to dismiss a borrower's claims against the lender. The Borrower alleged that the lender's failure to modify the terms of the loan constituted a breach of the lender's obligation to deal with the borrower in good faith, as well as an unfair or deceptive trade practice. This was because the borrower alleged that the servicer, as agent of the lender, wanted the loan to go into default as a means of acquiring the real property collateral. While the court acknowledged that the lender had no obligation to modify the terms of the loan, the court still reasoned that the failure to modify the loan under the particular circumstances of this case could constitute a breach of the lender's obligations to proceed in good faith, and could constitute an unfair and deceptive trade practice under North Carolina law.

Burcam Capital II, LLC (Burcam Capital) is the **owner of commercial real property containing retail and office units in Raleigh, NC.** The real property serves as collateral for two separate loans, with both loans administered by CWCapital Asset Management, LLC (CWCapital) as special servicer. Burcam Capital defaulted on its note payments in 2011, and CWCapital initiated foreclosure as a result of this default. On June 28, 2012, Burcam Capital filed for relief under Chapter 11 of the United States Bankruptcy Code to stay the foreclosure.

In the course of the bankruptcy proceedings, Burcam Capital filed a complaint against CWCapital alleging that after Burcam Capital's default, CWCapital acted outside of its narrow role as special servicer of the debt. In particular, Burcam Capital alleged that CWCapital concocted a scheme whereby CWCapital would position itself to either buy the debt from the lender whose loans it was servicing at an artificially low price, or would buy the real property collateral at the foreclosure sale for below market value in order to benefit itself at the expense of both Burcam Capital and the lender whose loans CWCapital was servicing. Burcam Capital alleged that in furtherance of this scheme, CWCapital obtained a severely below market appraisal for the real property collateral and refused to deal with Burcam Capital in any meaningful way regarding any modification or work-out.

CWCapital moved to dismiss the complaint on the basis that neither the lender nor CWCapital breached the loan contract, and that absent a breach of contract or allegations of deceit, there could be no liability for CWCapital under North Carolina Law. CWCapital argued that because under the existing loan contract neither CWCapital nor the lender had any obligation to modify the existing loan, the complaint against CWCapital and the lender should be dismissed.

While the court acknowledged that a lender does not have to reach an agreement with its borrower to modify its loan, and it does not act improperly when enforcing its rights, such as initiating foreclosure when the loan goes into default, the court refused to dismiss the complaint against CWCapital and the lender. The court reasoned that Burcam Capital's complaint alleged facts that could constitute a breach of the implied covenant of good faith and fair dealing which is applicable to contracts in North Carolina, together with facts that could constitute deceptive trade practices. Unfortunately, the court did not explain its reasoning in great detail. In particular, the court did not specifically address CWCapital's argument that CWCapital cannot be liable for failing to act in good faith if there was never any breach by CWCapital of the existing loan contract. Nevertheless, the court agreed with Burcam Capital's allegations that CWCapital's negotiations were a sham and its appraisal of the property constituted a ruse that could rise to the level of a breach of the lender's obligations to deal in good faith as well as a false and deceptive trade practice.

One of the primary lessons for lenders in this case is that when the lender agrees to entertain discussions regarding potential loan modifications it should take steps to ensure that it will be seen by any future court or jury as having considered a borrower's loan modification proposals in good faith. Burcam Capital's complaint placed great emphasis on CWCapital's refusal to provide any reasoning behind its rejection of Burcam Capital's modification proposals, CWCapital's representative in the negotiations having no actual authority to agree to the terms of any settlement or work-out agreement, and CWCapital never informing Burcam Capital of what types of offers it would agree to regarding any future modification or work-out of the existing loan. Once negotiations with a borrower begin, the lender should take steps to ensure that its negotiations are conducted in good faith. If there are credible allegations that the lender refused to negotiate in good faith, such allegations may be used to prevent an early dismissal of a borrower's counter-claims against a lender.

One means of preventing such allegations may be for the lender to require that the borrower agree to a pre-negotiation agreement prior to entering into loan modification discussions with the lender. A well drafted pre-negotiation agreement can help reduce misunderstandings and later claims by a borrower against a lender. The pre-negotiation agreement can help establish the ground rules of the discussion, and should include, among other things, agreements that: (a) no oral or written statements made during the negotiation may be used against the other side (to encourage open discussion); (b) any statements made prior to or during the negotiations are not admissible in court for any reason; and (c) confirm the validity of the existing loan documents. While lenders may encounter some resistance from borrowers in using such an agreement, if a borrower does agrees to its terms, a lender may negotiate more freely because the risk of any liability to the lender as a result of such negotiations is minimized.

In this case, the court did not agree that Burcam Capital's claims against CWCapital should be dismissed, so not all is lost for CWCapital. While Burcam Capital survives in its battle against CWCapital, it must now prove its allegations against CWCapital in court, which is a much higher hurdle than simply arguing that its claims have some legal merit and should not be dismissed. CWCapital recently amended its answer to Burcam Capital's complaint in light of the court's refusal to dismiss CWCapital's claims, and Burcam Capital will now bear the burden of proving that the actions alleged in its complaints are true and that those actions constituted a breach of CWCapital's obligation to deal in good faith and an unfair and deceptive trade practice.



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