# Course of Dealing—The Unintended Consequence of "Working With" Your Borrower During Times of Financial Distress

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During the financial downturn of the late 1980's, many Lenders worked with their financially distressed Borrowers in an attempt, in the face of financial or covenant defaults, to avoid immediately exercising remedies. The unfortunate result of many of these efforts was the onslaught of "lender liability" litigation that followed. In those cases when these efforts to support Borrowers ultimately failed and the Lenders then proceeded to exercise remedies, many of the Borrowers later successfully argued that, based upon the Borrower's reliance upon "promises made" by their Lender, the Borrowers were ultimately damaged when the Lender subsequently exercised remedies and foreclosed on all or a portion of its collateral. For example, in return for injecting more capital into the Borrower, or selling assets which secured the Lenders loan, the Lender agreed to give the Borrower more time to make payments or comply with financial ratios. In part, these aggrieved Borrowers' arguments were based on the Lender failing to immediately exercise remedies available as a result of these defaults. These Borrower claims were often successful in spite of the fact that most loan documents contained anti-waiver provisions such as the following:

"***4.1 No Waiver; Amendment. No failure to accelerate the indebtedness evidenced by this Note by reason of an Event of Default hereunder, acceptance of a partial or past due payment, or indulgences granted from time to time shall be construed… (i) as a waiver of such right of acceleration or of the right of Lender thereafter to insist upon strict compliance with the terms of this Note, or (ii) to prevent the exercise of such right of acceleration or any other right granted under this Note, under any of the other Loan Documents or by any applicable laws. Borrower hereby expressly waives and relinquishes the benefit of any statute or rule of law or equity now provided, or which may hereafter be provided, which would produce a result contrary to or in conflict with the foregoing. …No extension of the time for the payment of this Note or any installment due hereunder, made by agreement with any person now or hereafter liable for the payment of this Note, shall operate to release, discharge, modify, change or affect the original liability of Borrower under this Note, either in whole or in part, unless Lender specifically, unequivocally and expressly agrees otherwise in writing.***"

Despite these "anti-wavier" clauses, case law in Texas has held that a course of dealing by a Lender will negate the benefits of an "anti-waiver" clause. *See Bodiford v. Parker*, 651 S.W.2d 338 (Tex. App. Fort Worth 1983, no writ); *Dhanani Inv. v. Second Master Belt Homes*, 650 S.W.2d 220 (Tex. App. Fort Worth 1983, no writ). In Dhanani, the court held that "acceptance of seven consecutive late payments certainly constituted a waiver by appellee [Lender] of his right to accelerate and foreclose without giving further notice that such tardiness would not be tolerated in the future."

Many of these successful Lender liability arguments were based upon discussions between the parties which the Borrower later argued they had relied upon to their detriment.

In an effort to deal with these types of promissory estoppel or "arguments" based upon oral agreements, the State Legislature passed in 1989 the so-called "No Oral Agreements" statute. This is located at Section 26.02 of the Texas Business and Commerce Code. We have all seen the statutorily required language to allow a Lender to benefit from this so-called "No Oral Agreements" statute. It reads generally as follows:

4.22 ENTIRE AGREEMENT. THIS NOTE AND THE OTHER LOAN DOCUMENTS CONTAIN THE FINAL, ENTIRE AGREEMENT BETWEEN THE PARTIES HERETO RELATING TO THE SUBJECT MATTER HEREOF AND THEREOF AND ALL PRIOR AGREEMENTS, WHETHER WRITTEN OR ORAL, RELATIVE HERETO AND THERETO WHICH ARE NOT CONTAINED HEREIN OR THEREIN ARE SUPERSEDED AND TERMINATED HEREBY, AND THIS NOTE AND THE OTHER LOAN DOCUMENTS MAY NOT BE CONTRADICTED OR VARIED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS OR SUBSEQUENT ORAL AGREEMENTS OR DISCUSSIONS OF THE PARTIES HERETO. THERE ARE NO UNWRITTEN ORAL AGREEMENTS AMONG THE PARTIES HERETO.

This statute has been used successfully to defeat Borrower arguments that an oral agreement exists to modify, for example, the percentage of interest to be paid, the amount of installments, etc. *See Kiper v. VAC Home Loan Servicing, LP*, 84 F.Sup. 2d 561, 571 (S.D. Tex. 2012), *aff'd*, No. 12-20790 (5th Cir. 2013) (not published., 7-5-13). Nonetheless, the statute may not defeat the promissory estoppel and detrimental reliance argument set forth above. I.E., that based upon the Lender's oral representation: "It's okay to skip the next few monthly payments, so long as you keep insurance on our collateral". A Borrower who does so, but later suffers foreclosure, might again argue they have been damaged where that Lender subsequently exercises remedies when, notwithstanding maintaining insurance on the Lender's collateral, the loan goes into subsequent financial default.

With these issues in mind, careful consideration should be given to first entering into a formal Pre-Negotiation Agreement with any distressed Borrower the Lender is willing to discuss providing financial accommodations to. These Pre-Negotiation Agreements provide that, should negotiations not result in the execution of any formal waiver or forbearance agreement, any discussions that occur and any action taken by either party in connection with those discussions, even where those discussions do not result in a final agreement, would not be the basis of future damage claims.

Where such negotiations result in some formal wavier, a formal written Wavier and Reservation of Rights agreement that delineates the exact events of defaults waived, reserves the Lender's right to pursue remedies should any other events of defaults occur, and waives the Lender's remedies for a limited period of time for the known events of default, will protect the Lender from subsequent arguments by the Borrower that the scope of their agreement was broader.

Finally, in cases where a greater possibility of exercising remedies in the future exists, consideration should be given to entering into a formal Forbearance Agreement. The nature of a formal Forbearance Agreement is that the Borrower and Lender recognize the existence of existing Events of Default, acknowledge that the Lender has accelerated the maturity of the indebtedness so that it is fully due and payable as of the execution of the Forbearance Agreement, but that the Lender will forbear from exercising remedies for a window of time provided certain performance occurs on the part of the Borrower. For example, the Borrower would self-liquidate some collateral during the forbearance period and provide enhanced financial reporting to the Lender during that time. These agreements benefit the Lender because they clarify that the debt has been accelerated and is due and payable in full and the only impediment to the Lender exercising remedies is the running of the term of the Forbearance Agreement period and the Borrower's continued compliance with the terms of the Forbearance Agreement.

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**Contact:**
Jim Doyle I 713.650.2718 I jdoyle@winstead.com