

## Third Circuit Upholds Mortgage Foreclosure Over Borrower's Negligence Claims Against Lender

Lydia C. Stefanowicz

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Every recession spurs a new wave of lender liability claims in defense of foreclosure actions, and the Great Recession was no different. In September of 2008, a Princeton, New Jersey homeowner obtained a \$1.5 million construction loan from Bank of America to finance a home renovation. The construction loan agreement called for disbursements during construction based upon successful inspections of the project, but expressly disclaimed any obligation on the lender's part to supervise the construction or conduct the inspections for the benefit of the borrower.

In 2012, after the borrower had failed to complete the project by its stated completion date of March 2010, and failed to correct his defaults, the lender sued for foreclosure. The borrower responded with 25 affirmative defenses and 13 counterclaims, all of which were based on allegations that the lender had negligently and improperly inspected the construction project as a condition of loan disbursements.

Specifically, the borrower alleged that since he lacked experience with construction projects or lending, despite contrary language in the loan agreement, he was induced by the lender to believe that its agents were assuming responsibility to oversee and monitor the construction project by making disbursements tied to its inspections and that the lender's procedures existed to ensure the timely completion of the project at or under cost.

The borrower further alleged that because the lender failed to adequately monitor the project and refused to provide him with relevant inspection reports, and because the lender's representatives told him that construction progress was "fine" and "looked good," the lender had created a special relationship with him which gave rise to a duty of care, a duty which the lender subsequently breached. As a result, the borrower charged that the lender was complicit in the events giving rise to the

### Attorneys

Lydia C. Stefanowicz

alleged default.

The lower court was not swayed by these arguments, especially in light of the fact that the borrower did not dispute the core elements of a mortgage foreclosure case, i.e., the existence of the debt, validity of the mortgage and default under the note. The court dismissed the counterclaims and subsequently granted the lender a judgment of foreclosure. The borrower appealed.

On March 20, 2017, the United States Court of Appeals for the Third Circuit affirmed the lower court in the matter of Bank of America, N.A. v. Westheimer. The court found that the borrower showed no special circumstances creating a fiduciary duty on the lender's part because the loan agreement assigned to the borrower a duty to hire contractors, disclaimed quality assurances and contained an integration clause, and further because the lender did not encourage the borrower to rely on its advice or conceal its self-interest.

In reaching its decision, the court summarized New Jersey law on this issue: "[A]bsent an egregious breach of good faith, there is 'no duty on the part of lenders to disclose information they may have concerning the financial viability of the transactions the borrowers were about to enter.' And in light of the clear language of the Agreement to the contrary, [borrower] cannot meaningfully show that BoA owed a duty to conduct the inspections for *his* benefit or that he reasonably relied on them for that purpose."

The Westheimer case does not make new law in New Jersey; however it does confirm that under New Jersey law, creditor-debtor relationships rarely give rise to a fiduciary duty. The Third Circuit's opinion also underscores the necessity of clear language in loan documents that provide that inspections and other measures taken by the lender in the administration or underwriting of a loan are solely for the benefit of the lender, and are not to be relied upon by the borrower.

Please contact the author, **Lydia C. Stefanowicz**, with any questions regarding the issues discussed in this Alert.