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COMMERCIAL LENDING ALERT

MISSOURI LAW PROTECTS COMMERCIAL LENDERS

February 2009

Commercial Lender-Friendly Laws

Missouri law is generally friendly to the commercial lender and therefore should be the law chosen to govern commercial loan agreements and promissory notes whenever feasible. Missouri statutes (properly utilized) and court-made law:

- Protect commercial lenders against claims that a lender made oral agreements that contradict written terms, even a claim that a borrower was fraudulently induced to sign loan documents in reliance on such oral statements;
- Enforce agreements in business contracts (including loan agreements and notes) to waive the constitutional right of trial by jury if a dispute arises;
- Enforce "one-way arbitration," requiring one party to arbitrate while reserving to the other party (e.g., the lender) the right to foreclose or obtain court orders to enforce an agreement; and
- Minimize the risk of a borrower to claim successfully that a lender's actions were not taken in "good faith."

This *Alert* explains how the Missouri law definition of good faith – unlike the same concept in most other states - protects commercial lenders and other parties to business agreements.

"Good Faith" and Missouri Law

All contracts include an unwritten legal requirement that the parties act in "good faith." Under the laws of most states, meeting the obligation of "good faith" requires meeting two elements: first, honesty in fact; and, second, the observance of reasonable commercial standards of fair dealing.

The requirement of "honesty in fact" is not a general reasonableness requirement. Under this element of the definition, a person could be acting in "good faith" when that person acts on what that person believes, whether or not such belief is true or reasonable. The requirement to act in good faith is a subjective obligation that only requires that a contracting party not prevent or hinder performance by the other party. See Schell v. Lifemark Hospitals of Missouri, 92 S.W. 3(d) 222 (Mo. App. W.D. 2002).

The second element of good faith in most states is the requirement that a party to an agreement must observe reasonable commercial standards of fair dealing, which is an objective, negligence test. The potential impact of a good faith definition that includes the reasonableness requirement is that a borrower or a guarantor bringing or defending a judicial action to negate the obligations under a credit agreement, note or guaranty could put an expert witness on the stand to testify that the lender's actions in its relationship with the borrower or guarantor were not made in "good faith" because, with perfect 20-20 hindsight, they were not commercially reasonable.

The Missouri Law Approach

Under the common law of Missouri, "good faith" means only honesty in fact. The test is subjective, not objective. In furtherance of that well-established doctrine, the Missouri General Assembly re-wrote the uniform versions of Article 3 of the Uniform Commercial Code covering promissory notes and other negotiable instruments and Article 9 of the Uniform Commercial Code covering secured transactions to eliminate the objective, negligence test from the definition of good faith. That is the law in most states.

Can Lenders Safely Act Unreasonably?

The Schell case points out that "reasonableness" does play a role in the analysis of whether an individual is acting in good faith as a subjective matter – not as an element of good faith but as evidence from which a court or a jury could determine that a party in fact had the subjective intent to undermine the fulfillment of a contract.

The purpose of lender and borrower entering into a credit agreement and borrower or guarantor executing a note or a guaranty is expressly set forth in those documents – for one party to obtain a financial consideration from a lender in exchange for promises to repay and other promises freely agreed to. It is difficult to imagine that enforcement of specifically stated rights in a commercial loan agreement or a guaranty could be deemed to be an action taken not in good faith absent strong evidence that the action was taken for a malevolent purpose – e.g., to destroy the borrower's business or out of some personal vendetta.

Conclusion

The interpretation of "good faith" under Missouri law confirms that Missouri law continues to be friendly to parties to commercial agreements, including lenders. This approach is consistent with the general tendency of Missouri courts to enforce contracts between businesses as written and to enforcement pro-lender terms such as those listed at the beginning of this *Alert*.

Under Missouri law, lenders can anticipate that loan terms in commercial credit arrangements will mean exactly what they say. For that reason, if there is a reasonable relationship between a lender, a lending transaction or a borrower and the State of Missouri, a lender should consider requiring that Missouri law govern the transaction.

This *Commercial Lending Alert* was prepared by John P. Walsh, Chair of the Business Services Department and the Commercial Lending and Borrowing Practice Group of Gallop, Johnson & Neuman, L.C. Mr. Walsh is a member of the Commercial Financial Services Committee, the Legal Opinions Committee and the Negotiated Transactions Committee of the Section of Business Law of the American Bar Association. He is also a member of the Bank Counsel Section of the Missouri Bankers Association and its past chair. If you wish to obtain further information regarding the developments discussed above, please contact either the Gallop, Johnson & Neuman attorney who normally provides or manages your legal services or a member of the Firm's Commercial Lending and Borrowing Practice Group. Members include:

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