

## Borrower permitted to prove delays and bad faith by lender and servicer - by Thomas Kearns



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A series of decisions in New York County Supreme Court involving a California hotel highlight the risks to lenders and their servicers when they delay negotiations over defaulted loans. The decisions in *Newage Garden Grove LLC v. Wells Fargo Bank, N.A.*, detail allegations against the servicer, including taking many weeks (and, in one case, months) to respond to proposals to resolve existing defaults, taking weeks to respond to a payoff letter

request, and changing the terms of a workout after proposed settlement terms were agreed to — following nearly six months of claiming to be preparing definitive paperwork. In addition, *Newage* alleged that the lender demanded default interest and fees based on defaults it claims were manufactured, suggesting this was part of a broader strategy to exploit borrowers in challenging market conditions. In a lengthy March 2024 decision, the court permitted the borrower to proceed with its allegations of a breach of New York’s implied covenant of good faith and fair dealing.

The decision was made on a motion to dismiss, meaning the court had to assume that the allegations were true. The borrower still has a long road ahead to prove

the claims, and the extent of the damages if the claims are proven, but the case underscores the litigation risks lenders face when they delay or obstruct negotiations with borrowers.

The lender did, however, score some points in its favor, including the argument that a default rate of 5% per annum over the base interest rate was not unlawful, and that the lender did not have an obligation to agree to any particular modification of the mortgage (yet another COVID era holding to the same effect).

The delays seemed to trouble the court primarily due to the continued accumulation of default interest and servicing fees. As practitioners know, the accrual of default interest is a potent weapon in the hands of a lender, but courts occasion-

ally see the injustice of extended accrual periods.

The court also addressed the borrower’s waiver of money damages against the lender for any breaches in the loan documents. The court wrote “Such clauses, however, are unenforceable when in contravention of acceptable notions of morality, the misconduct for which it would grant immunity smack of intentional wrongdoing or bad faith...”

Parties involved in loan workouts and their counsel should review the *Newage* series of decisions carefully. While lenders have much power in these situations, courts will apply guardrails when they sense inequitable conduct.

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