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LIABILITY OF A CREDITOR IN A CONTROL RELATIONSHIP WITH ITS DEBTOR

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I. INTRODUCTION

A creditor who, by virtue of loan agreements or the acquiescence of its debtor, exercises substantial influence and authority over the business affairs of the debtor risks potential liability for all the debtor's debts. Most of the leading cases which illustrate this principle are not widely known or discussed. Therefore, this article will analyze these cases in the hope that it will provide creditors and their counsel with the means to assure recovery of debts without incurring the inordinate risk that the creditor — in the clear and unerring perspective of judicial hindsight — will be held liable to others for improperly exercising such control. The discussion will also assist counsel by isolating factors which courts have found important in determining whether liability will be imposed.

Potential liability arising out of a control relationship transcends the typical institutional lender-borrower loan arrangement. Thus, the term "creditor" includes any person to whom a debt is owed, whether through a loan of money, sale of goods or otherwise and who, by virtue of the creditor-debtor relationship, is in a position to exert control over the business affairs of a borrower.[1]

There are a variety of theories under which "control liability" may arise. First, under the instrumentality or alter

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1. For example, loan covenants often grant lenders the right to call a loan upon changes in management, a merger of the company, a sale of substantial portions of the business or a decline in net worth or other measures of performance; to appoint positions on the debtor's board of directors; and to require that the borrower continue its present business. Moreover, the right to call a loan by virtue of any real or imagined default (including the elusive "deems itself insecure" clause) vests a considerable amount of control in a lender. *See* H. PROCHNOW, BANK CREDIT (1981).