Commercial & Business Litigation
Winter 2013, Vol. 14 No. 2

Banks' Duty to Speak

By John P. McCahey and Alison M.C. Schrag

As a general rule, banks do not have a duty to divulge to a third party (except as may be required by law to a governmental or regulatory entity) any information concerning the financial affairs of its depositors or borrowers. *See Athey Prods. Corp. v. Harris Bank Roselle, 89 F.3d 430, 435 (7th Cir. 1996)*; *First Nat'l Bank & Trust Co. v. Brakken, 468 N.W.2d 633, 637 (N.D. 1991)*. Indeed, under both common law and various statutes and regulations, a bank may be precluded from disclosing sensitive financial information entrusted to it by customers. *See Ritzert Co., Inc. v. United Fid. Bank, FSB, 935 N.E.2d 756, 762 (Ind. Ct. App. 2010)* ("That a Bank has an implied contract not to disclose certain financial information pertaining to its depositors has been accepted by American courts and authorities.") (internal citation and quotation marks omitted); *Fleming v. Tex. Coastal Bank, 67 S.W.3d 459, 462 (Tex. App. 14th Dist. 2002)* (citing state and federal statutes prohibiting or limiting disclosure). Numerous courts, however, have concluded that a bank's obligation to maintain the confidentiality of a customer's financial information may not always be absolute and, in some cases, may be outweighed by a bank's duty of disclosure to a private third party where "special circumstances" exist. *See, e.g., Buxcel v. First Fid. Bank, 601 N.W.2d 593, 596–97 (S.D. 1999)*; *R.A. Peck, Inc. v. Liberty Fed. Sav. Bank, 108 N.M. 84, 89–90 (N.M. 1988)*.

Although those courts have recognized that a bank may be under a duty to speak as to a customer's financial information, they have had difficulty defining precisely the "special circumstances" necessary to give rise to that duty. As a result, courts have tended to address a bank's duty to speak (and its alleged breach) by focusing on the particular facts presented in each case and without necessarily providing clear guidelines for a bank to follow in other instances when that duty may arise. This article highlights decisions addressing a bank's duty to speak and potential liability for its breach where (1) the bank, at its customer's behest, voluntarily undertakes that duty to a third party; (2) the bank owes the duty by reason of a fiduciary or confidential relationship to another; and (3) the duty arises by reason of the bank's knowledge of its customer's fraud.

When a Bank Undertakes a Duty to Speak

If a bank, through one of its authorized officers or agents and at its customer's request, undertakes to respond to a third-party inquiry by supplying financial information concerning the customer, it may have a duty to disclose all information in its possession that would reasonably be considered material to the request. *See ADL, LLC v. Tirakian*, No. CV 2006-5076 (SJF)(MDG), 2010 U.S. Dist. LEXIS 110563, at *34 (E.D.N.Y. Aug. 26, 2010); *Ostlund Chem. Co. v. Norwest Bank of Jamestown, 417 N.W.2d 833, 836 (N.D. 1988)*; *Bank of Nev. v. Butler Aviation O'Hare, Inc., 96 Nev. 763, 764–66 (Nev. 1980)*.

This situation frequently arises when a customer provides its bank as a credit reference for a commercial transaction or other business venture. That bank ordinarily will be under no obligation to serve as a credit reference for its customer. *Berkline Corp. v. Bank of Miss., 453 So.*

2d 699, 702 (Miss. 1984). If, however, it chooses to respond to a specific credit inquiry, "the bank and its officers are bound to use the skill and expertise which they hold themselves out to the public as possessing" and may not make "representations or omissions of material facts false at the time." *Id.* Failure to disclose complete and accurate financial information about its customer can expose the bank to fraud- and negligence-based claims. *See* *Ragland v. Shattuck Nat'l Bank, 36 F.3d 983, 990–92 (10th Cir. 1994)* (bank liable for fraud and negligent misrepresentation by conveying inaccurate financial information to third party about its customer's ability to perform a contract); *MSA Tubular Prods., Inc. v. First Bank & Trust Co., 869 F.2d 1422, 1424–25 (10th Cir. 1989)* (reversing trial court holding that bank could not be held liable for constructive fraud by failing to provide adverse credit information in response to credit inquiry received from third party engaged in sale negotiations with bank customer); *Hess v. Beach First Nat'l Bank*, No. 09-cv-362(JCC), 2009 U.S. Dist. LEXIS 57380, at *19–20, *24 (E.D. Va. July 7, 2009) (allegations that bank made incomplete disclosure to third party about borrower's loan status sufficient to state claims for actual and constructive fraud).

Not all courts, however, have found that a bank's inaccurate or incomplete response to a third party's inquiry concerning the bank's customer will suffice by itself to impose liability on the bank. *See, e.g.*, *FMC Corp. v. Fleet Bank, 226 A.D.2d 225, 641 N.Y.S.2d 25, 26 (N.Y. App. Div. 1st Dep't 1996)* (bank's incomplete response to third party concerning creditworthiness of customer did not create a duty on the part of the bank to respond fully and accurately). Those courts have identified additional factors—such as the pecuniary benefit received by the bank as a result of the non-disclosure—as relevant to a duty-to-disclose analysis. *See* *Cent. States Stamping Co. v. Terminal Equip. Co., Inc., 727 F.2d 1405, 1409 (6th Cir. 1984)* (duty to disclose "particularly clear" where third party's reliance on bank's representations enabled customer to pay down $30,000 debt owed to bank); *see also R.A. Peck, Inc.*, 108 N.M. at 91 (finding that bank's duty to disclose material facts concerning its customer's loan accounts "all the more compelling" because its collateral position stood to directly benefit from third party's investment).

In *Reimsnyder v. Southtrust Bank, N.A., 846 So. 2d 1264 (Fla. Dist. Ct. App. 4th Dist. 2003)*, for example, a third party relied on a bank's representation that its corporate customer was "safe, secure, and reputable" before making a substantial investment in that company. *Id.* at 1265. Six months later, the Securities and Exchange Commission filed a complaint against the company for fraud, and the investor subsequently lost most of his investment. The investor then commenced an action against the bank for fraud, negligent misrepresentation, and breach of fiduciary duty based on the bank's incomplete and inaccurate disclosure of information concerning its customer. The trial court granted summary judgment in favor of the bank, and its ruling was affirmed on appeal. The appellate court concluded that summary judgment was properly entered because, even though information was provided to the third party at its request, the "bank had no pecuniary interest in the transaction between [the investor] and [its customer] and no evidence of actual fraud was presented." *Id.* at 1270.

Existence of a Confidential or Fiduciary Relationship

A bank's duty to speak may also be triggered by the existence of a confidential or a fiduciary relationship between it and the third party. *See Jebran v. LaSalle Bus. Credit, 33 A.D.3d 424, 824 N.Y.S.2d 224, 225 (N.Y. App. Div. 1st Dep't 2006)* (no duty to disclose where bank did not share "fiduciary or special relationship" with third party). A number of decisions that have dealt with this issue involve a bank's failure to disclose material facts to its own borrower or depositor concerning another bank customer. Although it is well settled that a bank's relationship with its customer is generally viewed as a debtor-creditor relationship and one that does not create a fiduciary duty owed by the bank, the existence of "special circumstances" may be sufficient to carve out an exception to this common-law principle. *See Am. Bank Ctr. v. Wiest, 793 N.W.2d 172, 182–83 (N.D. 2010)*; *Hodge v. First Nat'l Bank*, No. CA 93-627, 1994 Ark. App. LEXIS 223, at *5–9 (Ark. Ct. App. May 4, 1994); *Parker v. Columbia Bank, 91 Md. App. 346, 368–69 (Md. Ct. Spec. App. 1992)*.

For example, if a customer is able to make a showing that it reposed special trust or confidence in the bank, a fiduciary or confidential relationship can be created and a duty to disclose another customer's financial condition imposed. *See, e.g.*, *Barnett Bank of W. Fla. v. Hooper, 498 So. 2d 923, 925 (Fla. 1986)*. Such fiduciary or confidential relationship usually requires a factual finding that the relationship between the parties went beyond that of conventional banking or lending, and it is often accompanied by evidence of one or more of the following: (1) the bank's superior knowledge of facts not readily accessible to its customer, (2) a longstanding history between the bank and its customer, (3) the bank's rendering of financial advice to the customer, and (4) the bank's active involvement in the underlying transaction. *See, e.g.*, *Chain Tech., Inc. v. Fleet Nat'l Bank (In re Handy & Harman Ref. Grp., Inc.), 293 B.R. 299, 305–6 (Bankr. D. Conn. 2003)* (customer's reliance on bank's advice in conjunction with bank's involvement in transfer created genuine issue of fact as to whether fiduciary relationship and a duty to disclose existed); *Wiest*, 793 N.W.2d at 184 (fiduciary duty existed given bank's "greater knowledge" of material facts and its "continuing involvement" in requesting and using the loan advances at issue). Although not as common, these principles have been applied by courts even when the complaining party is not a bank customer. *See, e.g.*, *Thomas v. N.A. Chase Manhattan Bank, 1 F.3d 320, 328–29 (5th Cir. 1993)* (whether bank owed fiduciary duty to third-party investor based on the parties' "extensive prior dealings" and bank's superior knowledge of customer's banking history was a material issue of fact warranting the reversal and remand of trial court's grant of summary judgment in favor of bank).

Courts are more likely to find a fiduciary duty of disclosure if the bank knew or had reason to know of the customer's trust or confidence. *See, e.g.*, *Klein v. First Edina Nat'l Bank, 293 Minn. 418, 422 (Minn. 1972)* (rejecting argument that bank had duty to inform customer of borrower's loan history where "no evidence in the record . . . indicat[ed] that [bank] ought to have known that [customer] was placing her trust and confidence in [bank] and was depending upon [bank] to look out for her interests"). In some instances, a showing that the bank exploited its position of trust and confidence in order to receive a direct economic benefit may even be required. *See, e.g.*, *De Jong v. Leitchfield Deposit Bank, 254 S.W.3d 817, 823 (Ky. Ct. App. 2007)* (finding no genuine issue of material fact as to whether bank owed customer duty of disclosure where customer "did not allege that the bank profited from any confidence gained from him"); *see also Barnett Bank*, 498 So. 2d at 925 (holding that "where a bank becomes involved in a transaction with a customer with whom it has established a relationship of trust and confidence, and it is a transaction from which the bank is likely to benefit at the customer's expense, the bank may be found to have assumed a duty to disclose").

Actual Knowledge of Fraud

A bank's actual knowledge of its customer's fraudulent activities may also be sufficient to impose a duty of disclosure to the defrauded third party. *See, e.g.*, *Richfield Bank v. Sjogren, 309 Minn. 362, 367 (Minn. 1976)*. In most instances, however, actual knowledge of the fraud is not enough. Courts typically require evidence that other "special circumstances" are present before concluding that a duty to speak exists.

Some courts, for example, have held that actual knowledge of fraud will not create a duty of disclosure if no fiduciary or confidential relationship exists, the bank was never asked to disclose information concerning the customer or account in question, and all material facts were available to the third party. *See* *E.B. Smith, Jr. v. Am. Nat'l Bank & Trust Co., 982 F.2d 936, 943 (6th Cir. 1992)*. This issue will present itself in cases where a third-party bank has accused a competing bank of not disclosing a check-kiting or other fraudulent scheme perpetuated by a common customer and evidence of the fraud was known or ascertainable by the complaining third-party bank. *See* *Frost Nat'l Bank v. Midwest Autohaus, 241 F.3d 862, 874 (7th Cir. 2001)* (finding "no duty between competing institutions to inform one another of the existence of a check kiting scheme because these institutions deal at arm[']s length, [and] have their own means of detecting check kiting [schemes]") (internal citation and quotation marks omitted); *Alta Vista State Bank v. Kobliska, 897 F.2d 930, 934 (8th Cir. 1990)* (finding no duty to disclose where "there [was] no evidence that [competing banks] dealt with each other short of arm's length" and plaintiff bank was "in just as good a position to discover the [fraud]" as the defendant bank); *see also* *Citizens Nat'l Bank v. First Nat'l Bank, 347 So. 2d 964, 967–68 (Miss. 1977)* (in the absence of a confidential or fiduciary relationship between the banks or an allegation that plaintiff bank did not know about the check-kiting scheme, defendant bank owed no duty of disclosure).

If, however, a bank engages in a course of dealing with a third party where it can reasonably be inferred that an element of trust or confidence exists between them, the bank can be found liable for not disclosing the fraud even if the information could have been discovered by the third party through simple due diligence. *Merrill Lynch v. First Nat'l Bank of Little Rock, Ark., 774 F.2d 909, 914 (8th Cir. 1985)* (where defendant bank had "committed itself" to providing prompt notice of checks to be charged back to plaintiff bank's account, defendant bank was required to disclose knowledge of fraudulent check-kiting scheme being perpetuated by mutual customer of both banks).

Conclusion

The general prohibition of a bank's disclosure of its customer's financial information to a third party is riddled with caveats and exceptions. To this end, the concept of special circumstances is instructive and provides some guidance on when a bank's duty to maintain its customer's confidentiality can be trumped by a countervailing "duty to speak." The case law, however, renders it difficult, if not impossible in some instances, to formulate and apply a precise test to all situations to determine when "special circumstances" will give rise to that duty. Careful consideration therefore need always be given to the bank's actions, as well as the relationship between the bank, its customer, and the third party, when considering whether a duty to speak exists. A bank must also be mindful that if a duty to speak does exist, a materially inaccurate or misleading response to the third party may expose it to liability, particularly where the bank can be found to have benefited from that response.

Keywords: litigation, commercial, business, banks, duty to speak, special circumstances, customers, financial records, disclosure, liability

John P. McCahey is a partner and Alison M.C. Schrag is an associate at Hahn & Hessen LLP in New York City, New York.