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Michigan Statute of Frauds: Prohibition of Oral Settlement Agreements

Introduction

A Borrower executed a Promissory Note ("Note") in favor of a Bank. Borrower subsequently defaulted on the Note. Later, borrower and Bank entered into settlement negotiations and Borrower and Bank's workout officer agreed to a settlement of the Note for a reduced amount. The Officer agreed to suspend all collection activities on the Note until Bank's outside counsel presented a formal written settlement agreement to Borrower. Borrower reasonably relied upon this oral agreement. However, Bank's outside counsel never prepared or presented the written version of the settlement agreement to Borrower. Subsequently, Bank sold the Note, as part of a package of defaulted notes, to Buyer. Buyer now sued to enforce the Note. Buyer's status as Holder in the course is assumed.

Short Question

1. Is the Buyer bound by the post-default oral settlement agreement made by the Bank's workout officer?

Short Answer

1. No. The Buyer is not bound by the post-default oral settlement agreement made by the Bank's workout officer.

Discussion

I. The Lender Liability Amendment to the Michigan Statute of Frauds Prohibits the Borrower from Taking Any Action against the Buyer

The lender liability amendment to the Michigan statute of frauds took effect on January 1, 1993 and is codified in MCL § 566.132 (2)-(3) which states in its relevant part:

> "(2) An action shall not be brought against a financial institution to enforce any of the following promises or commitments of the financial institution unless the promise or commitment is in writing and signed with an authorized signature by the financial institution:
> (a) A promise or commitment to lend money, grant or extend credit, or make any other financial accommodation.
> (b) A promise or commitment to renew, extend, modify, or permit a delay in repayment or performance of a loan, extension of credit, or other financial accommodation.
> (c) A promise or commitment to waive a provision of a loan, extension of credit, or other financial accommodation.
> (3) As used in subsection (2), "financial institution" means a state or national chartered bank, a state or federal chartered savings bank or savings and loan association, a state or federal chartered credit union, a person licensed or registered under the mortgage brokers, lenders, and servicers licensing act, Act No. 173 of the Public Acts of 1987, being sections 445.1651 to 445.1683 of the Michigan Compiled Laws, or Act No. 125 of the Public Acts of 1981, being sections 493.51 to 493.81 of the Michigan Compiled Laws, or an affiliate or subsidiary thereof."

MCL 566.132(2) expressly states that "an action shall not be brought against a financial institution to enforce [a promise or commitment to waive a provision of a loan] unless the promise or commitment is in writing and signed with an authorized signature by the financial institution." *Crown Tech. Park v. D&N Bank, F.S.B.*, 242 Mich. App. 538, 550 (Mich. Ct. App. 2000). This language is unambiguous. *Id.* It plainly states that a party is precluded from bringing a claim--no matter its label--against a financial institution to enforce the terms of an oral promise to waive a loan provision. *Id.*

The statute of frauds specifically bars "an action." *Crown Tech. Park*, 242 Mich. App. at 550. By not specifying what sort of "action" MCL 566.132(2) prohibits, there is an unqualified and broad ban. *Id.* The subsections of MCL 566.132(2) use generic and encompassing terms to describe the types of promises or commitments that the statute of frauds now protects absolutely. *Id.* This is consistent with interpreting MCL 566.132(2) to

preclude all actions for the enumerated promises and commitments, including actions for promissory estoppel. *Id*. Further, it would make absolutely no sense to conclude that the Legislature enacted a new section of the statute of frauds specifically addressing oral agreements by financial institutions but, nevertheless, the Legislature still intended to allow promissory estoppel to exist as a cause of action for those same oral agreements. *Id*. The Legislature used the broadest possible language in MCL 566.132(2) to protect financial institutions by not specifying the types of "actions" it prohibits, eliminating the possibility of creative pleading to avoid the ban. *Id*. at 551.

In *Crown Technology case*, Plaintiff Crown Technology, a partnership firm formed in 1985 to construct and own an office building in Warren, Michigan sued defendant D& N Bank ("D& N"), a lending institution incorporated in Michigan, for promissory estoppel and negligence, alleging that defendant refused to honor an oral agreement that a promissory note could have been pre-paid with no penalty. *Crown Tech. Park*, 242 Mich. App. at 540-543. In 1987, D& N loaned Crown Technology $720,000 to refinance the Warren office building and secured this loan with a mortgage on the property. *Id*. at 541. In conjunction with the refinancing agreement, the parties executed a promissory note containing a prepayment penalty clause. *Id*. Later in 1994, Crown Technology wanted to repay its original loan from D& N, and therefore, inquired with a commercial loan officer for D&N whether "there was going to be any problem with paying off the loan early" in the event Crown Technology sought refinancing elsewhere. *Id.* at 543. At that time, the commercial loan officer informed counsel for Crown Technology that there would be no problem with paying off the loan and there would be no prepayment penalty. *Id.* Relying on this, on June 28, 1994, Crown Technology and GE Leasing signed a lease, and in September of 1994, Crown Technology's counsel contacted D& N and requested an early payoff by September 15. *Id.* at 544. However, D& N demanded prepayment penalty. *Id.* at 544-546.

In *Crown Technology*, the trial court accepted one of the main contentions of the plaintiff Crown Technology that MCL 566.132 does not bar a promissory estoppel claim. *Id.* at 548. However, the Court of Appeals reversed and found that Crown Technology's argument that MCL 566.132(2) does not eliminate promissory estoppel as a cause of action for an unfulfilled oral promise to waive a loan term is unpersuasive. *Id.* at 550. In *Crown*, the Appellate Court also disagreed with Crown Technology's argument that "legislative acquiescence" preserved promissory estoppel as a permissible form of action to enforce an unwritten promise or commitment by a financial institution because MCL 566.132(2) banned *any* action. *Id.* at 551-552. Further, the Appellate court stated that there was no evidence whatsoever to suggest that by failing to enact separate lender liability legislation, the Legislature intended to preserve promissory estoppel as a viable form of action against financial institutions to enforce oral loan modifications. *Id.* at 552. As a result, the Court of Appeals held that promissory estoppel relief was improperly granted by the trial court, and therefore, reversed the judgment. *Id.* at 554.

In the instant case, although the Borrower and Bank's workout officer agreed to a settlement of the Promissory Note for a reduced amount and agreed to suspend all collection activities on the Note until Bank's outside counsel presented a formal written settlement agreement to Borrower, nothing was put in writing. There was only an oral promise on the part of the Bank's official. Bank's outside counsel never prepared or presented the written version of the settlement agreement to Borrower. Therefore, pursuant to MCL § 566.132 (2), which mandates the financial institution's promise or commitment to be in writing and signed with an authorized signature by the financial institution to bring an action against the institution, the Buyer is not bound by the post-default oral settlement agreement made by the Bank's workout officer.

Moreover, the defense of promissory estoppel cannot be used in an action to collect on the note. *Cadle Co. II v. P.M. Group*, 2007 Mich. App. LEXIS 2468 (Mich. Ct. App. 2007) (Unpublished). In *Cadle*, plaintiff Cadle Co. brought an action to collect on a note that defendant personally guaranteed. The loan had originally been made by Fifth Third Bank, plaintiff's predecessor in interest. Fifth Third Bank then assigned its right to collect on the note to plaintiff. In defense of the collection action, defendant argued that Fifth Third Bank waived or modified the provision in the guaranty specifying that it extended to all future debts.

In rejecting this argument, the Court of Appeals held that the alleged modification or waiver of the guaranty was unenforceable under Michigan's statute of frauds, MCL 566.132. *Cadle Co. II*, 2007 Mich. App. LEXIS 2468. The Court noted that the guaranty was part of a financial accommodation between Fifth Third Bank, plaintiff's predecessor in interest, and P.M. Group. As such, it falls within the meaning of MCL 566.132(2). Accordingly, any modification or waiver of the guaranty is not enforceable unless it is in writing and signed by an authorized representative of Fifth Third Bank. Because it was undisputed that no authorized representative of Fifth Third Bank signed a modification or waiver, the alleged agreement to modify or waive the guaranty was unenforceable under MCL 566.132(2) and could not be used as a defense to the action brought by Cadle Co.