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Bank of America v. C.D. Smith Motor Company, Inc.

106 S.W.3d 425 (Ark. Sup. Ct. 2003)

This case may be of particular interest to leasing companies involved in broker-funder relationships. In this case, C.D. Smith Motor Co., Inc. ("Originator") was a used-car dealer who established a recourse-financing relationship with Bank of America and its predecessor banks ("Funder"). Originator sold approximately seventy percent of its cars through financing and assigned approximately thirty-five percent of that loan paper, with recourse, to Funder. Under this arrangement, Originator was required to repurchase any loans that were more than ninety days past due.

Over the years, Originator and Funder developed various procedures that governed their relationship. One such procedure was that Funder would attempt to collect on accounts that were less than sixty days delinquent. Funder would also: (1) provide a list to Originator of any such accounts so that Originator could assist in collection and could ready itself for any required repurchase; and (2) provide Originator with a list of any bankruptcy filings by the delinquent debtors so that Originator could file a proof of claim with the bankruptcy court.

Funder notified Originator that it would no longer purchase any accounts from Originator and that it would not longer provide any of the lists mentioned above. Originator was unable to obtain financing from other lenders and eventually went out of business. Originator then sued Funder for breach of contract and the trial court granted it over one million dollars for consequential damages stemming from the breach. It should be noted that nothing in the court's decision indicates whether the underlying agreements required Funder to finance certain of Originator's loans or whether such decisions where discretionary to Funder. If there had been explicit language in the underlying agreement which provided that nothing therein constituted a commitment by Funder to lend any money to, or accept any assignments from, Originator, such language would likely have been very helpful in limiting the type of breach that Originator could claim.

Funder appealed to the Arkansas Supreme Court, arguing three main points: (1) that evidence of the parties previous course of dealing should not have been admitted; (2) that Funder did not agree to be liable for consequential damages caused by a breach; and (3) that Originator did not prove any damages stemmed from the breach.

The Court first held that the evidence that Funder used to provide certain assistance with collection and certain lists to Originator was admissible under sections 1-205 and 2-202 of the Uniform Commercial Code since it constituted a "sequence of conduct" which could "fairly . . . be regarded as establishing a common basis of understanding." It is noteworthy that the Court allowed admission of this evidence notwithstanding a standard merger clause that stated that the written agreement contained all of the terms and that no other statement or agreement shall have any force or effect.

Then, the Court addressed Funder's argument with respect to consequential damages, defining them as "those damages that do not flow directly and immediately from the breach, but only from some of the consequences or results of the breach." In this case, Originator was awarded over one million dollars for lost profits and the loss of its business. The Court articulated a two-prong test that the Originator satisfied in order to recover such damages. First, the Originator produced evidence that Funder had actual knowledge that Originator "would look to [Funder] for compensation if [its] business was destroyed."

Next, Originator produced evidence that Funder tacitly agreed to pay consequential damages by signing the agreement *after* Funder conveyed the foregoing point.

Once again, Funder tried to escape liability by pointing to the merger clause. However, the Court noted that merger clauses only prevent extraneous evidence that alters, varies or contradicts the written contract. In this case, the recourse financing agreement was silent on the issue of consequential damages and the oral evidence with therefore admissible. *Funders should consider adding a limitation of liability clause to their broker agreements whereby the parties to the agreements explicitly waive consequential damages.*

Lastly, the Court rejected Funder's third argument, that Originator failed to prove any damages resulted from the default, and held that Originator introduced sufficient evidence indicating that the Originator's profits declined drastically after Funder's breach.