A New Tenant Remedy: Lender Liability For Structural Defects

I. INTRODUCTION

The California Supreme Court, in its 1968 decision of *Connor v. Great Western Savings and Loan Association,*[1] has established that a lender of money is liable to parties injured by the negligent use of loaned money where, in lending money, its financing takes on "ramifications beyond the domain of the usual money lender." Many articles have been written in analysis of the *Great Western* case. Some have solely noted the holding in the case,[3] while others have discussed its probable impact on and possible ramifications to the lending industry.[4] None of the published articles to date, however, have considered whether the *Great Western* holding can be extended so as to justify a remedy to a lessee against a lender of money for damages suffered as a result of lender-financed, poorly constructed leasehold property. It is the purpose of this paper to explore that possible extension.

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[1]69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968).

[2]*Id.* at 864, 447 P.2d at 616.

[3]*See* 37 U. CHI. L. REV. 219 (1968); 56 GEO. L. J. 788 (1968); 73 DICK. L. REV. 730 (1969); 6 HOUSTON L. REV. 730 (1969); 44 N.Y.U. L. REV. 639 (1969); 10 WM. & MARY L. REV. 1000 (1969).

[4]*See* Comment, *Liability of the Institutional Lender for Structural Defects in New Housing,* 35 U. CHI L. REV. 739 (1968); Comment, *The Expanding Scope of Enterprise Liability,* 69 COLUM. L. REV. 1084 (1969); Comment, *New Liability in Construction Lending: Implications of Connor v. Great Western Sav. & Loan Ass'n.* 42 S. CAL. L. REV. 353 (1969); Note, 47 NO. CAROLINA L. REV. 989 (1969).

In order to say that a tenant remedy does exist against a lender for the negligent use of loaned money two conclusions must be reached. First, it must be established that the lender was negligent[5] in its lending practices and thereby responsible for the proximate results thereof. And secondly, it must then be shown that the lender was responsible to the individual plaintiff for its negligence because it violated a duty of care owed to him.[6] Note that the first conclusion is that the lender committed a negligent act and questions the desired limit of a general lender liability, while the second assumes the existence of a general lender liability and then asks whether, as a matter of policy, the lender owed a legal duty to the particular lessee.

It is the conclusion of this study that a tenant remedy against a lender of money already does exist but that it is an extremely limited one. As a matter of general policy, lender liability is limited to the rare situations where the lender has acted beyond the scope of normal lender activities, for only then will a lender be held responsible to the tenants who can show that they have suffered injuries proximately resulting from the negligent use of loaned money.

II. THE CONCEPT OF LENDER LIABILITY

A. THE HOLDING IN THE *GREAT WESTERN* CASE

Connor v. Great Western Savings and Loan Association[7] is the landmark case in the field of lender liability. No case in California, or in the nation, prior to this decision had seen a court question the existence of an *independent* lender liability for damages sustained by misuse of loaned money.[8] For a case of first impression, however, the factual deck of cards was stacked heavily against the lending institution. Great Western Savings and Loan Association (hereinafter Great

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[5]"One is not 'negligent' unless he fails to exercise that degree of reasonable care that would be exercised by person [*sic*] of ordinary prudence under all the existing circumstances in view of the probable danger of injury." BLACK'S LAW DICTIONARY 1187 (4th ed. rev. 1968).

[6]"[D]uty is a question of whether the defendant is under any obligation for the benefit of the particular plaintiff; and in negligence cases, the duty is always the same, to conform to the legal standard of reasonable conduct in the light of the apparent risk. What the defendant must do, or must not do, is a question of the standard of conduct required to satisfy the duty. The distinction is one of convenience only, and it must be remembered that the two are corelative, and one cannot exist without the other." W. PROSSER, THE LAW OF TORTS 331 (3d ed. 1964).

[7]69 Cal. 2d 850, 447 P. 2d 609, 73 Cal. Rptr. 369 (1968).

[8]*See id.* at 868, 447 P.2d at 619.

Western) was found financing a proposed 2,000 home subdivision that was controlled by inexperienced developers operating through a thinly capitalized development company.[9] In addition, the lending institution was intimately involved in the transactions between the developers and the purchasers of homes.

Initially, Great Western provided the funds needed to purchase the land to be developed by actually acquiring title to the property,[10] a land purchase arrangement commonly known as "land warehousing."[11] The land was later sold to the developers at a 20 percent capital gain. Once the land purchase agreement had been completed, Great Western further negotiated with the developers to furnish them with needed house construction loans. It thereupon agreed to provide the requisite funding only if the following conditions were met: (1) a specified number of houses were to be reserved in advance by buyers; (2) Great Western was to have the right of first refusal on all construction loans; (3) the developers were to pay Great Western the fees and interest obtained by the underwriters of any other construction loans; and (4) the development company was to pay Great Western a one percent fee for construction loans made to qualified buyers and a one and one-half percent fee for loans made to buyers who, in Great Western's opinion, were poor risks.

In addition to the "unusual" financial involvement of Great Western,[12] the lender further deviated from its normal lending policies in its approval of the individual home construction blueprints. "Great Western departed from its normal procedure of reviewing and approving plans and specifications before making a commitment to provide construction funds. It did not examine the foundation plans

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[9]Estimated future profits represented 64/65ths of the total purported capital assets of the company prior to the financing agreement. *Id.* at 860, 447 P.2d at 613.

[10]CAL. FIN. CODE § 1155 (West 1954) at the time of the Great Western financing agreement prohibited savings and loan associations from making loans upon the security of unimproved real property in excess of 33 1/3 percent of the appraised value of such real property. Amended effective June 28, 1961, this section now prohibits such loans in excess of 70 percent of the appraised value (Stats. 1961 ch. 871 § 15 p. 2288, Stats. 1961 ch. 885 § 4 p. 2322).

[11]Land warehousing is a financing arrangement whereby a lending institution purchases property desired by the borrower by acquiring title thereto and later "selling" it to the borrower for a profit. It is a method of financing used by saving and loan associations to avoid the limitations in CAL. FIN. CODE § 1155 (West 1954). Note that CAL. FIN. CODE § 6705 (West 1954) permits savings and loan associations to invest in real property only so long as the aggregate of that type of investment does not surpass 5 percent of its total assets or an amount equal to the sum of its capital, surplus, undivided profits, loan reserve, federal insurance reserve, and other such reserves as may be prescribed by the California Savings & Loan Commissioner. WEST. CAL. FIN. CODE § 6705 (West 1954).

[12]*See* 69 Cal.2d at 864, 447 P.2d at 616 (1968).

and did not make any recommendations as to the design or construction of the houses. It was preoccupied with selling prices and sales."[13] Consequently, Great Western failed to detect that the slab foundation design of the homes was ill-adapted to the expansive adobe soil conditions on the construction site.

Thus, it was through Great Western's generous financing that the developers were first able to purchase the land they hoped to develop and then were able to engage in individual home construction.[14] It was not until two years after the financing and home construction was completed that the expansion and contraction of the adobe soil finally cracked the foundations of the homes causing the extensive damage which prompted this suit. Therein, the aggrieved homeowners sought relief not only from the then heavily indebted developers but also from the lender, Great Western. Specifically, as against Great Western, the homeowners sought relief on a theory of joint venture between the lender and the developers as well as on a theory of breach of an independent duty owed by Great Western to plaintiff home buyers. In response to this dual contention the California Supreme Court reversed a lower court judgment of nonsuit and ruled that Great Western was liable to the plaintiff on the theory of breach of an independent duty, but denied the existence of a joint venture.

It is important to note that the court had to reach two conclusions to find Great Western liable to plaintiff home buyers. It first had to establish that the lender was negligent in its lending practices and responsible for the proximate results thereof. It then had to establish that the lender was responsible to plaintiffs for its negligence because it had violated a duty of care owed specifically to them.

As to the *first conclusion* that Great Western was culpably negligent in its lending of money, two factors appear to have most influenced the decision of the court. One was the general observation that "Great Western became much more than a lender content to lend money at interest on the security of real property. It became an active participant in a home construction enterprise."[15] More specifically, (1) its financing "took on ramifications beyond the domain of the usual money lender"[16] in that as a lender it received substantial fees from interest on construction loans, it realized a 20 percent capital gain by land warehousing, plus it had guaranteed protection against loss of profits if home buyers sought financing elsewhere;

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[13]*Id.* at 860, 447 P.2d at 614.

[14]Most of the home buyers applied to Great Western for mortgage construction loans. *Id.*

[15]*Id.* at 864, 447 P.2d at 616.

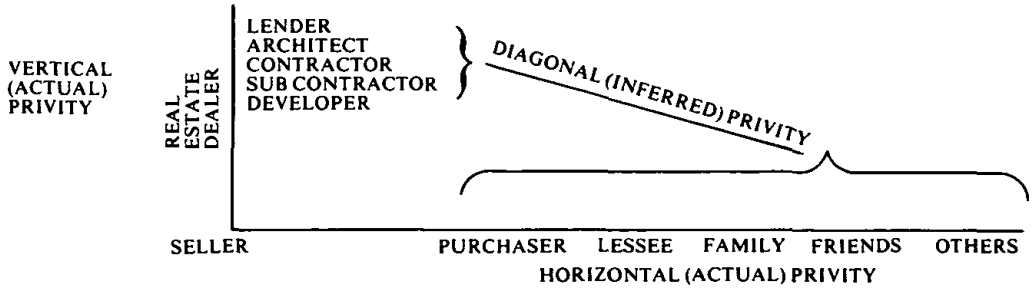
[16]*Id.*

and (2) "[i]t had the right to exercise extensive control of the enterprise"[17] in that no construction would begin until a specified number of loans had been received, control was levied over the price of the loans, and it was guaranteed the right of first refusal on loans whereby, once that option was successfully exercised, it could regulate the speed of construction. A second factor was that since the lender knew that undercapitalized, inexperienced developers controlled the development of the project, it therefore should have been aware of the possibility of faulty construction resulting from "cutting corners." Knowing this possibility, the court held that Great Western should then have closely examined all stages of the home construction and thereby have learned of the condition of the construction site soil and, in due course, uncovered the gross structural defect in the house foundation plans.

Once ruling that Great Western *should* be liable for its own negligence the court then reached its *second conclusion,* that Great Western also owed a duty of care to the plaintiff home buyers which had been violated by its negligent approval of the construction plans. It reached this conclusion by applying the basic test for determining the existence of a duty where, as here, no "actual" privity of contract[18] existed between plaintiffs and defendants, as set forth in the

[17] *Id.*

[18] In Ezer, *The Impact of the Uniform Commercial Code on the California Law of Sales Warranties,* 8 U.C.L.A. L. REV. 281, 323 (1961) it is noted that there are two types of "actual privity"—"vertical privity" and "horizontal privity"— and one type of inferred privity—"diagonal privity." Therein, the author observes that "[v]ertical privity, the least important of the three, lies within the marketing chain. It involves a reseller, usually the retailer, seeking to recover on his own account from a manufacturer protected by a phalanx of intervening middlemen. Horizontal privity, so denominated because it does not involve clambering up the market chain, arises only after all resales have been completed and one reaches a flat plane spreading outward from the last purchaser. Here, the party ultimately injured is not the consumer but a third party—a relative, friend, employee, or tenant, for example—who is seeking to circumvent the buyer and reach the last reseller. Finally, and most important, there is diagonal privity, involving suits by either the buyer or a beneficiary of his questionable largess attempting to reach not the immediate seller but some higher link in the marketing chain. . . ." *Id.* Altering the graphical description given by the author in illustrating the different types of privity to meet the purchaser verses lender situation in Great Western, the description of the three types of privity is expressed in the following chart:



California Supreme Court case of *Biakanja v. Irving.*[19] There the court declared:

> The determination whether in a specific case the defendant will be held liable to a third person not in [actual] privity is a matter of policy and involves the balancing of various factors, among which are [1] the extent to which the transaction was intended to affect the plaintiff, [2] its foreseeability of harm to him, [3] the degree of certainty that the plaintiff suffered injury, [4] the closeness of the connection between the defendant's conduct and the injury suffered, [5] the moral blame attached to the defendant's conduct, and [6] the policy of preventing future harm.[20]

Applying the *Biakanja* test, the *Great Western* court concluded that a duty of care did exist between Great Western and the homeowners and that it had been violated by Great Western's failure to uncover the structural defects in the foundation plans. The court declared that the transactions between the lender and the developers, which had made the home construction possible, were intended to significantly affect the home buyers and that the defects in that construction forseeably and proximately caused the actual damages claimed by the home buyers. The court also ruled that considering the magnitude of the investments made by the home buyers and the small cost to financiers to detect structural faults and that considering the inability of the usual home buyer to detect such faults, "[s]ubstantial moral blame attaches to Great Western's conduct"[21] such that "[t]he admonitory policy of the law of torts calls for the imposition of liability on Great Western for its conduct in this case."[22]

B. THE AFTERMATH OF *GREAT WESTERN*

The attorneys for Great Western were unquestionably correct when they contended in Great Western's unsuccessful petition to the California Supreme Court for rehearing that "[t]he majority decision creates more questions and uncertainties than it resolves."[23] The validity of this claim stems from the court's failure to provide in

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Note that the issue in Great Western is whether a duty of care, or "inferred privity", existed between the home purchasers and the lender. The issue to be considered later (Section II, B *infra*) is whether a duty of care exists between a lessee and a lender, or, in other words, whether a horizontal privity is inferred between the two.

[19]49 Cal. 2d 647, 320 P.2d 16 (1958).

[20]*Id.* at 650, 320 P.2d at 19.

[21]69 Cal. 2d 867, 447 P.2d 618 (1968).

[22]*Id.*

[23]Petitioner's Brief for Rehearing at 10, Connor v. Great Western Savings and Loan Association, 69 Cal. 2d 850 (1968).

its opinion a clear measuring stick to decide under what circumstances in the future a lender will be held liable for the use of its financing. It stated only that because Great Western engaged in abnormal lending practices it should be responsible for the proximate results of its negligent home construction financing.

A close analysis of the majority opinion discloses that the following questions are left unanswered: (1) What are the normal activities of a lender of money? (2) How much more financially involved than the "normal lender" must he be before being held liable? (3) Are different types of lenders (*e.g.*, savings and loan associations, commercial banks, mutual banks, insurance companies) held responsible to the same standard of activity? This section will analyze the responses of courts and the California legislature in the aftermath of the *Great Western* case in their struggle with these questions.

1. THE JUDICIAL RESPONSE

The California Court of Appeals, Second District, was the first court since the *Great Western* decision (and the only other court to date) to consider whether a lender should be held liable for the misuse of loaned funds.

In the case of *Bradler v. Craig*[24] the Second District unanimously held that the activities of a Santa Barbara savings and loan association were those "of the usual and ordinary construction and purchase money lender, content to lend money at interest on the security of real property,"[25] and that it therefore should not be held liable for injuries caused to homeowners by lender-financed, faulty construction.

The factual setting of this case bore a fundamental similarity to that in *Great Western.* As in *Great Western,* the lender, a savings and loan association, was financing the purchase and development of subdivision property; the lender authorized construction loans for the construction of the subdivision homes and approved their plans and specifications as well as the finished product; and, due to improper construction on adobe soil, severe structural damage to the foundations of the homes resulted, prompting a suit against the financing savings and loan association.

Unlike in the *Great Western* case, however, in *Bradler* the savings and loan association's financing

> did not take on 'ramifications beyond the domain of the usual money lender.' [*Great Western* cite] Unlike *Connor,* it was not financing the development of a large tract wherein it sought to receive substantial fees for making construction loans. Unlike *Connor,* it did not receive a fee for 'warehousing' the land. Unlike

[24]274 Cal. App. 2d 466, 79 Cal. Rptr. 401 (1969).

[25]*Id.* at 475, 79 Cal. Rptr. at 407.

> *Connor*, it received no guarantee from loss of profits in the event a home buyer sought permanent financing elsewhere. Unlike *Connor*, it was not 'preoccupied with selling prices and sales.' [*Great Western* cite][26]

The subject matter of the above distinction highlights elements of "abnormal lending" which were not found in the ***Bradler*** case. ***Great Western*** tells us that a lender who engages in large scale financing which will yield substantial fees, who warehouses land, who is assured of receiving construction loan profits, ***and*** who is preoccupied only with the sale prices of the financed loans is "more than a lender content to lend money at interest on the security of real property."[27] The ***Bradler*** case simply declares that a lender who does ***not*** engage in such activities acts as "the usual and ordinary construction and purchase money lender, content to lend money at interest on the security of real property."[28] As in the ***Great Western*** case, the ***Bradler*** court does not provide a standard or formula for determining future lender culpability, for it does not tell us how much less than the involvement of the savings and loan association in ***Great Western*** or more than the involvement of the Santa Barbara savings and loan association in the ***Bradler*** case is requisite to establish lender liability.

Though the opinion in ***Bradler*** fails to provide a test for determining lender liability, it does reveal that "[a]pproval of plans and specifications, and periodic inspection of houses during the construction is normal procedure for any construction money lender."[29] The court thus establishes that the mere approval of plans and inspection of construction, absent the activities seen in the above-noted four distinctions, will not impose lender liability in spite of the perhaps negligent approval of plans and inspection of construction by the lender. In other words, the court holds that, as a matter of general policy, lender liability will not be imposed upon a lender engaging in such limited activities.[30]

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[26] *Id.*

[27] 69 Cal. 2d at 864, 447 P.2d at 616 (1968).

[28] 274 Cal. App. 2d at 475, 79 Cal. Rptr. at 407 (1969).

[29] *Id.*

[30] The Bradler court fails to enunciate the distinction between (1) the question of whether a lender committed a negligent act and (2), if so, the question of whether the lender was responsible to the particular plaintiffs. Indeed, if the defendant committed no negligent act the question of whether it owed a duty of care to plaintiffs is moot. The court blurs the distinction by often concluding that the lender committed no negligent act, then needlessly imposing the Biakanja test to determine if a duty existed on the part of the lender. Applying the test it concludes that "under the first Biakanja test [the extent to which the transaction was intended to affect the plaintiff], Santa Barbara's participation was so minimal and restricted that it had no effect on plaintiffs; that as a result, Santa Barbara owed purchasers of the property, including plaintiffs, no legal duty to protect them from damages caused by defects in construction." *Id.* at 476, 79 Cal. Rptr. at 408.

Reviewing the questions left unanswered by the *Great Western* case, the ***Bradler*** case responds to the first question only, that of defining the normal activities of a lender of money, but leaves those of what degree of abnormality need exist for liability and of whether to differentiate between types of lenders unanswered. The one response is a declaration that the Santa Barbara savings and loan association's participation in its underwriting of the construction loans was "that of the usual and ordinary construction and purchase money lender, content to lend money at interest on the security of real property."[31] The Second District in its description of the activities of the Santa Barbara lender declares that they are the activities one would normally expect of a lender. In so doing, the court has held this particular lender up as "the normal lender" against which the activities of future lenders are to be compared.

Though the California Appellate Court had defined the normal activities of a lender of money, courts still had failed to specify the degree of lender involvement required to impose liability for misuse of loaned money. And, as a consequence, concerned lenders pursued legislation to define the limits of their liability.

2. *THE LEGISLATIVE RESPONSE*

In mid-1969, the California Banker's Association, the California Savings and Loan League, and the California Home Builder's Association, through the sponsorship of California State Senator George Deukmejian, introduced the following bill[32] in the California Senate:

> An Act to add Section 3434 to the Civil Code, relating to Creditors.
>
> The people of the State of California do enact as follows:
>
> Section 3434 is added to the Civil Code, to read:
>
> Section 1. *No creditor* shall be liable to any person as a result of making a loan, including any incidental to the making or disbursement of such a loan, for any loss, or damage to any person from the use, or any defect in, any property wholly or partly constructed, modified, acquired, or possessed with the proceeds of such loan, or for any loss or damage to any person from the performance of any service wholly or partly so financed.
>
> Section 2. This act is intended to abrogate the rule set forth in

[31] 274 Cal. App. 2d at 475, 79 Cal. Rptr. at 407 (1969).

[32] S.B. 1301, Cal. Legis., Regular Session (1969). This, as amended, adds CAL. CIV. CODE § 3434 (West 1971).

Connor-Burgess v. Great Western Loan Assn., 69 Adv. Cal. 887.[33]

In this attempt to provide a statutory standard for lender liability, the authors of the bill said they wanted "to let people know who would be liable" for personal injuries or other damages resulting from lender-financed property.[34] In addition, California lenders were concerned because their Supreme Court had failed to find the Great Western Savings and Loan Association liable on what they felt was the proper theory, that of joint venture.[35] Simply, the sponsoring lenders were reacting to the unfavorable holding in *Great Western* and trying to establish via legislative directive that which they had failed to achieve through the courts.

The language of the original, unamended version of S.B.1301 is unreserved. Had the bill been adopted in its initial form, the holding in the *Great Western* case would have been overruled. As a matter of general policy, a lender *never* would be liable for the misuse of loaned money. As stated in the Legislative Counsel's Digest of this proposed legislation, the bill "specifies that no creditor shall be liable to any person as a result of making a loan,"[36] and, moreover, as stated in Section 2 of the bill itself, "[t]his act is intended to abrogate the rule set forth in *Connor-Burgess v. Great Western Savings & Loan Assn.*, 69 Adv. Cal. 887."[37]

Compare now the bill in its final, adopted version:

An Act to add Section 3434 to the Civil Code, relating to Creditors.

The people of the State of California do enact as follows:

A lender who makes a loan of money, the proceeds of which are

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[33]S.B. 1301, as introduced by State Senator George Deukemejian, Cal. Legis., Regular Session (April 8, 1969).

[34]Interview with W. Dean Cannon, Jr., Senior Vice President of the California Savings and Loan League, in Sacramento, Apr. 28, 1970. Note that, in his opinion, the bill does not accomplish this end, as in its amended form it does not define the limits of lender liability.

[35]The lenders felt that Great Western could properly be held liable under a theory of joint venture between it and the developers. In their opinion, the court went out of their way to avoid the joint venture theory and to open a new area of the law. Moreover, they were fearful of the possible ramifications of the case. For example, in what was considered a classic example of potential lender liability by them, they feared that future courts would hold a lender liable as an insurer of its loans such that, say, if General Motors were to receive a loan to develop a new car design that later proved defective, that a lender would be deemed responsible for injuries caused by that defect. The legislation they sought hopefully would prevent such an extension. Interview with Frederick Pownall, California Banker's Association, via telephone in San Francisco, Apr. 23, 1970. *See* Badorek v. General Motors Corp. 12 Cal. App. 3d 447, 90 Cal. Rptr. 305 (1970).

[36]LEGISLATIVE COUNSEL'S DIGEST, S.B. 1301, Cal. Legis., Regular Session (1969).

[37]S.B. 1301 Section 2, Cal. Legis., Regular Session (1969).

> used or may be used by the borrower to finance the design, manufacture, construction, repair, modification or improvement of real or personal property for sale or lease to others, shall not be held liable to third persons for any loss or damage occasioned by any defect in the real or personal property so designed, manufactured, constructed, repaired, modified or improved or for any loss or damage resulting from the failure of the borrower to use due care in the design, manufacture, construction, repair, modification or improvement of such real or personal property, unless such loss or damage is a result of an act of the lender outside the scope of the activities of a lender of money or unless the lender has been a party to misrepresentations with respect to such real or personal property.[38]

A close examination of S.B. 1301, as adopted, suggests that the new CALIFORNIA CIVIL CODE § 3434 it creates is nothing more than a restatement of a "limited version" of the *Great Western* case.[39] Examination of the enacted legislation also shows that the questions left unanswered by *Great Western* and *Bradler* still remain unanswered.

The legislative history of S.B. 1301 tells that the bill led a turbulent and reversive life. From its introduction in the Senate until its final adoption it was radically amended twice in the Senate, once in the Assembly and once in Senate-Assembly conference.

In its initial form the bill stood little chance of adoption, as many members of the legislature did not want to abrogate the ruling in *Great Western.*[40] Simply, the bill was too broad in its attempt to unconditionally absolve all creditors from any liability. Realizing this, its sponsors quickly retreated to the position that they only wanted limited lender liability[41]—*e.g.*, an assurance that the *Great Western* holding could not be expanded and used as a base for extending lend-

[38] *Id.* This adds CAL. CIV. CODE § 3434 (West 1970). [Added by Stats. 1969 Ch. 1584 § 1.]

[39] It is the concensus of those more closely involved with the drafting and amending of the bill that if the Great Western case were to reappear on today's docket that the lender would still be found negligent and liable to the injured home buyers under § 3434. The final legislation does *not* abrogate the Great Western ruling, but seeks to put limits upon its extension. Interview with Edward Levy, Legislative Consultant to Sen. Geo. Deukemejian, via telephone in Sacramento, Jan. 29, 1970; Interview with Frederick Pownall, Cal. Banker's Ass'n., *supra* note 35; Interview with W. Dean Cannon, Jr., Senior Vice President of the Cal. Sav. & Loan Ass'n., *supra* note 34; Interview with Anthony Joseph, Deputy Cal. Atty. Gen., in Sacramento, May 7, 1970.

[40] Specifically, many legislators did not want to reduce the protection granted by the law to homeowners, but, rather, tended to be overly protective towards the consumer. Interview with Edward Levy, Legislative Consultant to Sen. Geo. Deukemejian, *supra* note 39; Interview with W. Dean Cannon, Jr., Senior Vice President of the Cal. Sav. & Loan League, *supra* note 34.

[41] Interview with Anthony Joseph, Deputy Cal. Atty. Gen., *supra* note 39.

er liability. Correspondingly, the bill's first amendment saw an abandonment of the "no lender liability" concept.[42]

In its first amended form, instead of absolving "creditors" in general from all liability, the bill suggested that no "lender" should be liable for the misuse of loaned money unless (1) "any relationship of partnership or joint venture" existed between the lender or the borrower, or (2) the damage alleged "results from a willful act of the lender."[43] Suddenly the bill became an attempt to conform with the *Great Western* holding instead of overruling it. Even Section 2 of the original bill which contained language to unconditionally abrogate the *Great Western* case was amended so that the bill merely overruled "any contrary rule" set forth in *Great Western.* But even the attempt to replace the *Great Western* decision with the language in Section 1, in an effort to make the case inoperative as to determining future lender liability, was unsuccessful as a later amendment[44] eliminated even that mitigated limitation.

With the amendments, vague and undefined language began to appear in the bill. For example, the bill's second amendment saw the addition of a vague limiting clause stating that a lender is not to be held liable "unless the lender has been a party to false representations with respect to such real or personal property." But what is meant by "false representations?" A later amendment saw the phrase changed to "misrepresentations",[45] but that helps the problem of interpretation very little for, as Deputy California Attorney General Tony Joseph has observed, even the authors themselves had little idea what that term meant.[46] The later versions of the bill included similar language which, in final analysis, finds the bill so "watered down" that it creates many of the unanswered questions of interpretation that were left by the *Great Western* case.

It is a fair summary and analysis to observe that S.B. 1301, now enacted as CALIFORNIA CIVIL CODE § 3434, does little more than add to the already present confusion surrounding lender liability. The identical questions left unanswered by the *Great Western* case remain in the wake of this new CIVIL CODE section: (1) What are the normal activities of a lender of money?[47] (2) How much more financially involved than the normal lender must one be before being held liable?

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[42]*Id.*

[43]S.B. 1301, as amended by the Senate, Cal. Legis., Regular Session (May 23, 1969).

[44]S.B. 1301, as amended by the Assembly, Cal. Legis. Regular Session (July 11, 1969).

[45]*Id.*

[46]Interview with Anthony Joseph, Deputy Cal. Atty. Gen., *supra* note 39.

[47]Note that the Bradler case answers this question, *supra* p. 174.

(3) Are all lenders to be held accountable to the same standard of activity? Indeed, the aftermath of *Great Western* is devoid of the certainty as to the limits of lender liability that lenders and consumers alike desire and need to know.

C. LENDER LIABILITY TODAY

As seen in the prior sections, judges and legislators have struggled with the concept of lender liability but have so far failed to provide a reliable test to indicate when future defendant lenders will be held responsible for the negligent use of loaned money. The question involved is one of policy whose specific answer may well already be foreshadowed in the past struggles of jurists and law makers with it. In attempting to assess the present limits of lender responsibility for the money it lends, it is first important to measure the effect that the adoption of CALIFORNIA CIVIL CODE § 3434 had upon the prior case law in the area. Once that is determined, the present status of lender liability may then be evaluated.

The California legislature, in adopting CIVIL CODE § 3434, did not overrule the prior court decisions in the field of lender liability.[48] Rather, the new section supplemented the *Bradler* and *Great Western* opinions, its language having been designed to compliment and codify the case law expressed therein.

Several specific reasons substantiate the conclusion that § 3434 should be construed in light of prior case law, particularly that embodied in the *Great Western* decision. First, Section 2 of the original S.B. 1301, which declared that the new CIVIL CODE section should abrogate the ruling in *Great Western* so as to absolve all lenders from any liability for misuse of loaned money, was first amended by the California legislature so that it applied to "any contrary rule" found in the decision and then, in the adopted version of the bill, removed all together, indicating a desire to compliment and not upset the holding of the case.[49] Second, the legislative history of S.B. 1301 reveals that it was the intent of the legislature in its creation of § 3434 to provide a code provision which affirmed the holding in *Great Western,* though perhaps limiting any extension of the law expressed in that case.[50] And, thirdly, the wording of the final version of S.B. 1301

[48]CAL. CIV. CODE § 3434 was adopted in Aug., 1969, after the Jul., 1969 Bradler decision and the Dec., 1968 Great Western decision.

[49]P. 178 *supra.*

[50]P. 176 *et. seq. supra.*

which became enacted as § 3434 mirrors that of the *Great Western* case, further indicating the desire to codify a limited version of that decision.[51]

Moreover, the California Supreme Court, in analyzing the general effect of CIVIL CODE sections upon prior case law, has long held that unless there is a clear intent to overrule prior court decisions the CODE is to be read with reference to those decisions. The court observed in its 1920 *In re Elizalde's Estate*[52] opinion, for example, that

> [t]he Civil Code was not designed to embody the whole law of private and civil relations, rights, and duties; it is incomplete and partial; and, except in those instances where its language clearly and unequivocally discloses an intention to depart from, alter, or abrogate the common law rule concerning a particular subject-matter, a section of the Code purporting to embody such doctrine or rule will be construed in light of common-law decisions on the same subject.[53]

Thus, it is a fair conclusion that the adoption of § 3434 was an attempt to compliment prior case law and that the language of the statute should be construed in light of that law, rather than as overruling it. The wording of § 3434 as well as the *Bradler* and *Great Western* opinions, then, serve as evidence of the present status of lender liability.

Looking now to the present limits of lender liability, the *Bradler* case defines the normal activities of a lender of money. It was seen above in the analysis of that opinion how a lender who approved construction plans and specifications in addition to making periodic inspections of homes which it had financed, via loans where its only profit was from the simple interest it received on money lent, was not liable for the negligent use of that money. Simply, the acts it engaged in were those of a "normal construction lender." Consistent with the policy suggested in *Great Western*, only those lenders whose financing takes on "ramifications beyond the domain of the usual money lender"[54] should be responsible for the misuse of that financing, so that the *Bradler* lender was ruled not responsible for the negligent use of loaned funds.

Section 3434 apparently echoes the *Bradler* conclusion. Without defining its terms, the section provides that a lender shall be liable for loss or damage occasioned by defects in financed property only if it

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[51]P. 178 *supra*.

[52]182 Cal. 427, 188 P. 560 (1920).

[53]*Id.* at 433, 188 P. at 562.

[54]Connor v. Great Western Savings and Loan Association, 69 Cal.2d at 864, 447 P.2d at 616.

is a "party to misrepresentations with respect to it" or if the inury is "a result of an act of the lender outside the scope of the activities of a lender of money." The latter phase is similar to the language used by the *Bradler* and *Great Western* courts and is, I suggest, identical in meaning.

Once having defined the normal activities of a lender of money, the question arises as to how much more financially involved than the "normal lender" a lender must be to become responsible for negligent use of loaned money. As already discussed,[55] both case law and § 3434 remain silent on this issue. In *Great Western* the California Supreme Court had no occasion to comment on this question, it merely declared that the acts of the particular lender were "*much more*" than those of the normal lender; in *Bradler* the California Appellate Court had occasion only to say that the involvement of the lender there was "*that of*" the normal lender; and in § 3434 the California legislature remained totally silent.

As it is unlikely that the governing CIVIL CODE section will be amended to declare the degree to which a lender can deviate from normal lending practices without incurring liability, as its authors appear unwilling to pursue further legislation to clarify its application and there are no other such interested parties as of date. It appears, then, that the courts will be left to answer this question. In reaching their conclusion, judges should take a "hard line" approach against lending institutions. Any deviation from what was observed above in the *Bradler* decision as the normal lending practices of a construction lender should be viewed as presumptive of lender liability. Clearly, financing through which a lender gains a capital interest in the thing financed should result in the lender being held liable for damages resulting from misuse of the financing. W. Dean Cannon, Jr., Senior Vice President of the California Savings and Loan League, is in agreement with this position. When asked what advice he now gives to lenders since the adoption of § 3434 he replied that "if the bank takes an equity position or seeks to control the quality of the structure then it is exposing itself outside the statute, in my opinion."[56] He further commented that lenders should be aware of their own construction loan policies and if they do anything that they routinely would not do they must bear the liability for defects in the structure.[57]

Thus, while an explanation of where the brink of lender liability

[55]P. 174, 178 *supra.*

[56]Interview with W. Dean Cannon, Jr., Senior Vice President of the Cal. Sav. & Loan League, *supra* note 34.

[57]*Id.*

lies remains unprovided by the legislature, the courts should entertain the position that acts deviating from the norm are presumptive of lender liability, thereby placing the burden of proof on the lender as opposed to the injured consumer.

A further subsidiary aspect of the policy question as to the desired lines of lender liability is whether the activities of all lenders should be measured with respect to the same standard of financing activity. That is, does the lending activity of savings and loan associations, commercial banks, or mutual banks vary and, if so, then should this variance result in different "normal standards of activity" being applied to each. The perhaps surprising, yet apparent, answer here is that the activities of construction lenders are basically the same, irrespective of the type of lending institution. Except for statutory limitations on the amount and type of loans and for interest rates, the procedural loan activities of differing types of lending institutions are identical. And as such, CIVIL CODE § 3434 as well as the *Great Western* and *Bradler* decisions must be deemed to anticipate one "normal lender" and hold all lending institutions accountable to that norm.

Though it has been said that savings and loan associations tend to provide financing for the more undercapitalized land developer at higher interest rates,[58] there is no fundamental difference between the lending policies of a savings and loan association and those of other institutional construction lenders.[59] The main areas of difference are (1) that savings and loan associations have tended to be more liberal in their loan to value ratio[60] than other lenders[61] and as a result have tended to attract inexperienced builders who are unable to obtain loans from commercial banks or insurance companies;[62] and (2) that state and federal statutes place restrictions on savings and loan associations which are not found on commercial banks and insurance companies, resulting in a concentration of association loans in the area of mortgage financing.[63] These individual character-

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[58]*See* Comment, *Liability of the Institutional Lender for Structural Defects in New Housing* 35 UNI. CHI. L. REV. 739, 743-744 (1968); Lefcoe, *Savings Association as Land Developers* 75 YALE L. J. 1271 (1966).

[59]Interview with Howard Hubbard, Executive Vice President of Senator Sav. & Loan Ass'n., in Sacramento, May 7, 1970.

[60]"Loan to value ratio" is defined as "*the amount of money* [loaned] on a first mortgage as a percentage of the *selling price or market value of the property* securing the loan." J. CLAUSON, THE SAVINGS AND LOAN INDUSTRY IN CALIFORNIA XIII-13 (Stanford Research Center 1960).

[61]J. HERZOG, THE DYNAMICS OF LARGE-SCALE HOUSEBUILDING 37 (1963).

[62]Lefcoe, *Savings Associations as Land Developers* 75 YALE L. J. 1271, 1285-86 (1966).

[63]*See* J. GILLIES AND C. CURTIS, INSTITUTIONAL MORTGAGE LENDING IN L.A. COUNTY 34 (Real Estate Research Program, Univ. of Cal. 1956).

istics explain why the loan portfolio of a savings and loan association will differ from that of a commercial lender or insurance company. Again, the differences result from variations in type and character of the loans granted, not in the policy which underlies their issuance.

A practical analysis of lender liability today, then, should find all lenders held responsible to a single norm and declare that any deviation in loan practices from that norm are presumptive of lender liability. As a matter of policy only where a lender has deviated from the norm and has taken an equity position in the property financed will the activities of a lender be held to create a responsibility for injuries resulting from improper use of loaned funds, for only then will it be seen committing a negligent act.

It is important to add at this point, though, that today's lenders rarely deviate from the "normal lending activities" suggested above and therefore rarely will be held responsible for the misuse of loaned money. Perhaps two factors account for this more than anything else. First, in a present era of "tight money" lenders are less likely to become deeply involved in undercapitalized real estate developments. With "loanable" funds scarce and available only at high interest rates there are an abundance of prospective borrowers and lenders can pretty well "pick and choose" among those that they wish to finance. Resultantly, the more fully capitalized, better experienced, and lower risk applicants for available funds are the first (and often only) individuals to receive construction loans. Undercapitalized and inexperienced development companies, like the Conejo Valley Development Company in *Great Western,* would subsequently rarely be in a position to receive funds today. And secondly, even assuming abnormal lender involvement, amendments to local building codes decrease the likelihood that structural errors will be committed for which a lender may be held liable.[64] For example, since 1959, when Great Western was involved in the construction financing of the Conejo Valley Development Company, soil tests have become a prerequisite to obtaining a building permit via local building codes so it is less likely that the type of error in construction seen in *Great Western* will be committed to be attributable to an "abnormal lender".

Thus, only in extremely rare cases will one find the degree of lender involvement requisite to establish liability, and even then the probability of structural defects is being decreased as building code regulations become stricter. As a practical matter, thus, only in rare cases will a lender be held accountable for the misuse of loaned funds. At

[64]Interview with Howard Hubbard, Executive Vice President of Senator Sav. & Loan Ass'n., *supra* note 59.

once the possibility of a remedy against a lender becomes extremely limited.

III. LESSEE V. LENDER

The preceding section focused on the limits of lender liability in terms of "when has a lender committed a negligent act." There it was seen that only in rare cases will a lender be found culpably negligent such that it is held responsible for the misue of its loaned money. In this section it is *assumed* that the lender has committed a negligent act—specifically that it has become so unusually involved in its financing arrangements as to be held responsible for lender-attributable damages resulting from a defect in the financed property. In this section the focus is on what is meant by "lender attributable damages." The particular problem is whether the personal or property damage suffered by a lessee as the result of a defect in a lender-financed building can be classified as "lender attributable", the specific issue being whether a lender has thereby breached a legal duty of care owed to the lessee. Without the presence of such a duty of care owed by lender to lessee any injury to the lessee is "*damnum absque injuria,*" or injury without wrong,[65] leaving the lessee with no remedy against the lender. Note that once a legal duty is found to exist between the lender and the lessee the possibility of recovery by the lessee then is reduced to a question of fact as to whether the breach of that duty was the "proximate cause" of the lessee's injury, and that question is left for the jury.[66]

In a suit by a lessee against a lender there is no express contractual relationship from which to derive a legal duty. In its financing of an apartment house, or any other structure that is leased, the lender has made no promise nor has received any gain from the future lessee of the structure; there is no "privity of contract" between the two. Indeed, any contractual relations that existed from the financing agreement were between the lender and the persons who received the financing, not between the lender and the lessee.

Until the 1958 decision of *Biakanja v. Irving,*[67] California courts

[65]Coleman v. California Yearly Meeting of Friends Church, 27 Cal. App. 2d 579, 81 P.2d 469 (1938).

[66]Fennessey v. Pacific Gas and Electric Company, 20 Cal. 2d 141, 124 P.2d 51 (1942); Jackson v. Utica Light & Power Company, 64 Cal. App. 2d 885, 149 P.2d 748 (1944); Stockwell v. Board of Trustees, 64 Cal. App. 2d 197, 148 P.2d 405 (1944).

[67]49 Cal. 2d 647, 320 P. 2d 16 (1958).

generally held that the only persons who could recover damages on the negligent performance of a contract were those who entered into it.[68] In *Biakanja v. Irving*, however, the California Supreme Court reversed the requirement of contractual privity to establish the existence of a legal duty and held that one may recover for breach of a contract "despite the absence of privity"[69] so long as certain aforementioned[70] policy considerations indicate that defendant should be held liable to the plaintiff. Specifically, recovery will depend upon balancing (1) the extent to which the contractual transaction was intended to affect plaintiff; (2) the foreseeability of harm to plaintiff; (3) a showing that plaintiff suffered actual injury; (4) the closeness of the connection between defendant's conduct and the injury suffered; (5) the moral blame attributable to defendant conduct; and (6) the desirability and policy of preventing future harm.[71] Whether the privity requirement should be shunned in a particular case is a question of policy, then, to be answered by a court by balancing the above six factors.

Subsequent application of the "*Biakanja* tests" have seen the privity requirement often discarded to allow a wide variety of plaintiffs to recover property damages. For example, while not privy to a defendant, a legal duty was found to exist between an architect and a plaintiff seeking damages for personal injuries suffered when she fell down an allegedly negligently designed stairwell.[72] Likewise, a widow was allowed to recover in a wrongful death action against an architect where the following of the architect's plans led to her husband's death.[73] Similarly, the absence of privity did not prevent recovery against a concrete company for negligent inspection of a mixture of concrete,[74] or recovery by beneficiaries under a will against an attorney for negligence in his preparation of the will,[75] or recovery by a lessee against a lessor for personal injuries caused by a defective bathroom fixture in an apartment occupied by defendant.[76]

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[68]Buckley v. Gray, 110 Cal. 339, 42 P. 900 (1895); Bilich v. Barnett, 103 Cal. App. 2d Supp. 921, 229 P.2d 492 (1951); Mickel v. Murphy, 147 Cal. App. 2d 718, 305 P.2d 993 (1957).

[69]49 Cal. 2d 647, 651, 320 P.2d 16, 19 (1958).

[70]P. 172 *supra*.

[71]49 Cal. 2d 647, 650, 320 P.2d 16, 19 (1958).

[72]Montijo v. Swift, 219 Cal. App. 2d 351, 33 Cal. Rptr. 133 (1963).

[73]Mallow v. Tucker, Sadler & Bennett, Architects & Engineers, Inc., 245 Cal. App. 2d 700, 54 Cal. Rptr. 174 (1966).

[74]Walnut Creek Aggregate Co. v. Testing Engineers, Inc., 248 Cal. App. 2d 690, 56 Cal. Rptr. 700 (1967).

[75]Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961).

[76]Rowland v. Christian, 69 Cal. 2d 108, 443 P. 2d 561, 70 Cal. Rptr. 97 (1968).

The recent recognition in California of the possibility of a non-privity, contractually based duty has been accompanied by a continued extension of situations where a duty is ruled to exist where there was no privity between the parties. Consider the following three cases. In 1963, a homeowner was ruled able to recover against a *contractor/seller* for damages from improper construction on filled ground where the homeowner was a *subsequent purchaser* and not privy to the contractor. There the court said ". . . while the house was not constructed with the intention of ownership passing to these particular plaintiffs, [they] are members of the class of prospective home buyers for which [the contractor] admittedly built the dwelling."[77] In 1968, a *homeowner* was declared able to recover from a *subcontractor* for improper construction as a result of failing to detect expansive adobe soil conditions, the court declaring that a duty did exist between the subcontractor and purchaser.[78] And, later in 1968, as closely examined *supra,*[79] in *Connor v. Great Western Savings and Loan Association*[80] a homeowner was able to recover against a *lender* for damages resulting from improper construction on expansive adobe soil. The natural extension of the non-privity exception to the theory of legal duty is obvious: from (1) subsequent purchaser v. builder to (2) purchaser v. sub contractor to (3) purchaser v. lender. The theme of this extension is typically expressed in *De Zemplen v. Home Federal Savings and Loan Association,*[81] involving a savings and loan association which had made false representations to a purchaser as to the condition of an apartment house:

> . . . the defendant must intend that plaintiff rely on the information and the plaintiff must rely on the information to his detriment. *To impose an additional limitation that the parties must be in privity of contract with each other would serve no useful purpose. Indeed, it would release from liability those whose representations are most often believed to be true because not affected by obvious motives of self interest.* (emphasis added)[82]

The trend of the law has clearly been to extend the once traditional concept of legal duty. As demonstrated by the cases cited above, where an economic interest motivates a transaction non-privy parties who are eventually and forseeably affected by the transaction have been allowed recovery against those privy to the transaction. The ex-

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[77]Sabella v. Wisler, 59 Cal. 2d 21, 28, 377 P.2d 889, 27 Cal. Rptr. 689 (1963).

[78]Oakes v. McCarthy Co., 267 Cal. App. 2d 231, 73 Cal. Rptr. 127 (1968).

[79]P. 168 *et. seq. supra.*

[80]69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968).

[81]221 Cal. App. 2d 197, 34 Cal. Rptr. 334 (1963).

[82]*Id.* at 206, 34 Cal. Rptr. at 339.

tension has been a logical one, as courts now look to the purpose of a transaction and include within those to whom the contracting parties are responsible the individuals who the agreement is most likely to affect, regardless of the once traditional and still archaicly ritualistic requirement of privity of contract.

No court to date has had to determine if a duty of care is owed by a lender unusually involved in the financing of a leased building to a lessee injured by a defect in the property. In light of the trend of the law and applying the "tests" set forth in *Biakanja* to determine whether a duty exists where the parties are not privy to one another, a duty of care does exist between lender and lessee such as to support a lessee's cause of action for personal, property, or general damages. The recognition of such a duty is a logical, natural extension of the developing concept of legal duty.

The recognition of such a duty also satisfies all the *Biakanja* requirements for when no privity of contract exists. A lender's agreement to provide funds is intended to significantly affect a lessee as required in the first of the *Biakanja* tests. Just as the lender's transactions in *Great Western*[83] were seen to affect a homeowner residing in a purchased home, they will affect a lessee renting from an owner. If a commercial tenant, the financing will provide the identical place of business to a lessee as to an owner of a building, and if a residential tenant a home is provided in each case. The only difference between the owner and the lessee is the equity interest each has in the financed building. For example, when a building collapses an owner will suffer the same personal injury or general damages[84] and personal property damages as will a lessee except that he also loses the investment he made in the structure. To say that a lessee is not significantly affected by such a collapse merely because he holds no equity interest in the building itself is often a false statement[85] and, moreover, is the result

[83]69 Cal. 2d 850, 866, 447 P.2d 609, 617 (1968).

[84]"General damages" are defined as "such [damages] as the law itself implies or presumes to have accrued from the wrong complained of, for the reason that they are its immediate, direct, and proximate result, or such as necessarily result from the injury, or such as did in fact result from the wrong, directly and proximately, and without reference to the special character, condition or circumstances of the plaintiff." BLACK'S LAW DICTIONARY 468 (4th ed. rev. 1968).

For a residential tenant, moving costs, loss of a low rent contract, and inconvenience are elements of damages. For a commercial tenant loss of good will, loss of profits, and loss of a long term lease are additional elements of general damages.

[85]For the commercial lessee his lease and place of business often are valuable assets to him. Not only is he often assured of a long term low rent lease but much of the "good will" of a business resides in a commonly known place of business. The proximity of a business to a residential section of a community or to a supply of materials is a valuable asset to a business, not to mention the business's location serving as its means of identity. Moreover, the long term commercial tenant may have made

of a failure to appreciate the substantial interest a lessee has in his tenancy.[86]

The injuries a lessee suffers are reasonably foreseeable by a lender when he enters into his financing agreements. It is reasonable to predict, for example, that if an apartment house collapses or is found structurally unsound that the tenant might incur moving expenses, damage to personality, or personal injury; or, if a commercial tenant is involved, that a long term, low rent lease may be lost along with the good will that results from the convenient and familiar location of a business.

Where a lessee is forced to move out of a negligently constructed building or has suffered personal injury or actual damage to personality as a result of a defect in the building it is certain that he has suffered injury.

Where the negligence of a lender by financing a building and controlling its construction is seen as a direct cause of the lessee's injury then the lessee must be granted recovery from the lender. For where it can be said that had the lender exercised reasonable care in its control over the construction of the building it would have uncovered the error that caused the injury, then it has violated a duty of care owed to a lessee.

The *Great Western* case labels the moral blame that attaches to a lender who negligently approves construction plans or negligently supervises the construction of a project and enunciates the policy of preventing future harm. There the court's words apply to a lender-lessee relationship as well as to that of lender-owner. The court said that the lender "failed of its obligation to the buyers, . . . because it was well aware that the usual buyer of a home is ill-equipped with experience or financial means to discern such structural defects [as resulted from defective foundation plans]."[87] The court then sums up its findings as to the liability of a lender for negligent approval of construction plans by declaring that "[t]he admonitory policy of the law of torts calls for the imposition of liability on [the lender] in this case. Rules that tend to discourage misconduct are particularly ap-

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substantial improvements or modifications in the leasehold property to give him a *de jure* equity interest in that property.

[86]In addition to the financial interests of a lessee, there are the psychological aspects of security and well-being that are associated with a decent home. As expressed in THE REPORT OF THE PRESIDENT'S COMMITTEE ON URBAN HOUSING — A DECENT HOME 3 (1969), "[d]ecent housing is essential in helping lower-income families help themselves achieve self fulfillment in a free and democratic society." This principle, arguably, is applicable to all lessees.

[87]69 Cal. 2d 850, 867, 447 P.2d 609, 618 (1968).

propriate when applied to an established industry."[88] The identical policy demands the extension of that liability to the lessee.[89]

IV. CONCLUSION

A tenant remedy against a lender does exist. Where a tenant suffers damages, whether from personal injury, damage to his personality, or general damages in the form of moving expenses or loss of business resulting from having to move out of a convenient place of business due to the structural failure of the building he rents, he may have a cause of action for those damages not only against his landlord and the building's architect, contractor or sub-contractor, but also against the lender who financed the building's construction. To maintain this cause of action against the lender a tenant must first show that the lender in its financing arrangements gained such an equity position in the building as to be held responsible, as a matter of general policy, to assure that the loaned money was not used for faulty construction. Once establishing that the lender's involvement created this general responsibility, the tenant must then show that the lender was negligent in allowing the faulty construction to occur and that he, the lender, thereby violated a duty of care owed to him as lessee, as one who would foreseeably be injured by such lender-attributable negligence.

Present statutory and case law *will* support the tenant's cause of action against a lender. The *Great Western* case, the *Bradler* decision, and CALIFORNIA CIVIL CODE § 3434, in their description of the general limits of a lender's responsibility for loaned funds, hold a lender liable for negligent use of such funds where it deviates from its normal lending practices in its construction financing agreements. And a natural extension of the *Biakanja* tests of the duty of care one owes to those not in privity of contract with him would place the tenant in the same position of the plaintiff homebuyers in *Great West-*

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[88] *Id.*

[89] Moreover, if a remedy is not recognized against the lender an injured lessee, like an injured homeowner, is often left without a remedy. "[T]hose suffering personal injury and property damage from faulty housing construction have often found their products liability remedy inadequate. The culpable land development companies are frequently either insolvent or defunct when building defects are first discovered, leaving aggrieved home purchasers without redress for damages caused by faulty construction." Comment, *Liability of the Institutional Lender for Structural Defects in New Housing* 35 UNI. CHI. L. REV. 739, 740 (1968) (footnotes omitted).

ern, allowing recovery to the tenant against a lender just as was allowed to the home buyer there.

The practical limits of such a remedy, however, find the tenant remedy a limited one. For while a tenant will almost always be in the class of people forseeably to be injured by faulty construction of leasehold property, under the present policies determining lender liability a cautious lender will seldom be in the position where he can be declared responsible for any negligent use of its loaned money. Simply, lenders rarely deviate from their normal lending practices such as to be declared responsible under the tests set forth in *Great Western, Bradler,* and § 3434 for the misuse of loaned funds.

Thus, while a legitimate tenant cause of action theoretically exists today it is sharply limited by the practical restrictions upon a lender's responsibility for the use of its loaned funds. The lender is not an insurer of its loaned funds and, until such a day that it is, will only be legally responsible to those tenants damaged by lender-financed faulty construction in few cases. In such cases, though, where a lender can be seen unusually involved via its financing agreements in the leasehold property, the injured tenant's right to recover for the personal, property, and general damages he suffers from construction defects in that property is clearly established and must be recognized.

Ronald K. Clausen