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# BANKING LAW

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**A**S in previous years, many of the cases included in this Survey focus on litigation arising from insolvencies of financial institutions as the courts continue to interpret and define the rights of the various parties following an insolvency of a financial institution. The cases indicate a willingness on the part of the courts to uphold the broad enforcement powers provided to the regulatory agencies with respect to officers and directors of failed financial institutions. This result is not surprising in light of the broad spectrum of enforcement powers enacted in response to the savings and loan and banking industry crises.

## I. CASE LAW

### A. DIRECTORS' AND OFFICERS' LIABILITY

#### 1. *Duty of Controlling Shareholder and Director*

In *FDIC v. Wheat*<sup>1</sup> the Fifth Circuit broadly construed the bounds of the fiduciary duty of a bank's controlling shareholder and chairman of the board. *Wheat* involves a suit for negligence, breach of fiduciary duty, and breach of contract, brought by the FDIC, acting in its corporate capacity, against Ben Sudderth. Sudderth was the Chairman of the board of directors and majority shareholder of Early Bank, a state chartered financial institution located in Early, Texas. On June 21, 1984, Sudderth entered into negotiations with George Day to sell the bank. Eight days later, Early Bank made a personal, unsecured loan of \$125,000 to Day (Day loan). Day subsequently bought United Traverlars Insurance Company (UT). On November 16, 1984, Day sent the President of UT, Jack Pike, to Early Bank to execute the necessary documentation for a \$126,753.41 loan to UT (UT loan). The sole collateral for the UT loan was the personal guaranty of Pike, whose net worth equaled approximately \$10,000. In addition, the terms of the note explicitly revealed that UT's financial strength was not security for the loan. The cashier's check for the UT loan was processed through the bank's ledger and proof machine on November 21, 1984; however, UT did not cash the

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1. 970 F.2d 124 (5th Cir. 1992).

check until December 17, 1984. The funds were used to pay off the Day loan.

At the time the UT loan was approved, Sudderth presided over the bank's loan committee and received daily loan information from the bank's cashier. As chairman of the board of directors, Sudderth developed the loan procedures and guidelines for the bank. Sudderth also wrote a memorandum to the bank's loan officers regarding the bank's loan policy, which stated in part: "There will be no more unsecured loans made by this Bank without written approval from Ben D. Sudderth, Chairman of the Board."<sup>2</sup> Additionally, Sudderth wrote the Federal Deposit Insurance Corporation (the FDIC) inspectors in October 1984, stating that "every loan (regardless of size) [must] be approved by the Loan Committee" with "[myself] . . . attending all Loan Committee meetings."<sup>3</sup>

The sale of the Early Bank to Day was scheduled to close on November 16, 1984. At Day's request, the closing was postponed until November 20, 1984. Sudderth elected Day and Day's nominees to the bank's Board of Directors and then resigned from the board of directors on November 26, 1984. In October 1985, the FDIC was appointed as receiver for Early Bank and on October 18, 1985, the FDIC, in its receivership capacity, assigned all assets of Early Bank to the FDIC, in its corporate capacity.<sup>4</sup>

In its analysis, the court initially considered whether the statute of limitations had expired before the FDIC brought suit against Sudderth alleging damages proximately caused by Sudderth's negligence, breach of contract, and breach of fiduciary duty in connection with the UT loan transactions. Applying the three year limitation period for tort claims used when the United States is a party,<sup>5</sup> the court held that the limitations period did not begin until the FDIC had constructive knowledge of the cause of action.<sup>6</sup> Early Bank made the UT loan in November 1984 between FDIC and state inspections that occurred in September 1984 and the appointment of the

2. *Id.* at 129 n.11.

3. *Id.* at 129.

4. The FDIC in its receivership capacity has all rights and duties that any other receiver would have in accordance with the laws of the state where the insolvent bank is organized. When the FDIC, as receiver, assigns rights, title, and interest in the assets of the failed institution to the FDIC, in its corporate capacity, then the rights and obligations of the FDIC, in its corporate capacity, are determined by the applicable federal law. 12 U.S.C. §§ 1811-1823 (Supp. II 1990); *FDIC v. Sumner Fin. Corp.*, 602 F.2d 670, 679 (5th Cir. 1979). *See also* *Vernon v. RTC*, 907 F.2d 1101, 1106 (11th Cir. 1990) (FDIC in its corporate capacity has a complete defense against state claims); *FDIC v. Lauterbach*, 626 F.2d 1327, 1330 n. 4 (7th Cir. 1980) (FDIC, as two separate entities, may deal with itself); *FDIC v. Design and Dev., Inc.*, 73 F.R.D. 442, 443 (E.D. Wis. 1977).

5. 28 U.S.C. § 2415(b) (Supp. II 1990).

6. *Wheat*, 970 F.2d at 128. The court held that 28 U.S.C. § 2415 is subject to 28 U.S.C. § 2416, which states:

For the purpose of computing the limitations periods established in § 2415, there shall be excluded all periods during which —

(c) facts material to the right of action are not known and reasonably could not be known by an official of the United States charged with the responsibility to act in the circumstances. . .

28 U.S.C. § 2416(c) (1988).

FDIC as receiver in October 1985. Because the UT loan was made after the most recent regulatory examinations of the bank, but prior to the appointment of the FDIC as receiver, the court reasoned that neither the FDIC nor the state regulatory authority could reasonably have known about the UT loan until October 1985. Thus, the court determined the statute of limitations began to run when the FDIC was appointed receiver in October 1985, and since the FDIC commenced the action in July 1988, the claim was not barred.<sup>7</sup>

Sudderth contended he had no duty with respect to the UT loan because no evidence supported his alleged knowledge of the loan and because he no longer served as director of the Bank when the check was presented for payment. The *Wheat* court cited *Lyman v. Bank of the United States*,<sup>8</sup> *Hoye v. Meek*,<sup>9</sup> and *Seale v. Baker*,<sup>10</sup> and ruled that a fiduciary duty exists if the director knew or should have known about the loan.<sup>11</sup> The court rejected Sudderth's contentions, noting that a director's duty to a Bank has both statutory and common law origins.<sup>12</sup> The statutory duty arises, in part, from the Texas Banking Code of 1943, as amended,<sup>13</sup> (the Banking Code), which provides that prior to taking office, each director takes an oath that he will diligently perform his duties as director.<sup>14</sup> A director's duties include the obligation to "review and approve or disapprove each loan and investment made."<sup>15</sup> The *Wheat* court, citing *Seale*, also noted a director's common law duty to the Bank.<sup>16</sup> The court then considered the facts that Sudderth (i) presided over the loan committee when the UT loan was made, (ii) wrote the loan procedures and guidelines for the Bank, (iii) wrote a memo to the Bank's loan officers directing that no unsecured loans be made by the Bank without his written approval, (iv) wrote the FDIC inspectors that "every loan (regardless of size) [must] be approved by the Loan Committee" with "[myself] . . . attending all Loan Committee meetings,"<sup>17</sup> and

7. *Id.*

8. 53 U.S. (12 How.) 225, 243 (1851).

9. 795 F.2d 893, 896 (10th Cir. 1986).

10. 70 Tex. 283, 289, 7 S.W. 742, 745 (1888).

11. *Wheat*, 970 F.2d at 129.

12. *Id.*

13. TEX. REV. CIV. STAT. ANN. art. 342 (Vernon Supp. 1993).

14. TEX. REV. CIV. STAT. ANN. art. 342-407 (Vernon Supp. 1993).

15. TEX. REV. CIV. STAT. ANN. art. 342-409 (Vernon Supp. 1993).

16. *Wheat*, 970 F.2d at 129. The *Wheat* court set forth the common law existence of a director's duty to the bank as follows:

Directors of banking corporations occupy one of the most important and responsible of all business relations to the general public. By accepting the position, and holding themselves out to the public as such, they assume that they will supervise and give direction to the affairs of the corporation, and impliedly contract with those who deal with it that its affairs shall be conducted with prudence and good faith. They have important duties to perform toward its creditors, customers, and stockholders, all of whom have the right to expect that these duties will be performed with diligence and fidelity, and that the capital of the corporation will thus be protected against misappropriation and diversion from the legitimate purposes of the corporation.

*Seale v. Baker*, 70 Tex. 283, 289, 7 S.W. 742, 744 (1888).

17. *Wheat*, 970 F.2d at 129.

(v) received daily loan information from the cashier. It concluded this to be a sufficient basis for holding that Sudderth knew or should have known about the UT loan and therefore had a fiduciary duty as a matter of law when the UT loan was made.<sup>18</sup> The court relied on the enforcement provisions in the Change in Bank Control Act<sup>19</sup> and held that Sudderth's sale of the Bank and his resignation as a director did not eliminate the FDIC's right to sue him for breach of fiduciary duties.<sup>20</sup>

The court then examined the extent of Sudderth's liability to the FDIC for the breach of these duties. The Banking Code stipulates that "directors . . . of state Banks shall be liable for financial losses sustained . . . to the extent that directors . . . of other corporations are now responsible for such losses in equity and common law."<sup>21</sup> In order to determine the extent of Sudderth's liability pursuant to the provisions of the Banking Code, the court examined the liability of a corporate director for breach of fiduciary duty to the corporation itself pursuant to Texas common law. The court held that Texas common law provides that a director is personally liable for a breach of fiduciary duty only to the entity that he or she represents, not to individual shareholders or creditors of the corporation.<sup>22</sup> Based on these findings, the court held Sudderth liable to the FDIC in its corporate capacity, since it stood in the shoes of the failed Bank.<sup>23</sup> Sudderth asserted that the jury charges given by the court were flawed, contending that the special issues regarding duty should have been excluded and a special issue on the business judgment defense should have been given instead. On review, the court held that the jury charges accurately and completely stated the law.<sup>24</sup>

18. *Id.*

19. Financial Institutions Reform Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, § 905(d), 103 Stat. 460 (codified as amended in 12. U.S.C. § 1828(j)(6) (Supp. II 1990)). Section 905(d) of FIRREA states in relevant part:

The resignation . . . of an institution-affiliated party . . . shall not affect the jurisdiction and authority of the Corporation to . . . proceed under this section against any such party, if such notice is served before the end of the 6-year period beginning on the date such party ceased to be a party with respect to such nonmember bank . . . (whether such date occurs before, on, or after August 9, 1989).

FDIC v. Wheat, 970 F.2d 124, 128 n.8 (5th Cir. 1992).

20. *Wheat*, 970 F.2d at 130.

21. TEX. REV. CIV. STAT. ANN. art. 342-410 (Vernon Supp. 1992).

22. *Wheat*, 970 F.2d at 130.

23. *Id.*

24. *Id.* The jury instructions on fiduciary duty and the business judgment rule were given as follows:

**BREACH OF FIDUCIARY DUTY.** Directors and officers of a bank owe a fiduciary duty to the bank, its shareholders, depositors, and creditors. As fiduciaries, directors and officers have a duty to act with the highest degree of loyalty, trust, and allegiance toward the bank, and with the utmost candor, unselfishness and good faith. Directors and officers of a bank are held to a higher standard of fair-dealing than a person not in a fiduciary position because they are responsible for other people's money. A breach of fiduciary duty consists of any failure of a director or officer to comply with such standards. A director or officer of a bank shall not be held liable if his conduct falls within the business judgment rule, as defined in these instructions.

**BUSINESS JUDGMENT RULE.** You are instructed that a director or officer of a bank shall not be liable for claims against him if, in the discharge of his

Sudderth contended that the FDIC should have tried to mitigate its damages by collecting payment for the UT Loan from the UT and its assets. The court reasoned that although the usual duty of a tort plaintiff to mitigate damages applies in failed bank director and officer cases, based upon the terms of the loan agreement between the bank and the borrower, which provided that UT's financial status was not collateral for the UT loan the FDIC could not assert an action against the insurance company's assets.<sup>25</sup> Therefore, the FDIC did not violate its duty to mitigate damages.<sup>26</sup>

## 2. Negligence Standard

In *FDIC v. Williams*<sup>27</sup> the United States District Court for the Northern District of Texas followed the weight of authority<sup>28</sup> by holding that section 212(k) of FIRREA<sup>29</sup> does not establish a national standard of gross negligence as the threshold for liability for breach of a director's duty.<sup>30</sup> The court relied on *FDIC v. McSweeney*<sup>31</sup> for the proposition that the plain language of the statute does not preempt causes of action for less than gross negligence pursuant to state law.<sup>32</sup> The statute at issue reads as follows:

[A] director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by, on behalf of, or at the request or direction of the [FDIC or RTC], which action is prosecuted wholly or partially for the benefit of the Corporation [FDIC or RTC] . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State Law. Nothing in this paragraph shall impair or affect any right of the [FDIC or RTC] under other applicable law.<sup>33</sup>

A number of courts have reviewed this provision in order to determine whether a national standard of gross negligence for director liability exists

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duties, he exercised ordinary care and acted in good faith and honestly exercised his best business judgment within the limits of the actual authority of his position with the bank.

A director or officer of a bank shall not be held liable for honest mistake of judgment if he acted with due care, in good faith, and in furtherance of a rational business purpose.

*Id.* at n.13.

25. *Id.* at 132.

26. *Id.*

27. 779 F. Supp. 63 (N.D. Tex. 1991).

28. Other cases decided in favor of the government include: *FDIC v. McSweeney*, 976 F.2d 532 (9th Cir. 1992); *FDIC v. Canfield*, 967 F.2d 443 (10th Cir. 1992); *cert. dismissed*, 113 S. Ct. 516 (1992); *FDIC v. Nihiser*, 799 F. Supp. 904 (C.D. Ill. 1992); *FSLIC v. Shelton*, 789 F. Supp. 1360 (M.D. La. 1992); *FDIC v. Miller*, 781 F. Supp. 1271 (N.D. Ill. 1991); *FDIC v. Fay*, 779 F. Supp. 66 (S.D. Tex. 1991); *FDIC v. Burrell*, 779 F. Supp. 998 (S.D. Iowa 1991); *FDIC v. Haddad*, 778 F. Supp. 1559 (S.D. Fla. 1991); *FDIC v. Isham*, 777 F. Supp. 828 (D. Colo. 1991); *FDIC v. Black*, 777 F. Supp. 919 (W.D. Okla. 1991).

29. Pub. L. No. 101-73, 103 Stat. 183 (Aug. 9, 1989) (codified at 12 U.S.C. § 1821(k)).

30. *Williams*, 779 F. Supp. at 64.

31. 772 F. Supp. 1154 (S.D. Cal. 1991).

32. *Williams*, 779 F. Supp. at 64.

33. 12 U.S.C. § 1821(k) (Supp. II 1990).

(thereby preempting state law), or whether directors can be held personally liable under varying state laws for conduct short of gross negligence.<sup>34</sup> The government's position in these cases has been that FIRREA preempts only those state laws that seek to insulate directors from liability for conduct more culpable than gross negligence, and not state laws that would hold the directors liable for lesser conduct.<sup>35</sup> The defendants in these cases have typically argued that FIRREA establishes gross negligence as a minimum national uniform standard of liability, preempting state remedies predicated on a lesser degree of fault.<sup>36</sup> Thus, the defendants argue they cannot be held liable for actions constituting less than gross negligence. This issue continues to be one of the most controversial issues in the area of directors' and officers' liability. To date, the Ninth and Tenth Circuits have ruled in favor of the government's position.<sup>37</sup>

### 3. *Directors' and Officers' Liability Insurance*

The Fifth Circuit examined the right of the FDIC to recover under a directors' and officers' liability insurance policy which provides an exclusion for coverage of claims made against officers and directors by any state or federal official or agency. In *Fidelity & Deposit Co. of Maryland v. Conner*<sup>38</sup> the FDIC appealed a judgment that declared Fidelity & Deposit Company of Maryland (F&D) did not have a duty to provide coverage under a directors' and officers' (D&O) liability insurance policy issued to Northwest Commercial Bank, N.A. (Northwest) for claims by the FDIC against former Bank directors of Northwest.

Northwest purchased a D&O policy from F&D that was in effect January 3, 1986, through April 3, 1987. The policy contained a regulatory exclusion that provided:

[i]t is understood and agreed that the Company shall not be liable to make payment for Loss in connection with any claim made against the Directors and Officers by any State or Federal Official or Agency, including but not limited to the [FDIC] or Federal Savings and Loan Insurance Corporation.<sup>39</sup>

The policy also included an insured versus insured exclusion provision that provided:

[i]t is understood and agreed that the company shall not be liable to make any payment for Loss in connection with any claim made against the Directors and Officers by any other Director or Officer of the Bank/Association or by the Bank/Association, except for a shareholder's derivative action when such action is brought by a shareholder who is neither a Director nor Officer of the Bank/Association nor a

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34. For a list of relevant cases, see *supra*, note 28.

35. See *supra*, note 31.

36. *FDIC v. Canfield*, 967 F.2d 443 (10th Cir. 1992) (en banc.), *aff'g* prior panel, 957 F.2d 786 (10th Cir. 1992), *rev'g* district court, 763 F. Supp. 533 (D. Utah 1991), *petition for cert. filed* 61 USLW 3205 (Sept. 14, 1992) (No. 92-454), *cert. dismissed*, 113 S. Ct. 516 (1992).

37. 976 F.2d 532 (9th Cir. 1992); 967 F.2d 443 (10th Cir. 1992).

38. 973 F.2d 1236 (5th Cir. 1992).

39. *Conner*, 973 F.2d at 1238.

beneficial holder of shares for a Director or Officer of the Bank/Association.<sup>40</sup>

On June 11, 1987, the Office of the Comptroller of the Currency (OCC) closed Northwest and appointed the FDIC as receiver in accordance with 12 U.S.C. section 1821(c).<sup>41</sup> The FDIC, as receiver, then transferred Northwest's assets to itself in its corporate capacity. The assets transferred included Northwest's right to assert claims against its officers and directors for failure to adequately perform their duties as officers and directors. The FDIC filed suit on January 9, 1989 against eight of Northwest's former directors seeking damages in excess of \$2,000,000 for breach of fiduciary duty, negligence, negligence per se, and breach of contract under federal law. On February 1, 1990, Thomas Conner, a defendant director, filed a third party complaint against a number of former directors not named as defendants by the FDIC, alleging that the directors were jointly liable. Most of the defendants notified F&D of the lawsuit and demanded that F&D defend them under the terms of the D&O policy. F&D refused to provide defense for the defendant directors.

On March 17, 1989, F&D filed an action seeking a declaratory judgment, stating that it had no duty to provide coverage under the D&O policy for further claims asserted by the FDIC against Northwest's directors. The FDIC then intervened in the action. The District Court for the Southern District of Texas granted a summary judgment in favor of F&D, holding that the regulatory exclusion is applicable and coverage for the claims asserted by the FDIC are barred.<sup>42</sup> The court also held that the third party claims asserted by Conner were not covered by the D&O policy.<sup>43</sup>

The FDIC asserted on appeal that its suit is a shareholder derivative suit and, to the extent that the regulatory exclusion bars the FDIC from bringing such claims but does not bar shareholders from bringing a claim, the exclusion is invalid as a matter of public policy. The FDIC agreed that the exclusion violated public policy because the FDIC, as receiver, is entitled to "all rights, titles, powers, and privileges"<sup>44</sup> of the shareholders and depositors of Northwest with respect to the assets of Northwest. The court held that the FDIC's action was not derivative for purposes of section 1821(d)(2)(A)(i),<sup>45</sup> Noting that the FDIC did not allege facts meeting the requirement for estab-

40. *Id.*

41. *FDIC v. Wheat*, 970 F.2d 124, 128 n.8 (5th Cir. 1992); *see* 12 U.S.C. § 1821(c) (1988) (notwithstanding any other provision of law, whenever the comptroller of the currency shall appoint a receiver . . . he shall appoint the Corporation receiver for such closed bank").

42. *Connor*, 973 F.2d at 1236.

43. *Id.* at 1239-40.

44. *Id.* at 1239.

45. Section 1821(d)(2)(A)(i) provides that:

The corporation shall, as conservator or receiver, and by operation of law, succeed to —

(i) all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, account holder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution

12 U.S.C. § 1821(d)(2)(A)(i) (Supp. I. 1989).

lishing independent shareholder liability, which is necessary for a shareholder derivative suit. In order to meet this requirement, the FDIC would have had to show that an independent breach of duty by Northwest's officers and directors toward Northwest's depositors or shareholders occurred.<sup>46</sup> Further, the court noted that the FDIC's complaint did not comply with the pleading requirements of Rule 23.1 of the Federal Rules of Civil Procedure.<sup>47</sup> The requirements of Rule 23.1 indicate that a shareholder's or depositor's right to bring a derivative action on behalf of the corporation arises out of an unwillingness on the part of the management of that corporation to bring the claim directly.<sup>48</sup> Thus, the court found that the FDIC's claims against the Bank's directors did not constitute the exercise of shareholder/depositor derivative rights. Instead, the claims were asserted as a subrogee of the Bank.<sup>49</sup>

The FDIC also argued that the D&O policy exclusions deprived the FDIC of its statutory rights under 12 U.S.C. section 1821(d)(2)(A)(i) as subrogee of Northwest or as subrogee of Northwest's shareholders and depositors. In rejecting this argument, the court relied on the plain language contained in the regulatory exclusion and noted that such exclusion "explicitly omits coverage of all of these entities for claims brought by the FDIC."<sup>50</sup> The court reasoned that because Northwest did not have the right to sue its officers and directors pursuant to the regulatory exclusion, the FDIC, in its corporate capacity, also had no right to recover under the insurance policy as subrogee of Northwest.<sup>51</sup>

Finally, the FDIC asserted that enforcement of the regulatory exclusion was against public policy and would "substantially impair the congressional policy" reflected in FIRREA.<sup>52</sup> The court noted that "[a]lthough contractual agreements may be invalidated on grounds of public policy, public policy opens only a narrow exception within this general rule — an exception to

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46. *Connor*, 973 F.2d at 1236; *Commonwealth of Mass. v. Davis*, 140 Tex. 398, 407-08, 168 S.W.2d 216, 221-22 (1942).

47. *Connor*, 973 F.2d at 1240 n.9. Rule 23.1 provides in part:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.

FED. R. CIV. P. 23.1.

48. *Connor*, 973 F.2d at 1240-41.

49. *Id.* at 1241.

50. *Id.* at 1240.

51. *Id.*

52. *Fidelity & Deposit Co. of Md. v. Connor*, 973 F.2d 1236, 1239 (5th Cir. 1992) (citing Brief for FDIC at 2).

be applied cautiously and only in plain cases involving dominant public interests.”<sup>53</sup> In order to determine whether such interests existed, the court reviewed the legislative history of FIRREA and concluded that “Congress intended to remain neutral regarding regulatory exclusions.”<sup>54</sup> In reaching this conclusion, the court relied on a statement made by Senator Garn regarding the enforceability of the regulatory exclusion. Senator Garn stated:

[w]ith respect to Directors’ and Officers’ liability insurance contracts, there has been a substantial split in the decisions relating to the validity of regulatory exclusion clauses that prohibits a regulator from enforcing rights under the contract. It is not the intent of the conferees to influence these decisions or to affect the development of case law or statutory provisions relating to the validity of these clauses and directors’ and officers’ liability insurance contracts or fidelity or indemnity bonds. The intent of the conferees is to remain neutral in these matters.<sup>55</sup>

The court reasoned that in light of the legislative history of FIRREA, no dominant public interest existed, and held that the “FDIC cannot rely upon FIRREA as creating public policy against enforcement of the regulatory exclusion.”<sup>56</sup>

## B. ENFORCEMENT

### 1. Net Worth Maintenance Agreements

In *Akin v. Office of Thrift Supervision Department of Treasury*<sup>57</sup> the Fifth Circuit upheld an order from the Director of the Office of Thrift Supervision (OTS) requiring Akin to pay over \$19 million to restore the net worth deficiency of a failed association, pursuant to the terms of a Net Worth Maintenance Agreement.<sup>58</sup> Akin was the sole shareholder, President, Chief Executive Officer, and Chairman of the Board of TexasBanc Savings Association in Conroe, Texas. He executed a Net Worth Maintenance Agreement with the FSLIC on February 10, 1987, which provided that Akin would maintain TexasBanc Savings Association’s net worth at levels required by applicable regulations.<sup>59</sup> Akin agreed to be personally liable for any net worth deficiency. Further, he agreed that upon notification from the FSLIC of any net worth deficiency, he would infuse capital correcting the deficiency within ninety days of the date of the notice. Beginning in March 1989, the FSLIC and its successor, OTS, issued a series of net worth deficiency notices to Akin. By September 30, 1989, the net worth deficiency totaled \$19,597,000. On November 7, 1989, the OTS brought formal cease and desist proceedings to enforce the Net Worth Maintenance Agreement under 12

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53. *Connor*, 973 F.2d at 1241; see *Twin City Pipe Line Co. v. Harding Glass Co.*, 283 U.S. 353, 356 (1931).

54. *Connor*, 973 F.2d at 1242.

55. *Id.* at 1242-3 n.16 (citing 135 Cong. Rec. S10198 (daily ed. Aug. 4, 1989) (statement of Sen. Garn)); see also H.R. Rep. No. 101-54(I), 101st Cong., 1st Sess. 331, 416-17, reprinted in 1989 U.S.C.C.A.N. 86, 127, 212-13.

56. *Connor*, 973 F.2d at 1242-43.

57. 950 F.2d 1180 (5th Cir. 1992).

58. *Id.* at 1186.

59. See 12 C.F.R. § 563.13 (1986).

U.S.C. section 1818(b)(1).<sup>60</sup> Akin denied any net worth deficiency in a hearing before an administrative law judge on February 7, 1990. On February 23, 1990 the Director of the OTS appointed the Resolution Trust Corporation (RTC) as receiver for TexasBanc Savings Association. On the same day, the judge issued his proposed decision to the directors. This decision found that Akin had breached the Net Worth Maintenance Agreement and recommended that he be required to infuse a sufficient amount of capital to remedy the deficiencies resulting from the breach. On December 24, 1990, the Director of the OTS issued a final decision and a cease and desist order against Akin. The order required Akin to immediately pay \$19,527,000 into the TexasBanc Savings Association receivership. Akin appealed the order, claiming it was unenforceable because it exceeded the cease and desist powers granted to the OTS under 12 U.S.C. section 1818(b)(1). The court noted that 12 U.S.C. section 1818(b)(6) authorizes the director to issue a cease and desist order requiring affirmative action to correct conditions resulting from violations of regulations or written agreements, including the power to seek reimbursement and restitution when a party is unjustly enriched through the violation.<sup>61</sup> The court rejected Akin's argument that the Net Worth Maintenance Agreement was invalid because of lack of consideration.<sup>62</sup> In reaching this decision, the court relied on *Groos Natl. Bank v. Comptroller of the Currency*,<sup>63</sup> in which the Fifth Circuit held that agreements between regula-

60. 12 U.S.C. § 1818(b)(1) provides as follows:

If, in the opinion of the appropriate Federal banking agency, . . . any institution-affiliated party is engaging or has engaged, or the agency has reasonable cause to believe that . . . any institution-affiliated party is about to engage, in an unsafe or unsound practice in conducting the business of such depository institution, or is violating or has violated, or the agency has reasonable cause to believe . . . any institution-affiliated party is about to violate, a law, rule, or regulation, or any condition imposed in writing by the agency in connection with . . . any written agreement entered into with the agency, the agency may issue and serve upon . . . such party a notice of charges in respect thereof . . . [If] upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the . . . institution-affiliated party an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the depository institution or its institution-affiliated parties to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

12 U.S.C. § 1818(b)(1) (Supp. II 1990).

61. 12 U.S.C.A. § 1818(b)(6) provides:

The authority to issue an order under this subsection and subsection (c) of this section which requires an insured depository institution or any institution-affiliated party to take affirmative action to correct any condition resulting from any violation or practice with respect to which such order is issued includes the authority to require such depository institution or such party to —

(A) make restitution or provide reimbursement, indemnification, or guarantee against loss if —

(i) such depository institution or such party was unjustly enriched in connection with such violation or practice . . .

12 U.S.C. § 1818(b)(6) (Supp. II 1990).

62. *Akin*, 950 F.2d at 1186.

63. 573 F.2d 889 (5th Cir. 1978).

tory agencies and financial institutions may be employed to achieve compliance with regulatory schemes<sup>64</sup> and that such agreements pursuant to 18 U.S.C. section 1818(b), notwithstanding the lack of contractual consideration.<sup>65</sup>

The court also rejected Akin's argument that he was not unjustly enriched.<sup>66</sup> The court found that the benefit received by Akin, forbearance from an immediate cease and desist action, as well as the retention of capital that he was obligated to contribute but failed to pay, constituted sufficient unjust enrichment for purposes of section 1818(b)(6)(A)(i).<sup>67</sup> The court noted that the use of section 1818(b) orders to recover monies from bank officers has been upheld when the bank has suffered losses as a consequence of the officer's actions.<sup>68</sup>

In reaching its holding, the court analyzed *Larrimore v. Comptroller of the Currency*,<sup>69</sup> a Seventh Circuit decision which held that the Office of the Comptroller of the Currency's (OCC) cease and desist authority did not extend to requiring reimbursement from bank directors who had authorized loans in violation of lending limits.<sup>70</sup> The court found that *Larrimore* was distinguishable because the OCC had not shown that the directors were aware of the violation and none of the directors had directly benefitted from the violation.<sup>71</sup> More importantly, the court noted that the legislative history of FIRREA indicated that section 1818 was intended to strengthen the agency's regulatory authority in situations involving unsafe or unsound banking practices where an officer was unjustly enriched by a violation.<sup>72</sup> The court also rejected Akin's argument that the cease and desist authority under section 1818 is not viable once an institution is placed in receivership.<sup>73</sup> Citing 12 U.S.C. section 1818(i)(3),<sup>74</sup> the court held that section 1818 is applicable even after an institution is taken into receivership.<sup>75</sup>

64. *Id.* at 896.

65. *Id.*

66. *Akin*, 950 F.2d at 1184.

67. *Akin*, 950 F.2d at 1184.

68. *Id.* (citing *Hoffman v. F.D.I.C.*, 912 F.2d 1172 (9th Cir. 1990); *del Junco v. Conover*, 682 F.2d 1338 (9th Cir. 1982), *cert denied*, 459 U.S. 1146 (1983)).

69. 789 F.2d 1244 (7th Cir. 1986) (en banc).

70. *Id.* at 1256.

71. *Akin*, 950 F.2d at 1184.

72. *Id.* at 1184. 12 U.S.C. § 1818 was specifically enacted to stop challenges against agency authority to seek restitution and reimbursement. See H.R. Rep. No. 54(1), 101st Cong., 1st Sess. 467-68 (1989).

73. *Akin*, 950 F.2d at 1185.

74. 12 U.S.C. § 1818(i)(3) provides as follows:

The resignation, termination of employment or participation, or separation of an institution-affiliated party (including a separation caused by the closing of an insured depository institution) shall not affect the jurisdiction and authority of the appropriate Federal banking agency to issue any notice and proceed under this section against any such party, if such notice is served before the end of the 6-year period beginning on the date such party ceased to be such a party with respect to such depository institution (whether such date occurs before, on, or after August 9, 1989).

12 U.S.C. § 1818(i)(3) (Supp. II 1990).

75. *Akin*, 950 F.2d at 1185.

## 2. Administrative Actions

The U.S. Supreme Court ruled in *Board of Governors of the Federal Reserve System of the United States v. MCorp Financial, Inc.*<sup>76</sup> that the Board of Governors of the Federal Reserve System (Federal Reserve Board) can proceed with administrative actions against MCorp Financial, Inc. (MCorp) for alleged statutory violations.<sup>77</sup> Alleged to have been violated were the Federal Reserve Board's 'source of strength' regulation<sup>78</sup> and section 23A of the Federal Reserve Act.<sup>79</sup> In March 1989, MCorp, a bank holding company, filed voluntary bankruptcy petitions and initiated an adversary proceeding against the Federal Reserve Board in order to enjoin the prosecution of administrative proceedings concerning alleged statutory violations. The district court enjoined both proceedings and the Federal Reserve Board appealed. The court of appeals held that the district court had no jurisdiction to enjoin the section 23A proceeding. The court of appeals relied upon *Leedom v. Kyne*<sup>80</sup> in its determination that the district court had jurisdiction to review the validity of the source of strength regulation. The court of appeals ruled that the Federal Reserve Board exceeded its statutory authority by promulgating and enforcing the source of strength regulation.

The U.S. Supreme Court did not address the validity of the source of strength regulation in its opinion. Instead, the Court decided the case on a jurisdictional basis, relying on the plain language contained in 12 U.S.C., section 1818(i)(1),<sup>81</sup> which states "[E]xcept as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate or set aside any such notice or order."<sup>82</sup> MCorp argued that either the automatic stay provision in the Bankruptcy Code<sup>83</sup> or the provision of the Judicial Code<sup>84</sup> authorizing district courts in bankruptcy proceedings to exercise concurrent jurisdiction over certain civil proceedings authorized the district court to issue its injunction against the Federal Reserve Board's enforcement proceedings. The Supreme Court rejected these arguments, stating that "the Board's actions also fall squarely within section 362(b)(4), which expressly provides that the automatic stay will not reach proceedings to enforce a governmental unit's police or regulatory power."<sup>85</sup>

76. 112 S. Ct. 459 (1991).

77. *Id.* at 463-65.

78. The "source of strength" regulation provides in relevant part: "A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not con[d]uct its operations in an unsafe or unsound manner." *Id.* at 461 n.1 (citing 12 C.F.R. § 225.4(a)(1) (1991)).

79. 12 U.S.C. § 23A. "Section 23A sets forth restrictions on bank holding companies' practices, including restrictions in transactions between subsidiary banks and nonbanking affiliates." *Id.* at n.2 (citing 12 U.S.C. § 371c (1988)).

80. 358 U.S. 184 (1958).

81. *MCorp*, 112 S. Ct. at 463-65; see 12 U.S.C. § 1818(i)(1)(1988).

82. 12 U.S.C. § 1818(i)(1).

83. 11 U.S.C. § 362 (1988).

84. 28 U.S.C. § 1334(b) (1988).

85. *MCorp*, 112 S. Ct. at 464. Section 362(b)(4) provides:

MCorp also claimed that sections 362(a)(3) and 362(a)(6) of the Bankruptcy Code provide a basis for the district court's ruling. These sections of the Bankruptcy Code stay any act done in order to obtain possession of, or exercise control over, property of the estate, or to recover claims against the debtor that arose prior to the filing of the bankruptcy petition.<sup>86</sup> MCorp asserted that the Federal Reserve Board's goal in enforcing the source of strength regulation is to exercise control of corporate assets and that the section 23A proceeding seeks enforcement of a prepetition claim. The Supreme Court rejected these arguments, noting that a final order affecting the Bankruptcy Court's control over the property of the estate had not been entered.<sup>87</sup> The Court reasoned that the mere possibility that such an order may be entered in the future is not sufficient to justify the operation of the stay against an enforcement proceeding that is expressly exempted by 11 U.S.C. section 362(b)(4).<sup>88</sup> The Court said that "[t]o adopt such a characterization of enforcement proceedings would be to render section 362(b)(4)'s exception almost meaningless."<sup>89</sup> The Court also noted that it may be proper for the Bankruptcy Court to exercise its concurrent jurisdiction under 28 U.S.C. section 1334(b) at such time as the Federal Reserve Board's proceedings culminate in a final order, if the judicial proceedings are commenced to enforce such an order.<sup>90</sup>

MCorp also argued that the district court's ruling was valid based upon 28 U.S.C. section 1334(b). This section provides that the district court may exercise concurrent jurisdiction over certain bankruptcy-related civil proceedings that would otherwise be subject to the exclusive jurisdiction of another court.<sup>91</sup> The Court rejected this argument, pointing out that the Federal Reserve Board is an administrative agency rather than a court.<sup>92</sup>

The Supreme Court also rejected the Fifth Circuit Court of appeals reading of *Leedom v. Kyne*<sup>93</sup> that judicial review of any agency action that is alleged to have exceeded the agency's statutory authority is authorized.<sup>94</sup> The Court distinguished *Kyne* by noting that the National Labor Relations

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(b) The filing of a petition under §§ 301, 302 or 303 of this title, or of an application under § 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay —

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power . . . .

11 U.S.C. § 362(b)(4) (1988).

86. 11 U.S.C. §§ 362(a)(3) and 362(a)(6)(1988).

87. *MCorp*, 112 S. Ct. at 464.

88. *Id.*

89. *Id.*

90. *Id.*

91. 28 U.S.C. § 1334(b) (1988) provides: "Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district court shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11."

92. *MCorp*, 112 S. Ct. at 465.

93. 358 U.S. 184 (1958).

94. *MCorp*, 112 S. Ct. at 465-66.

Act<sup>95</sup> did not expressly authorize any method for judicial review of administrative determinations.<sup>96</sup> Thus, there was no mechanism for review by a court following the determination. The Court noted that the Financial Institutions Supervisory Act of 1966 (FISA)<sup>97</sup> expressly provides MCorp with an opportunity for judicial review of the validity of the source of strength regulation.<sup>98</sup> The Court went on to state that "if and when the Board finds that MCorp has violated that regulation, MCorp will have, in the court of appeals, an unquestioned right to review both the regulations and their application."<sup>99</sup> The Court also noted that in FISA, unlike the statute at issue in *Kyne*, Congress clearly stated that "[N]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any [Board] notice or order under this section."<sup>100</sup> It is clear from *Akin* and *MCorp* that the enforcement powers of regulatory agencies continue to enjoy broad interpretation by the courts. Although *MCorp* focuses only on a narrow jurisdictional question, the holding indicates that enforcement actions by the regulatory authorities will be difficult to overrule in the future.

### C. BANK CRIMES

#### 1. Double Jeopardy

In *United States v. Woods*<sup>101</sup> the Fifth Circuit considered whether an ongoing criminal prosecution for bank fraud placed the defendant in double jeopardy after the savings and loan association, where the alleged fraud occurred, had been placed into receivership. The defendant, Jarrett E. Woods, Jr., the sole owner of a savings and loan association that was placed in receivership by the government, contended that the harm he suffered amounted to a punishment for purposes of the Fifth Amendment. He claimed this caused his prosecution on a thirty-seven count indictment relating to bank fraud to violate the Double Jeopardy Clause of the Fifth Amendment of the United States Constitution. The court relied upon *United States v. Halper*<sup>102</sup> for the proposition that the government may pursue both civil and criminal remedies against the same defendant for the same conduct.<sup>103</sup> Further, the court stated that a civil remedy is not punishment as long as it does not serve the goals of punishment, i.e., retribution and deterrence.<sup>104</sup> In addition, the court noted that here the receivership was directed at the corporation and not at Woods.<sup>105</sup> The court reasoned that even if it considered the receivership to be directed against Woods personally, the goal and operation of the receivership is to protect the United State Treasury from

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95. 29 U.S.C. § 159(b)(1) (1988).

96. *MCorp*, 112 S. Ct. at 465.

97. 12 U.S.C. § 1818(i)(1) (1988).

98. *MCorp*, 112 S. Ct. at 466.

99. *Id.*

100. *Id.* at 466 (quoting 12 U.S.C. § 1818(i)(1) (Supp. I 1988)).

101. 949 F.2d 175 (5th Cir. 1991).

102. 490 U.S. 435 (1989).

103. *Id.* at 177.

104. *Id.*

105. *Id.*

avoidable insurance losses. Such a goal is not retributive nor meant as a deterrent, as these words have been interpreted to mean in the criminal law context.<sup>106</sup>

## 2. *False Financial Statement*

*United States v. Huntress*<sup>107</sup> was a criminal prosecution under 12 U.S.C. § 1014.<sup>108</sup> The defendant had presented a false financial statement to several banks and had made false oral statements regarding his continued ownership of assets listed on the statements. The financial statements listed an extensive stock portfolio which did not exist. He was tried and convicted and sentenced to two consecutive two-year sentences, five years of probation, and restitution of \$730,000. The court held that the essence of the offense is making a false statement with the intent to influence.<sup>109</sup> It does not matter if the defendant accomplished that purpose or not. In addition, the intent required to be proved is the intent to do the act.<sup>110</sup> The government is not required to prove that the defendant knew that what he was doing was a violation of law.<sup>111</sup>

## 3. *Bank Bribery*

The constitutionality of the Bank Bribery Act<sup>112</sup> was attacked by the defendant in *United States v. Kelly*.<sup>113</sup> Kelly, an officer of Valley-Hi National Bank, and Marburger, an officer at La Hacienda Savings Association, arranged for reciprocal loans to each other through their respective financial institutions. Kelly was convicted of violating the Bank Bribery Act. On appeal, he claimed the Act was unconstitutionally vague as applied to him, because he could not have reasonably understood that it prohibited his conduct since it is not clear that a loan is anything of value under the statute. The court held that the Bank Bribery Act is not unconstitutionally vague when applied to one who promises to give a loan from his bank to another in return for a loan from the other's bank.<sup>114</sup> Promising a loan "cannot reasonably be understood to be anything other than giving, offering, or promising a thing of value, or seeking, accepting, receiving or agreeing to receive anything of value contrary to the proscriptions of Section 215."<sup>115</sup>

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106. *Id.*

107. 956 F.2d 1309 (5th Cir. 1992).

108. The elements of an offense under 12 U.S.C. § 1014 are: 1) the defendant made a false statement to an insured financial institution; 2) the defendant made the false statement knowingly; 3) the statement was made for the purpose of influencing the financial institution's action; and 4) the statement was false as to a material fact. 12 U.S.C. § 1014 (1988).

109. *Id.* at 1317-18.

110. *Id.* at 1318.

111. *Id.*

112. 18 U.S.C. § 215 (1988).

113. 973 F.2d 1145 (5th Cir. 1992).

114. *Id.* at 1152.

115. *Id.*

#### 4. Bank Fraud

*United States v. Briggs*<sup>116</sup> involved the prosecution of the employee of two bank customers who made unauthorized transfers from her employers' accounts to her own. She pled guilty under the bank fraud statute, 18 U.S.C. § 1344(a)(2), but appealed her conviction, claiming that her guilty plea was not made intelligently and knowingly because she mistakenly believed that her conduct was covered by that statute. The issue before the court was whether transferring funds to one's personal account violates the bank fraud statute which makes it illegal to obtain funds from a financial institution by means of false or fraudulent pretenses, representations, or promises. The court ruled that by actually making the transfers, the defendant was impliedly representing that she had the authority to do so, and thus, violated the statute.<sup>117</sup> By falsely holding herself out as having authority, the defendant obtained the funds by false pretenses.<sup>118</sup>

#### D. PROFESSIONAL LIABILITY

In *FDIC v. Ernst & Young*<sup>119</sup> the Fifth Circuit reviewed an accounting firm's liability to the FDIC for negligently performing an audit as assignee of a corporation with a dominating sole owner. In *Ernst*, Arthur Young & Company (Arthur Young) and its successor, Ernst & Young (Ernst) performed audits of Western Savings Association (Western) for the years ending December 31, 1984, and December 31, 1985. All of the common stock of the parent company of Western was owned by Jarrett E. Woods, Jr. Mr. Woods was the Chairman of the Board and Chief Operating Officer of Western. He also served on the Executive, Loan, Audit, Compliance, and Credit Policy Committees of Western. Additionally, he held various offices in Western's wholly owned subsidiaries, including Westwood Mortgage Company and WS Service Corporation. Due to Western's aggressive pursuit of complex commercial ventures, which were often based upon unsafe and unsound underwriting practices, Western's financial condition seriously deteriorated. On June 22, 1984 the Federal Home Loan Bank Board (FHLBB) issued a temporary order to cease and desist Western's improper commercial lending practices. In accordance with the cease and desist order, Western engaged Arthur Young to review its financing transactions and to conduct independent audits for the years ending December 31, 1984, and December 31, 1985. Arthur Young's engagement letters specified its duties with respect to these audits. Arthur Young completed its audits and certified that it conducted the audits in accordance with generally accepted accounting principles. As a result of the 1984 audit, Arthur Young indicated that Western had a net worth of over \$41 million at the end of 1984. But in reality, Western was insolvent by more than \$100 million at that time. Similarly, Arthur

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116. 965 F.2d 10 (5th Cir. 1992).

117. *Id.* at 12.

118. *Id.*

119. 967 F.2d 166 (5th Cir. 1992).

Young's 1985 audit report certified that Western had a net worth of over \$49 million when it was actually insolvent by over \$200 million.

On September 12, 1986 the FSLIC was appointed as receiver for Western. Under FIRREA,<sup>120</sup> all FSLIC assets, including this claim, were transferred to the FSLIC Resolution Fund, which is managed by the FDIC. The FDIC filed a lawsuit against Ernst alleging damages of \$560 million, resulting from negligence and breach of contract by Arthur Young. The FDIC claimed that had Arthur Young's audits been accurate, Western's Board of Directors or government regulators could have prevented further losses. Although the FDIC had the authority to sue Ernst on its own behalf, or on behalf of Western's creditors, it brought suit only as assignee of a claim by Western against Ernst.<sup>121</sup>

The critical factor in the court's holding is the capacity in which the FDIC brought its suit. Since the FDIC did not sue on its own behalf nor on Western's creditors' behalf, the court viewed this as a client case where the client is suing its auditor. Thus, the court disregarded the effect of the auditor's alleged negligence on third parties<sup>122</sup> noting that "[a]n assignee obtains only the right, title, and interest of his assignor at the time of his assignment, and no more. Accordingly, an assignee may recover only those damages potentially available to his assignor."<sup>123</sup> Noting the FDIC contended that the court should treat it differently from other assignees. The court, relying upon *FDIC v. Cherry, Bekaert and Holland*,<sup>124</sup> declined to treat the FDIC differently from other assignees. In *Cherry*, the FDIC sued a partnership of certified public accountants for their negligent audit of a Bank. The *Cherry* court held that the FDIC, as assignee, was subject to the same defenses that could be asserted against other assignees.<sup>125</sup> The *Woods* court stated that "No statutory justification or public policy exists to treat the FDIC differently from other assignees when the FDIC, as a matter of choice in this case, has limited its claim to that of an assignee."<sup>126</sup>

The court then reviewed whether the district court had erred in granting Ernst's motion for summary judgment based on the allegation that neither Woods nor Western had relied upon the audit.<sup>127</sup> The FDIC argued that the district court erred in granting the summary judgment, stating that reliance is not an element of a negligence claim. The court reasoned that although an injury caused by reliance is not expressly a necessary element of

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120. 12 U.S.C. § 1821(a) (Supp. II 1990).

121. According to Section 1821(d)(2)(A), FIRREA grants the receiver "all rights, titles, powers, and privileges of the insured depository institution, and of any . . . account holder [or] depositor . . . with respect to the institution and the assets of the institution." 12 U.S.C. § 1821(d)(2)(A) (Supp. II 1990). Therefore, the FDIC can pursue claims on behalf of depositors, shareholders and creditors.

122. *Ernst & Young*, 967 F.2d at 169.

123. *Id.* (citing *State Fidelity Mortgage Co. v. Varner*, 740 S.W.2d 477, 480 (Tex. App.—Houston [1st Dist.] 1987, writ denied)).

124. 742 F. Supp. 612 (M.D. Fla. 1990).

125. *Id.* at 617.

126. *Ernst & Young*, 967 F.2d at 170.

127. *Id.*

negligence, “[p]roximate cause includes two essential elements: (1) foreseeability; and (2) cause in fact . . . Cause in fact means that the act or omission was a substantial factor in bringing about the injury and without which no harm would have incurred.”<sup>128</sup> The court held that without relying on the audit, there could not have been a “substantial factor in bringing about the injury.”<sup>129</sup> Following this reasoning, the court reviewed whether either Woods or Western had relied upon Arthur Young’s audit to cause injury to Western.<sup>130</sup>

Woods clearly did not rely upon the audit, as he had personal knowledge of the practices that led to the deteriorating financial condition of Western. His knowledge of the true financial condition of Western is also shown by his false entries in Western’s books and records in an effort to deceive auditors and examiners. The court applied the test set forth in *Greenstein, Logan & Co. v. Burgess Marketing, Inc.*<sup>131</sup> in reaching its decision that Woods acted on Western’s behalf and therefore his knowledge was imputable to Western.<sup>132</sup> The court in *Greenstein* set forth a test questioning whether an employee’s fraud is attributable to a corporation. It states:

Fraud on behalf of a corporation is not the same thing as fraud against it. Fraud against the corporation usually hurts just the corporation; the stockholders are the principal if not only victims; their equities vis-a-vis a careless or reckless auditor are therefore strong. But the stockholders of a corporation whose officers commit fraud for the benefit of the corporation are beneficiaries of the fraud . . . But the primary costs of a fraud on the corporation’s behalf are borne not by the stockholders but by outsiders to the corporation, and the stockholders should not be allowed to escape all responsibility for such fraud, as they are trying to do in this case.<sup>133</sup>

Applying this standard, the court held that Woods’ fraudulent actions, taken on behalf of Western, benefitted himself as sole shareholder and injured outsiders to Western.<sup>134</sup> Finally, the court rejected the FDIC’s argument that, but for Arthur Young’s negligence, someone, such as Western’s creditors or government regulators would have rescued Western.<sup>135</sup> Western was already aware of its financial condition and chose to ignore it.

It is important to note that the court specifically limited its holding to the facts of this case under Texas law, i.e. a case in which “the FDIC, as assignee of a corporation with a dominating sole owner, sues an auditor for negligently performing an audit upon which neither the owner nor the cor-

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128. 967 F.2d 166, 170 (citing *McClure v. Allied Stores of Texas, Inc.*, 608 S.W.2d 901, 903 (Tex. 1980)).

129. *Ernst & Young*, 967 F.2d at 170 (citing 601 S.W.2d 734, 736 (Tex. Civ. App.—Dallas 1980, no writ)).

130. *Id.*

131. 744 S.W.2d 170, 190-91 (Tex. App.—Waco 1987, writ denied) (quoting *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449, 456 (7th Cir.), *cert. denied*, 459 U.S. 880 (1982)).

132. *Ernst & Young*, 967 F.2d at 171.

133. *Greenstein*, 744 S.W.2d at 190-91.

134. *Ernst & Young*, 967 F.2d at 171.

135. *Id.*

poration relied."<sup>136</sup> The court specifically did not rule on whether Ernst can be liable for its negligence should the FDIC bring a cause of action on its own behalf or on behalf of Western's creditors.<sup>137</sup>

## E. PURCHASE AND ASSUMPTION TRANSACTIONS

### 1. Ratable Dividends

In *Texas American Bancshares, Inc. v. Clarke*<sup>138</sup> the Fifth Circuit reviewed the structure of a purchase and assumption transaction in which creditors closely affiliated with the insolvent bank were treated differently than unaffiliated creditors. The unaffiliated creditors received one hundred percent of the amount owed them while the affiliated creditors received only the liquidated value of their claims, i.e. approximately sixty-seven percent. The court reviewed whether such treatment by the FDIC violated sections 91<sup>139</sup> and 194<sup>140</sup> of the National Banking Act.<sup>141</sup> The case involved Texas American Bancshares, Inc. (TAB), which was the parent company of twenty-two national banks located in Texas and of two Texas state chartered banks. The deposits of the twenty-four banks were insured by the FDIC.

TAB Fort Worth, a national bank located in Fort Worth, Texas, began experiencing financial difficulties in 1988. On July 20, 1989 the Comptroller of the Currency declared TAB Fort Worth insolvent and appointed the FDIC as receiver. The OCC also granted a bridge bank charter under the name Texas American Bridge Bank, N.A. (Bridge Bank).<sup>142</sup> In this case of first impression in the Fifth Circuit, the sole issue on appeal was whether the FDIC violated sections 91 and 194 of the National Bank Act, which requires receivers of national banks to make ratable dividends and to avoid preference to creditors.<sup>143</sup> The FDIC, in its receivership capacity (FDIC Re-

136. *Id.* at 172.

137. *Id.* at 172. The FDIC appealed the Fifth Circuit decision; however, the OTS, FDIC, and RTC settled all of their existing and potential claims against Ernst & Young for \$400 million on November 23, 1992. *Bank Bailout Litigation News*, Vol. 3 No. 47 p. 1, November 26, 1992.

138. 954 F.2d 329 (5th Cir. 1992).

139. 12 U.S.C. § 91 (1988).

140. 12 U.S.C. § 194 (1988).

141. 12 U.S.C. § 38 (1988).

142. 12 U.S.C. § 1821 (1988). The court explained:

A bridge bank is a chartered bank that exists for a limited time to effectuate purchase and assumption transactions . . . § 1821(n). The bridge bank is authorized to assume deposits or other liabilities and/or purchase assets of the insured bank. *Id.* § 1821(n)(1)(B). The FDIC may provide operating funds or assistance to the bridge bank. *Id.* § 1821(n)(5), (7). The bridge bank terminates on the earliest of the following events: the passage of two years after the bridge bank was given a charter; the merger of the bridge bank with another bank; the sale of the stock of the bridge bank to another entity; or the assumption of substantially all the deposits and other liabilities of the bridge bank by another bank. *Id.* § 1821(n)(10).

954 F.2d 329, 333 n.5.

143. Section 194 provides that:

From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by

ceiver), entered into a purchase and assumption agreement with the Bridge Bank and a contract of sale with the FDIC in its corporate capacity (FDIC Corporate).

The contract of sale provided that certain assets of TAB Fort Worth, which were not transferred to Bridge Bank, would be transferred to FDIC Corporate. In exchange for such assets, FDIC Corporate would provide FDIC Receiver sufficient funds to pay all of the liabilities of TAB Fort Worth that were not assumed by the Bridge Bank. The contract of sale provided that the liabilities would be paid on pro rata basis, based on the aggregate fair market value of the assets of TAB Fort Worth, together with interest. FDIC Receiver then transferred most of the assets of TAB Fort Worth to the Bridge Bank, and the Bridge Bank assumed most of the TAB Fort Worth's obligations. The obligations for federal funds sold to TAB Fort Worth by other TAB subsidiary banks and the certificate of deposits that the other TAB subsidiaries had purchased from TAB Fort Worth were not assumed by the Bridge Bank. Those obligations, totalling approximately \$800 million, were retained by the FDIC Receiver. The FDIC then notified the Comptroller of the Currency that the other TAB subsidiary banks, which were owed the \$800 million by TAB Fort Worth, would receive only sixty-seven percent of the face amount of the obligations owed to them by TAB Fort Worth from the TAB Fort Worth receivership. As a result, the Comptroller determined that all twenty-one of the other TAB subsidiary national banks were insolvent, ordered them closed, and appointed the FDIC as receiver for each. In addition, the two TAB state chartered Bank subsidiaries were declared insolvent and were closed in a similar manner. The remaining twenty-three subsidiary banks were then sold to the same purchaser as TAB Fort Worth, through a series of coordinated purchase and assumption transactions.

If the banks had received one hundred percent of the federal funds sold to, and any certificates of deposit purchased from, TAB Fort Worth, or if such

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such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held.

12 U.S.C. § 194 (1988). Section 91 provides:

All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credits; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable things for its use, or the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction, or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county or municipal court.

12 U.S.C. § 91 (1988).

items had been assumed by the Bridge Bank, thirteen of the banks would not have become insolvent. The thirteen TAB subsidiary banks along with their parent company, TAB, brought this lawsuit. The court rejected TAB's argument that the FDIC sale of TAB Fort Worth to an outside investor in a purchase and assumption transaction generated proceeds that the FDIC was required to distribute equally to all TAB Fort Worth creditors.<sup>144</sup> The court held that 12 U.S.C. section 194 imposes a requirement of ratable payments to creditors; however, such payments are to be made only to the extent of the assets of the failed bank.<sup>145</sup> The parties had stipulated that if the TAB Banks had been liquidated, the proceeds generated from the liquidation of TAB Fort Worth would have paid the creditors no more than sixty-seven percent of the amounts owed them. The court held that the receipt of sixty-seven percent of the claims by the subsidiaries constituted a ratable distribution of the proceeds of the assets of TAB Fort Worth.

Further, the court reasoned that TAB's claim ignored the dual role that the FDIC played in the purchase and assumption transaction.<sup>146</sup> The FDIC acted both in its corporate capacity and as a receiver of TAB Fort Worth. As receiver, the FDIC sold the majority of the assets of TAB Fort Worth to the Bridge Bank. FDIC Corporate provided operating funds to the Bridge Bank and injected \$900 million from the insurance fund so that nonaffiliated creditors could be paid one hundred percent of their claims instead of only the sixty-seven percent pro rata share to which they were entitled. The court distinguished the obligations of the FDIC in its capacity as receiver to distribute the proceeds of the assets of a failed Bank ratably, from the obligations of the FDIC in its corporate capacity to compensate insured depositors fully.<sup>147</sup>

In reaching its holding, the court distinguished *First Empire Bank - New York v. FDIC*,<sup>148</sup> a case in which the FDIC closed United States National Bank of San Diego (USNB) and entered into a purchase and assumption agreement with Crocker National Bank. The majority of the assets and liabilities of USNB were purchased and assumed by Crocker; however, certain assets and liabilities associated with USNB's controlling shareholder were not assumed by Crocker. In connection with the transaction, the FDIC, in its corporate capacity, lent to the FDIC as receiver \$128,780,000, which was transferred by the receiver to Crocker pursuant to the purchase and assumption agreement. In order to secure its loan to the receivership, the FDIC, in its corporate capacity, received and retained a first lien, superior to that of any unassumed creditor, in all of the assets of the receivership estate that were not transferred to Crocker. The creditors whose claims were not assumed brought an action against the FDIC for payment of their claims in full. The *First Empire* court ruled in favor of the creditors on the basis that sections 91 and 194 of the National Bank Act apply to the FDIC when

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144. *Texas American*, 954 F.2d at 335.

145. *Id.*

146. *Id.*

147. *Id.* at 335-36.

148. 572 F.2d 1361 (9th Cir.), *cert denied*, 439 U.S. 919 (1978).

acting as receiver for a failed bank.<sup>149</sup> The court noted that the critical difference between *First Empire* and the present case is that in *First Empire*, the "FDIC made no provision for any payment of the creditors' claims that were not assumed in *First Empire*; the unassumed creditors, unlike the plaintiff TAB Banks here, did not receive a ratable dividend of the assets of the failed Bank."<sup>150</sup> Because the lien held by the FDIC would consume the remaining assets of the receivership estate, the unassumed creditors would have been left without any recovery, thereby denying the unassumed creditors what they would have received in a straight liquidation.

The court in *Texas American* noted that the parties extensively briefed the issue of whether FIRREA controls the outcome of the case. FIRREA was enacted approximately one month following the closure of the TAB Banks by the Comptroller.<sup>151</sup> The court declined to address the issue in a specific holding but said that the case would have been decided the same way even if FIRREA had applied.<sup>152</sup>

## 2. Loan Participations

In *First Indiana Federal Savings Bank v. FDIC*<sup>153</sup> the Fifth Circuit set forth basic rules for loan participation contests in which one party is a failed institution and the other party remains open. The predecessor of First Indiana Savings Bank (First Indiana) entered into a loan participation contract with the predecessor of United Savings Association of Texas (Old United). First Indiana acquired various interests in participations covering the development of four apartment complexes in Houston. First Indiana's interests equalled approximately ninety percent of the total outstanding loans on the apartment complexes. Old United retained ten percent of the total loans, along with the management responsibilities and the right to compensation for managerial services rendered. The participation agreement contained an option allowing First Indiana to direct Old United to repurchase First Indiana's interest in the loans if Old United violated any terms of the participation agreement and failed to cure such violations within thirty days after notice. Three of the four apartment complexes began experiencing problems leading to foreclosure on the underlying loans. First Indiana sued Old United seeking specific performance of repurchase of the participations pursuant to the participation agreement, claiming that Old United failed to notify First Indiana in advance of the problems and defaults as required by the participation agreement. Old United counterclaimed for management fees related to the properties.

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149. *Id.* at 1371.

150. *Texas American*, 954 F.2d at 337.

151. *Id.* at 340.

152. *Id.* FIRREA amended The Federal Deposit Insurance Act to provide that the maximum liability of the FDIC "acting as receiver or in any other capacity" to any person having a claim against the receiver or the failed bank shall be the amount the claim and would have received if the FDIC had liquidated the assets and liabilities of the bank. *See also* 12 U.S.C. § 1821(i)(2) (1988).

153. 964 F.2d 503 (5th Cir. 1992).

A trial followed in which the jury only answered special interrogatories, rather than rendering an overall verdict. The jury found against Old United on several issues; however, it found against First Indiana on other issues including a finding that First Indiana had waived its claims. Approximately three years elapsed before the district court entered its judgment. During that time, Old United was declared insolvent and United Savings Association of Texas, FSB (New United) was formed by the FSLIC as successor to Old United. Pursuant to an acquisition agreement between FSLIC and New United, most of the assets of Old United were sold to New United. Following the sale, New United intervened in the suit to reassert Old United's claims against First Indiana for management fees. First Indiana filed a motion for summary judgment, arguing that the insolvency of Old United was an event of default that terminated the participation agreement and triggered repurchase. The United States District Court for the Southern District of Texas entered judgments against First Indiana on its repurchase claim and awarded a money judgment to New United for \$77,403 in unpaid fees and expenses. The court dismissed First Indiana's claims against the FDIC as successor of the FSLIC and receiver of Old United.<sup>154</sup>

The appellate court reviewed section 3 of the acquisition agreement between the FSLIC and New United in making its determination of the rights of the parties. Section 3 states:

[New United] hereby expressly assumes and agrees to pay, perform and discharge . . . (b) [Old United's] liabilities that are secured by assets purchased by [New United] pursuant to section 2 of this Agreement to the extent of the value of the security . . . except as expressly set forth in this section 3, [New United] will not assume any of the claims, debts, obligations or liabilities (including, without limitation, known or unknown, contingent or unasserted claims, demands, causes of action or judgments, or debts, obligations or liabilities; or commitments to loan or obligations to make future fundings or advances under existing loans or other obligations even if such loans or other obligations are acquired by [New United]) of [Old United] . . . .<sup>155</sup>

First Indiana argued that Old United's obligations under the participation agreement were "liabilities that are secured by assets purchased"<sup>156</sup> by New United pursuant to the acquisition agreement between the FSLIC and New United. The court disagreed, holding that the parties' obligations under the participation agreement were never "anything more than unsecured personal obligations between the parties."<sup>157</sup> Therefore, the court reasoned that to the extent First Indiana had any valid claims against Old United, such claims were not secured claims and did not survive the transfer of assets under the acquisition agreement between the FSLIC and New United.<sup>158</sup> Instead, the unsecured liabilities of Old United, including the claims against

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154. *First Indiana*, 964 F.2d at 503.

155. *Id.* at 506.

156. *Id.*

157. *Id.*

158. *Id.*

Old United, accrued as of the date of the transfer and were retained by the FSLIC. Thus, First Indiana's only recourse was to bring an action against the FDIC as receiver for Old United. The court noted that it was not relevant whether the claims of First Indiana against Old United were valid because the liabilities of Old United exceeded its assets; therefore, there were no assets for the FDIC as receiver to distribute to general creditors of Old United such as First Indiana.<sup>159</sup>

Further, the court acknowledged that Congress intended to limit the maximum liability of the FDIC as receiver to the amount the claimant would have received had the institution been liquidated pursuant to federal priority regulations.<sup>160</sup> Applying this standard, the court noted that First Indiana would have received nothing as an unsecured creditor had the FDIC liquidated Old United.<sup>161</sup> The determination regarding the value of Old United by the Federal Home Loan Bank Board (FHLBB) established the value of First Indiana's unsecured claim and bound the court hearing the actions on those claims.<sup>162</sup> The court's decision is binding only as to claims made by First Indiana based on actions of Old United.<sup>163</sup> As successor in interest to Old United, New United is liable for any failure to live up to its responsibilities under the participation agreement after its transfer of assets from the FSLIC to New United.<sup>164</sup> The court stated "As far as obligations of the seller under the participation agreement are concerned, New United got a 'fresh start' as of the time it acquired the interest of Old United by transfer from the FSLIC."<sup>165</sup> As successor in interest to Old United, New United was also entitled to any rights and benefits of Old United under the participation agreement, regardless of the date such rights and benefits may have accrued or may accrue in the future.<sup>166</sup> Thus, the court affirmed the judgment against First Indiana based on Old United's counterclaim for unpaid fees and expenses.<sup>167</sup>

## F. THIRD PARTY V. THE FDIC OR RTC

### 1. *Enforcement of Standby Letters of Credit*

In *Citizens State of Lometa v. FDIC*<sup>168</sup> the court examined whether standby letters of credit issued by a national bank are valid against the FDIC, when the underlying default on the letter of credit occurs after the date the national bank is placed in receivership. In November 1986, Lampasas County Joint Venture (Joint Venture) executed a promissory note payable to Citizens State Bank of Lometa (Lometa) for the principal amount

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159. *Id.* at 507.

160. *Id.* See 12 U.S.C. § 1821(i)(2) (1988).

161. *First Indiana*, 964 F.2d at 507.

162. *Id.* at 506 n.7.

163. *Id.* at 507.

164. *Id.*

165. *Id.* at 508.

166. *Id.* at 507.

167. *Id.* at 508.

168. 946 F.2d 408 (5th Cir. 1991).

of \$295,200. The partners of the Joint Venture signed the note both as makers and in their capacities as partners. In addition, each of the individuals executed guaranty agreements in their individual capacities. North Central National Bank located in Austin, Texas (North Central) issued three letters of credit in favor of Lometa as consideration for the note and the guaranties. The letters of credit specified that North Central would pay Lometa upon Lometa's presentment to North Central (a) the original letter of credit, and (b) a written notification of an officer of Lometa certifying that the loan to the Joint Venture is in default.

Further, the terms of the letters of credit provided that upon presentment of a draft that complied with the terms of the letters, North Central would honor the draft. On April 23, 1987, North Central was declared insolvent, and the FDIC was appointed as receiver. All three of the letters of credit in question existed prior to the closing of North Central. Subsequent to the failure, the Joint Venture, along with the three individual guarantors, defaulted on their note and individual guarantees. Following the default, Lometa sent the following documents to the FDIC: (1) copies of the original letters of credit; (2) written notice certifying that the \$295,200 loan to the Joint Venture was in default; and (3) drafts in the amount of the letters of credit. Approximately two months later, Lometa sent the FDIC: (1) original proofs of claim on each of the letters of credit; (2) the original letters of credit; (3) written notice certifying that the loan to the Joint Venture was in default; and (4) drafts in the amounts of the letters of credit. The FDIC then notified Lometa that its claims were rejected, stating that the note was not in default prior to North Central's failure and therefore the claims by Lometa were not "provable claims" under section 194 of the National Bank Act. During 1988 and 1989, Lometa obtained judgments on the note and the guaranty agreements. As of the date of the court's decision, the FDIC had not made any distribution of assets in the receivership proceeding relating to North Central.

The court examined whether standby letters of credit are "provable claims" against the FDIC under section 194 of the National Bank Act.<sup>169</sup> Section 194 provides in part "[T]he Comptroller [receiver] shall make a ratable dividend on the money so paid over to him . . . on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction . . ."<sup>170</sup> In reaching the conclusion that the standby letters of credit were provable, the court relied on the provability test set forth in *First Empire Bank-New York v. FDIC*.<sup>171</sup> In *First Empire*, the court concluded that a standby letter of credit claim was provable even though the default on the underlying note occurred subsequent to the issuer's insolvency. The decision was based on the following criteria: "(1) it existed before the issuing Bank's insolvency and did not depend on any new contractual obligations arising later; (2) liability on the claim was absolute and certain in amount

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169. *Lometa*, 946 F.2d at 412. See U.S.C. § 194 (1988).

170. 12 U.S.C. § 194 (1988).

171. 572 F.2d 1361 (9th Cir.), *cert. denied*, 439 U.S. 919 (1978).

when suit was filed against the receiver; and (3) the claim was made in a timely manner."<sup>172</sup>

Relying on a series of cases interpreting the meaning of "ratable" in section 194, the FDIC argued that a claim must be absolutely fixed, due, and owing as of the date of insolvency to be provable and thus entitled to participate in a ratable funds distribution pursuant to 12 U.S.C. section 194. Further, the FDIC argued that no reference should be made to post insolvency events. Distinguishing *Merrill v. National Bank of Jacksonville*<sup>173</sup> and *American Surety Co. v. Bethlehem National Bank*,<sup>174</sup> the court held that although the two concepts are related, "whether a claim is provable under section 194, and whether a distribution is 'ratable', represent two entirely different inquiries."<sup>175</sup> Therefore, the Fifth Circuit affirmed the district court's ruling that Lometa could enforce the standby letters of credit against the FDIC as receiver for North Central.<sup>176</sup>

## 2. *Disappointed Bidder Denied Injunctive Relief*

In *Ward v. RTC*<sup>177</sup> the United States District Court for the Southern District of Texas dismissed an action to enjoin the RTC from selling government property to a third party.<sup>178</sup> The plaintiff submitted a bid to the RTC on an office building. The Resolution Trust Corporation (RTC) wrote a letter rejecting his bid and inviting him to submit another bid. Before he submitted a new bid, however, he was informed that the RTC was selling the property as part of a bulk sale of government property to Patriot American Investors (PAI). The plaintiff then brought the suit to enjoin the sale of the property to PAI. In dismissing the suit, the court relied on 12 U.S.C. section 1821(j), which states: "[E]xcept as provided in this section, no court may take any action, except at the request of the Board of Directors by regulation or order, to restrain or affect the exercise of powers or functions of the Corporation as a conservator or a receiver."<sup>179</sup> Since one of the functions of the RTC as receiver is the liquidation and receivership of assets, it follows that the RTC is free to liquidate receivership assets without being subject to injunctive actions.

The court stated that even if the anti-injunction statute was not applicable, an injunction would not be issued because the plaintiff failed to meet the test for injunctive relief, which requires a showing of likelihood of success on the merits.<sup>180</sup> The court found that Ward could not show a likelihood of success on the merits because he could not prove he was a third party beneficiary to the contract between the RTC and PAI.<sup>181</sup> Further, the letter from the

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172. *Lometa*, 946 F.2d at 412 (citing *First Empire* 572 F.2d at 1367-69).

173. 173 U.S. 131 (1899).

174. 314 U.S. 314 (1941).

175. *Lometa*, 946 F.2d at 413.

176. *Id.* at 417.

177. 796 F. Supp. 256 (S.D. Tex. 1992).

178. *Id.* at 259.

179. *Id.* at 258, citing 12 U.S.C. § 1821(j) (1988).

180. *Ward*, 796 F.2d at 258.

181. *Id.*

RTC inviting Ward to submit a new bid did not constitute a counter-offer; therefore, the property did not qualify as excluded property under the agreement between the RTC and PAI. In addition, the court found that the plaintiff would not suffer irreparable harm if the RTC proceeded with the sale to PAI. Relying on *Geneva Ltd. Partners v. Kemp*,<sup>182</sup> the court held that “[w]here the property in dispute is to be used for commercial purposes, money damages can provide an adequate remedy.”<sup>183</sup> The court additionally weighed any damage the plaintiff might suffer against the underlying public interest in the RTC’s ability to dispose of surplus government properties quickly and efficiently.<sup>184</sup> The court found that the “potential for harm to the public interest if an injunction is granted is considerable”<sup>185</sup> and outweighs the potential harm to the plaintiff.<sup>186</sup>

The court also held that the plaintiff lacked standing under FIRREA to bring an action challenging the RTC’s asset distribution.<sup>187</sup> In order to have standing, the plaintiff must show he suffered an injury as a result of not obtaining the property, and also that he is within the “zone of interest to be protected or regulated” by FIRREA.<sup>188</sup> The plaintiff asserted that he was within the zone of interest to be protected because FIRREA was enacted to protect and insure a fair bid process. The court disagreed, finding that the purpose of FIRREA “is to give the RTC broad powers to liquidate receivership assets within its control and plaintiff is not within the protected zone.”<sup>189</sup> The court noted that the RTC can maximize its profits on an entire group of properties through the use of bulk sales and to disturb the sale would be more detrimental to the RTC than to the plaintiff.<sup>190</sup>

### 3. *Ad Valorem Tax*

In *Irving Independent School District v. Packard Properties*<sup>191</sup> the Fifth Circuit analyzed the responsibilities of the FDIC with respect to property tax liens that were in existence prior to the acquisition of the property in question by the FDIC as receiver. The *Irving III* court’s decision encompassed two cases where property liens for the payment of ad valorem taxes, statutory interest, penalties, collection costs, and attorneys fees were incurred with respect to property that was then acquired by the FDIC as receiver.<sup>192</sup> The taxing authorities brought suit against the FDIC to recover the unpaid ad valorem real property taxes, penalties, interest, costs of collec-

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182. 779 F. Supp. 1237, 1240 (N.D. Cal. 1990).

183. *Ward*, 796 F. Supp. at 258.

184. *Id.* at 258-59.

185. *Id.* at 259.

186. *Id.*

187. *Id.*

188. *Ward*, 769 F. Supp. at 259 (quoting *Association of Data Processing Serv. Org., Inc. v. Camp*, 397 U.S. 150, 152 (1970)).

189. *Id.*

190. *Id.* at 258-59.

191. 970 F.2d 58 (5th Cir. 1992) (*Irving III*).

192. *Irving III*, 970 F. Supp. at 59. *See generally*, *Irving Indep. Sch. Dist. v. Packard Properties*, (*Irving II*), 762 F. Supp. 699 (N.D. Tex. 1991); *Irving Indep. Sch. Dist. v. Packard Properties*, (*Irving I*), 741 F. Supp. 120 (N.D. Tex. 1990).

tions, and attorneys fees relating to the unpaid taxes. The *Irving I* district court held that the FDIC was not liable for the additional charges denominated as penalties and interest.<sup>193</sup>

In a later decision in this series of cases, the *Irving II* court held that liens securing the unpaid taxes, penalties, and interest for the years prior to the ownership of the property by the FDIC were not extinguished by the FDIC's acquisition of that property.<sup>194</sup> The FDIC appealed the second holding, asserting that liens as security for the pre-existing charges constituted penalties that are invalid once the FDIC acquires the property. In its analysis, the *Irving III* court reviewed section 1825(b)(1)<sup>195</sup> and held that the FDIC is responsible for paying the base ad valorem taxes on the property it owns.<sup>196</sup> Reviewing 12 U.S.C. section 1825(b)(2),<sup>197</sup> the court held that "[t]he plain language of this statute means no involuntary lien attaches to the property held by the FDIC when the FDIC is acting as a receiver."<sup>198</sup> The court noted, however, that the language did not exclude liens attached to the property before the FDIC owned it.<sup>199</sup> The court held that although liens may not attach to the property owned by the FDIC, previous liens remain in place.<sup>200</sup> The FDIC asserted that 12 U.S.C. section 1825(b)(3)<sup>201</sup> requires that any lien on property owned by the FDIC, to the extent that the lien secures penalties, should be extinguished. The FDIC reasoned that if such liens are not extinguished, the FDIC will receive a lower price for the property upon resale, and that such reduction of price indirectly imposes a penalty upon the FDIC. The court rejected this argument, noting that the liens were in place before the FDIC obtained ownership of the property and therefore did not cause a reduction in the value of the FDIC's assets.<sup>202</sup> Further, the court noted that although the liens securing penalties incurred prior to FDIC ownership of the property would remain in place, the FDIC

193. See *Irving I*, 741 F. Supp. 120, 124 (N.D. Tex. 1990).

194. See *Irving II*, 762 F. Supp. 699, 704-05 (N.D. Tex. 1991).

195. 12 U.S.C. § 1825 (Supp. II 1990). Section 1825(b)(1) provides that when acting as a receiver, the following provisions shall apply with respect to the Corporation:

(1) the Corporation including its franchise, its capital, reserves, and surplus, and its income, shall be exempt from all taxation imposed by any State, county, municipality, or local taxing authority, except that any real property of the Corporation shall be subject to State, territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed . . . .

*Id.*

196. *Irving III*, 970 F. Supp. at 61.

197. 12 U.S.C. § 1825 (1984). Section 1825(b)(2) provides that "[n]o property of the Corporation shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of the Corporation, nor shall any involuntary lien attach to the property of the Corporation."

198. *Irving III*, 970 F.2d at 61 (citing *Irving Indep. Sch. Dist. v. Packard Properties*, (*Irving II*), 762 F. Supp. 699 (N.D. Tex. 1991)).

199. *Id.*

200. *Irving III*, 970 F. Supp. at 61.

201. See 12 U.S.C. § 1825 (1989). Section 1825(b)(3) provides that "[t]he Corporation shall not be liable for any amounts in the nature of penalties or fines, including those arising from the failure of any person to pay any real property, personal property, probate, or recording tax or any recording or filing fees when due." *Id.* § 1825(b)(3).

202. *Irving III*, 970 F. Supp. at 62.

is not liable for the payment of penalties incurred in connection with the failure of previous owners to pay property taxes.<sup>203</sup>

The taxing authorities argued that interest and collection costs associated with unpaid taxes are not penalties and therefore the FDIC should not be shielded from payment of those amounts. The long standing interpretation in Texas that interest charges are regarded as penalties is set forth in *Jones v. Williams*.<sup>204</sup> Although this interpretation may be changing,<sup>205</sup> the court declined to apply the emerging concept of interest as compensation for the use or the lost use of money,<sup>206</sup> and held that the interest charges were penalties.<sup>207</sup> Section 33.01 of the Tax Code recently was amended and provides that "interest payable under this section is to compensate the taxing unit for revenue lost because of the delinquency."<sup>208</sup> Although section 33.01(e) is contrary to the interpretation in *Jones*, the court noted that the amendment to section 33.01(c) of the Texas Tax Code did not become effective until August 26, 1991.<sup>209</sup> The *Irving* cases originated prior to such date and the court declined to apply the amendment retroactively.

The taxing authorities also contended that section 33.07(a)<sup>210</sup> is not a penalty provision. The court cited *Jones* as the controlling Supreme Court precedent.<sup>211</sup> The court stated:

the case of *Jones v. Williams* . . . decides that the penalty and interest added to delinquent taxes is not an incident of the taxes, but is a separate and distinct item provided by the Legislature as a punishment for the failure to pay taxes, prior to delinquency, and therefore a "penalty" within the meaning of the Constitution.<sup>212</sup>

Thus, pursuant to 12 U.S.C.A. section 1825(b)(3), the FDIC is not liable either by lien or suit, for interest, tax penalties, or collection costs incurred during the years the FDIC owned the property in question.<sup>213</sup>

203. *Id.*

204. 121 Tex. 94, 45 S.W.2d 130 (Tex. 1931).

205. See *Spindletop Oil and Gas Co. v. Parker County*, 738 S.W.2d 715 (Tex. App.—Fort Worth 1987, writ denied).

206. TEX. TAX. CODE ANN. § 33.01(d) (Vernon Supp. 1993).

207. *Irving III*, 970 F. Supp. at 65.

208. TEX. TAX. CODE ANN. § 33.01 (Vernon Supp. 1993).

209. *Irving III*, 970 F. Supp. at 65.

210. TEX. TAX. CODE ANN. § 33.07(a) (Vernon Supp. 1993). Section 33.07(a) provides:

A taxing unit or appraisal district may provide, in the manner required by law for official action by the body that taxes that remain delinquent on July 1 of the year in which they become delinquent incur an additional penalty to defray costs of collection, if the unit or district or another unit that collects taxes for the unit has contracted with an attorney pursuant to § 6.30 of this Code. The amount of the penalty may not exceed 15% of the amount of taxes, penalty and interest due.

*Id.*

211. *Irving III*, 970 F. Supp. at 64.

212. *Id.* at 66. See also *State v. Kingham*, 361 S.W.2d 191, 193 (Tex. 1962).

213. *Id.*

## G. BANK POWERS

In *Variable Annuity Life Insurance Co. v. Clarke*<sup>214</sup> the United States District Court for the Southern District of Texas, Houston Division, reviewed the Office of the Comptroller of Currency's (OCC) approval letters which allowed a national Bank to offer various annuity contracts through a wholly owned subsidiary. North Carolina National Bank (NCNB) and its wholly owned subsidiary, NCNB Securities, Inc. (NCNBS) applied to the OCC for approval to offer various annuity contracts on an agency basis through NCNBS. The Comptroller approved NCNB's request on March 21, 1990. In issuing its approval, the Comptroller found that annuities are primarily financial investments. As such, the sale of the annuities is within the power of national banks to broker financial investment instruments. Variable Annuity Life Insurance Company (VALIC), an insurance company with its principal place of business in Houston, Texas, underwrites and sells securities in fifty states. On April 16, 1991, VALIC filed suit seeking declaratory and injunctive relief. VALIC contended that the Comptroller's decision to allow NCNB and other national banks to offer annuity contracts on an agency basis through an operating subsidiary (1) was arbitrary, capricious, and an abuse of discretion; and (2) allowed and encouraged NCNB and other national banks to enter the insurance business in violation of section 24(7)<sup>215</sup> and section 92<sup>216</sup> of the National Bank Act. Relying on *Chevron USA, Inc., v. National Resources Defense Council, Inc.*,<sup>217</sup> the court initially inquired as to whether Congress had directly addressed this issue.<sup>218</sup> Finding that the issue had not been specifically addressed by Congress, the court reviewed whether the OCC's ruling was based on a reasonable interpretation of the statute in question.<sup>219</sup> The court applied the standard used in *Chevron*, which states that in order to uphold the OCC's decision, "[t]he Court need not conclude that the agency's construction was the only one it permissibly could have adopted, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."<sup>220</sup> Thus, provided that the Comptroller's interpretation of the National Bank Act is reasonable, and not arbitrary, capricious, or an abuse of discretion, and the interpretation is otherwise in accordance with the law, the court must defer to the Comptroller's interpretation.<sup>221</sup>

VALIC relied on *Saxon v. Georgia Ass'n of Independent Insurance Agents, Inc.*<sup>222</sup> for its contention that 12 U.S.C. section 92 plainly prohibits national banks from acting as sales agents for insurance companies in communities

214. 786 F. Supp. 639 (S.D. Tex. 1991).

215. 12 U.S.C. § 24(7) (Supp. II 1990).

216. 12 U.S.C. § 92 (1988).

217. 467 U.S. 837, 842-45 (1984).

218. *Variable Ins.*, 786 F. Supp. at 641.

219. *Id.*

220. *Id.* at 641 (citing *Chevron*, 467 U.S. at 843, n.11).

221. *Variable Ins.*, 786 F. Supp. at 641 (citing *Clarke v. Sec. Indus. Assoc.*, 479 U.S. 388, 403-04 (1987); *Camp, Comptroller of the Currency v. Pitts*, 411 U.S. 138, 140-42 (1973)).

222. 399 F.2d 1010 (5th Cir. 1968).

where the population exceeds 5,000.<sup>223</sup> In *Saxon*, the court held that the OCC exceeded its authority and acted contrary to section 92 when it granted national banks the broad and unlimited power to “act as agent in the issuance of insurance which is incidental to banking transactions.”<sup>224</sup> The court disagreed with VALIC’s reading of *Saxon* and relied on the legislative history for the proposition that section 92 was enacted, at least in part, to “provide an additional source of revenue for national banks located in small towns and not to protect the markets from competing insurance agents.”<sup>225</sup> The court also held that the term “insurance” which is not defined in section 92, probably cannot be construed to include annuities.<sup>226</sup> The court reasoned that Congress explicitly “left a gap for the [Comptroller] to fill”<sup>227</sup> when it did not define the term “insurance.”<sup>228</sup> The Comptroller filled the gap with respect to the definition of “insurance” by making a factual determination that annuities are primarily financial investment instruments and not insurance. In reaching this conclusion, the Comptroller found “that annuities lack the basic insurance characteristic of indemnification against risk of loss.”<sup>229</sup> The Comptroller also found that, to the extent the annuities at issue are securities, they fall within the securities brokerage authority of national banks.<sup>230</sup> The court held that it was neither arbitrary nor capricious for the Comptroller to view 12 U.S.C. section 92 as a supplemental powers provision and not as a limitation on the incidental powers of the Bank under 12 U.S.C. section 24(7).<sup>231</sup> The court also found that the Comptroller acted reasonably in determining that annuities are a specialized product and not a broad form of insurance that would be governed by *Saxon*.<sup>232</sup>

On February 24, 1992 the district court corrected its ruling by adding 12 U.S.C. section 24(7) to the statutory basis for the initial ruling. The correction contained no explanation, but noted that section 24(7) should be included as part of the ruling. A footnote was also included which stated “[T]he Court notes that section 92 is omitted from recent editions of the

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223. *Variable Ins.*, 786 F. Supp. at 641.

224. *Id.* (citing *Saxon*, 399 F.2d at 1012).

225. *Variable Ins.*, 786 F. Supp. at 641; *See* 53 Cong. Rec. 11001 (1916).

226. *Variable Ins.*, 786 F. Supp. at 641.

227. *Id.* (citing *Chevron*, 467 U.S. at 843).

228. *Variable Ins.*, 786 F. Supp. at 641.

229. *Id.*

230. *Id.* *See* 12 U.S.C. § 24 (Supp. II 1990). Section 24(7) provides in pertinent part: Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power . . . (T)o exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; . . . (T)he business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock . . . .

*Id.*

231. *Variable Ins.*, 786 F. Supp. at 642.

232. *Id.*

United States Code. Because the issue of section 92's continuing validity is not part of the case or controversy before the Court, the Court does not address this issue."<sup>233</sup> This footnote was added due to a holding by the U.S. Court of Appeals for the District of Columbia Circuit on February 7, 1992, which held that 12 U.S.C. section 92 was repealed in 1918, thereby leaving the OCC without a basis for a separate insurance ruling.<sup>234</sup> The impact of the revised ruling on the OCC's ability to approve applications by national banks to offer annuities through operating subsidiaries remains a question.

## H. NEGOTIABLE INSTRUMENT

### I. Negotiability

Prior to *Amberboy v. Societe de Banque Privee*,<sup>235</sup> no Texas case had addressed the affect that a variable rate of interest with respect to a promissory note may have on the note's negotiability. *Amberboy* answered a question certified to the Texas Supreme Court by the Fifth Circuit Court of Appeals. The specific question, which the Supreme Court answered affirmatively, was whether a promissory note is a negotiable instrument as defined by the Texas Uniform Commercial Code (Code) if the interest rate charged can only be calculated by reference to the bank's prime rate.<sup>236</sup> The Code sets forth the requirements of a negotiable instrument in section 3.104.<sup>237</sup> One of the requirements is that the instrument contain an unconditional promise or order to pay a sum certain in money. The Code does not define what is meant by the term "sum certain." The court recognized that most courts that have addressed the issue declined to hold that notes with variable interest rates are negotiable instruments. The court also recognized that the issue had been submitted to the Texas legislature in a bill that passed the House in 1991 but which was not voted upon by the Senate.<sup>238</sup> The court, however, believed its mandate under the Code and official comments to the Code was to advance the fundamental purpose of the Code set forth in section 1.102(b)(1).<sup>239</sup> That purpose is to "simplify, clarify and modernize the law governing commercial transactions" and to construe the Code's provisions "in the light of unforeseen and new circumstances and practices."<sup>240</sup> Although the official comment to section 3.106 of the Code states that the sum certain to be paid must be capable of computation "from the instrument itself without reference to any outside source," the court found the rule flexi-

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233. *Id.* at 640 n.1.

234. BNA's Banking Report, Vol. 58, p. 482, March 16, 1992.

235. 831 S.W.2d 793 (Tex. 1992).

236. *Id.* at 793.

237. TEX. BUS. & COM. CODE ANN. § 3.104 (Tex. UCC) (Vernon Supp. 1992).

238. At the time this article is going to press, at least one bill (HB 2195) has been introduced in the Texas House of Representatives which, if passed and signed by the Governor, would legislatively overrule *Amberboy* by amending § 3.106 of the Code to exclude from the term "stated interest" certain variable rates of interest which are not ascertainable on the face of the instrument. Tex. H.B. 2195, 3rd Leg., R.S. (1993).

239. *Amberboy*, 831 S.W.2d at 794.

240. *Id.* at 794 (quoting the comment to the Texas UCC. TEX. BUS. & COM. CODE ANN. § 1.102 (Tex. UCC) (Vernon Supp. 1992)).

ble because the Code itself permits reference to outside sources in determining the sum payable under a negotiable instrument.<sup>241</sup>

The court expanded on its answer to the certified question by explaining what it considered to be included in the phrase a "bank's published prime rate." By using that phrase, the court wrote:

we intend our answer to include only those rates which are public, either known to or readily ascertainable by any interested person . . . . We do not, however, specify or limit the manner in which the rate must be published. The requirement of commercial certainty is satisfied when the information is readily available to the public, regardless of the means utilized to make that information available.<sup>242</sup>

In another negotiability cases, the court held that incorporating the terms of another agreement into an otherwise negotiable instrument defeats its negotiability.<sup>243</sup> Reference in a note of the fact that it is secured by another document is a common practice that does not cause an otherwise negotiable note to become non-negotiable. However, by incorporating the other agreement into the note by reference, the note in question in *1601 Partners* became "subject to or governed by" another agreement for the purposes of section 3.105(b) of the Texas UCC.<sup>244</sup> The promise was, therefore, rendered conditional, and the note was not negotiable.<sup>245</sup>

## 2. Availability of Extrinsic Evidence to Alter Express Terms

Four cases were decided during the Survey period dealing with the issue of varying the express terms of a note by extrinsic evidence and all of them were decided in Houston. Three were decided by the court of appeals, first district, and one by the court of appeals, Fourteenth district. The first case, *Strickland v. Coleman*,<sup>246</sup> decided by the first district court of appeals, and the opinion by the Fourteenth District Court of Appeals in *Mestco Distributors, Inc. v. Stamps*<sup>247</sup> appear to be consistent, while the other two, *Simmons v. Compania Financiera Libano*<sup>248</sup> and *Litton v. Hanley*,<sup>249</sup> each consistent with the other, seem to differ from *Strickland* and *Mestco Distributors*.

In *Strickland v. Coleman*,<sup>250</sup> the lender sued the borrower for the full amount owing on a promissory note, although the borrower contended that he was liable only for half of the amount. The borrower claimed shared liability on the note and supported his claim with evidence of both an agree-

241. *Id.*

242. *Id.* at 797-98; *see also*, *FSLIC v. Kralj*, 968 F.2d 500 (5th Cir. 1992); *Ackerman v. FDIC*, 937 F.2d 1221 (5th Cir. 1992) (the federal case from which the question was certified to the Texas Supreme Court which was decided in *Amberboy*).

243. *See RTC v. 1601 Partners, Ltd.*, 796 F. Supp. 238 (N.D. Tex. 1992).

244. *Id.* at 240.

245. *Id.*

246. 824 S.W.2d 188 (Tex. App.—Houston [1st Dist.] 1992, no writ).

247. 824 S.W.2d 678 (Tex. App.—Houston [14th Dist.] 1992, no writ).

248. 830 S.W.2d 789 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

249. 823 S.W.2d 428 (Tex. App.—Houston [1st Dist.] 1992, no writ).

250. 824 S.W.2d 188 (Tex. App.—Houston [1st Dist.] 1992, no writ).

ment and a course of dealing. All of the evidence conflicted with the terms of the note, which indicated no such agreement.

The evidence introduced by the maker to support his defense was anything but conclusive. However, it was admitted into the record. The court characterized the promissory note as a contract between the maker and payee, and its introduction into evidence where execution has not been denied makes a prima facie case for the holder of the note.<sup>251</sup> When the holder is not a holder in due course, however, the maker can defend on the basis of any defense available to a simple contract.<sup>252</sup> The court stated:

Therefore, evidence is admissible that tends to prove a defense to the action on the promissory note, such as want or failure of consideration, non-performance of a condition precedent, non-delivery, delivery for a special purpose, fraud in the inducement, or other defenses which would be available in an action on a simple contract.<sup>253</sup>

The court also permitted evidence of custom or course of dealing to prove or interpret the terms of the contract. The court distinguished *North Town National v. Broaddus* because it involved a single transaction represented by only one promissory note and a claim of fraud in the inducement based on evidence of what the payee told the maker as an inducement to sign the note.<sup>254</sup> The dissent relied on *Broaddus* as prohibiting the variance or contradiction of the unambiguous terms of a promissory note by extrinsic evidence.<sup>255</sup> The dissent would allow avoidance of the promissory note only by representation of the payee that the maker would not be liable or if trickery, artifice or device were used to induce the payee.<sup>256</sup>

Similarly, in *Mestco Distributors, Inc. v. Stamps*,<sup>257</sup> the payee of several notes sued to collect. Some of the notes were clearly signed by the defendant in a representative capacity as an officer of a corporation in accordance with the provisions of section 3.403(c) of the Code. Others were clearly signed only by the individual with no representative capacity being indicated. The trial court allowed extrinsic evidence to show that the parties agreed or understood that the defendant would not be liable on the notes. Section 3.403(c) of the Code provides that representative capacity exists if a signature is preceded or followed by the name and office of an authorized signer.<sup>258</sup> If the signature is not shown to be in a representative capacity, the signer (in a dispute between the immediate parties) has the burden to offer proof that he signed only in a representative capacity.<sup>259</sup> The court cited *Griffin v. Ellinger*,<sup>260</sup> favorably, as follows:

Under Section 3.403(b), extrinsic evidence is admissible between the

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251. *Id.* at 192.

252. *Id.*

253. *Id.* (citing *North Town National Bank v. Broaddus*, 569 S.W.2d 489 (Tex. 1978)).

254. *Id.*

255. *Id.* at 194 (O'Connor, J., dissenting).

256. *Id.*

257. 824 S.W.2d 678 (Tex. App.—Houston [14th Dist.] 1992, no writ).

258. TEX. BUS. & COM. CODE ANN. § 3.403(c) (Tex. UCC) (Vernon Supp. 1992).

259. *Mestco Distributors, Inc.*, 524 S.W.2d at 980.

260. 538 S.W.2d 97 (Tex. 1976).

parties to the instrument to show that they agreed or otherwise understood that the signer would not be personally liable thereon, even though the instrument itself does not reveal the signer's representative capacity. *The Code does not delineate what proof is necessary to "otherwise establish" between the parties that the signer is not personally liable on an instrument which he intended to sign only in a representative capacity. Therefore, the general principles of law and equity are to be applied.* Section 1.103. In *Seale v. Nichols*, 505 S.W.2d 251 (Tex. 1974), this Court had occasion to construe Section 3.403(b). We there stated that, in order for an agent to avoid liability on his signature, "he must disclose his intent to sign as a representative to the other party." 505 S.W.2d at 255. We also recognized that prior dealings between the parties are relevant in determining whether the parties understood the signature to be in a representative capacity.<sup>261</sup>

The same court that decided *Strickland v. Coleman*<sup>262</sup> also decided the cases of *Litton v. Hanley*<sup>263</sup> and *Simmons v. Compania Finacing Libano*.<sup>264</sup> In *Strickland*, the court distinguished *Broaddus*,<sup>265</sup> but in *Litton* and *Simmons* the same court followed *Broaddus*.

Litton and Hanley were owners of a corporation that operated an unsuccessful restaurant business. They engaged in a dispute ending with Hanley purchasing Litton's interest. In exchange for Litton's stock in the corporation, Hanley agreed to make certain tax payments and executed and delivered to Litton a promissory note payable in fifty-eight monthly installments. When Hanley failed to make any payments on the note, Litton sued to collect. Hanley pled lack of consideration and failure of a condition precedent in defense of the suit and was able to introduce parol evidence at the trial in support of his defense. He contended that Litton induced him to sign the note by representing that his payment was contingent upon the success of the restaurant after Hanley took over its business. Litton, of course, denied making any such agreement.

The court addressed the issues as follows:

It is well settled that a written instrument may not be *varied* by evidence of an oral agreement that contravenes its terms. However, parol evidence is admissible to show (1) that the execution of a written agreement was procured by fraud, (2) that an agreement was not to become effective except upon certain conditions or contingencies, or (3) to ascertain the parties' true intentions, where the writing is ambiguous. If the written instrument is worded so that it can be given a certain definite meaning or interpretation, then it is not ambiguous, and the court will construe the contract as a matter of law.<sup>266</sup>

Under the fraud exception the court held that the payee must have used "trickery, artifice or device" and represented that the maker would not be

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261. *Mestco Distributors, Inc.*, 824 S.W.2d at 681.

262. 824 S.W.2d 188 (Tex. App.—Houston [1st Dist.] 1992, no writ).

263. 823 S.W.2d 428 (Tex. App.—Houston [1st Dist.] 1992, no writ).

264. 830 S.W.2d 780 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

265. 569 S.W.2d 489 (Tex. 1978).

266. *Litton*, 823 S.W.2d at 430 (citations omitted).

personally liable.<sup>267</sup> The only evidence that Hanley introduced was that Litton represented to him that he would be liable on the note only if the restaurant succeeded. That evidence did not rise to the level required to show fraud in the inducement and allow introduction of parol evidence.<sup>268</sup>

If an agreement existed that Hanley would be liable only if the restaurant succeeded, then the success of the restaurant would have been a condition subsequent, not a condition precedent. A condition subsequent extinguishes an existing agreement, whereas a condition precedent delays the formation of an agreement until the contingency occurs.<sup>269</sup> The note given by Hanley to Litton was given in consideration for the transfer by Litton to Hanley of Litton's stock in the corporation and was effective at that time. The agreement alleged by Hanley was a condition subsequent and, according to the court, parol evidence of its existence was not admissible.<sup>270</sup> Finally, the court believed that the terms of the promissory note were not ambiguous and parol evidence of the parties' intent should not be admitted when the language of the instrument is clear and unambiguous.<sup>271</sup>

The parties to the suit in *Simmons v. Campanio Financiera Libano*<sup>272</sup> were the maker of the note and the pledgor of collateral for the note. The pledgor, after his collateral was applied to the note, sued the maker on a suretyship theory. The maker asserted that he and the pledgor were partners, but the court of appeals, based on *Broaddus*, held that the parol evidence rule prohibited the use of parol evidence to alter the terms of the agreement.<sup>273</sup> Therefore, the maker could not prove any collateral agreements and was liable to the pledgor.

Consistent with *Litton* and *Simmons* was the holding by the Fifth Circuit in *Rosas v. United States Small Business Administration*.<sup>274</sup> Rosas brought suit against Meadowbrook National Bank, its president, and the United States Small Business Administration alleging, among other things, negligent misrepresentation. The claim of negligent misrepresentation dealt with the allegation that Meadowbrook verbally agreed to a twenty year payout on the promissory note even though the promissory note, by its explicit terms, required a fifteen year payout. The district court granted summary judgment, concluding that the testimony necessary to support this allegation was inadmissible under the parol evidence rule.<sup>275</sup> On appeal, the plaintiffs argued that the fraud exception to the parol evidence rule applied so that the testimony was admissible. The Fifth Circuit followed Texas law, which requires that a person seeking to utilize the fraud exception to the parol evidence rule, must prove more than just that a misrepresentation was made.<sup>276</sup>

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267. *Id.*

268. *Id.*

269. *Id.*

270. *Id.* at 431.

271. *Id.*

272. 830 S.W.2d 789 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

273. *Id.* at 791.

274. 964 F.2d 351 (5th Cir.1992).

275. *Id.* at 354.

276. *Id.* at 356.

The plaintiff is required to show some type of trickery, artifice or device employed by the bank in addition to the misrepresentation.<sup>277</sup>

### 3. Payment

Payment to a lender by a private mortgage insurer in accordance with the provisions of the insurance contract does not constitute payment on the note. This issue was raised and disposed of by the court in *Pineda v. PMI Mortgage Insurance Company*.<sup>278</sup> According to the court, the payment by PMI to the lender was pursuant to its insurance policy issued to the lender, not to Pineda. It was not a payment on behalf of Pineda because Pineda was not the insured.<sup>279</sup> Texas Insurance Code section 21.50 allows only lenders to be insured by mortgage insurance.<sup>280</sup>

The maker of a note in *Rea v. Sunbelt Savings*<sup>281</sup> was not allowed to raise the defense of payment because of his failure to comply with the procedural requirements of Rule 95 of the Texas Rules of Civil Procedure.<sup>282</sup> Payment is an affirmative defense, and Rule 95 requires the defendant to plead specifically the nature of the payment and the several items thereof.<sup>283</sup> Evidence regarding payment becomes inadmissible if not properly pled.<sup>284</sup> In this case, the maker pled the defense of payment only in general terms, and the court required the maker to specify what credits and offsets he was relying on.<sup>285</sup>

Although not a Texas case, the Supreme Court of New Mexico was faced with deciding whether, under Texas law, a borrower who was liable for interest only could tender the collateral to the lender in payment of the debt thereby discontinuing any liability for interest that would otherwise accrue in the future.<sup>286</sup> In *Brown*, the borrower executed a five-year real estate lien promissory note, a deed of trust, and a guaranty in which the borrower only guaranteed payment of interest accruing on the note and certain costs, and the lender agreed not to look to the borrower for the payment of the principal. The note provided for monthly interest-only payments during the five-year period. Upon maturity, all outstanding principal plus any unpaid interest was due. The borrower transferred its interest in the property to a partnership of which the borrower was the managing general partner. The partnership tendered a special warranty deed to the property along with other pertinent documents to a trustee for the lender with an amount of money representing all interest due under the note through three days after the tender. The lender rejected the tender and several weeks later the part-

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277. *Id.*

278. 843 S.W. 2d 660 (Tex. App.—Corpus Christi 1992, no writ).

279. *Id.* at 665.

280. TEX. INS. CODE ANN. art. 21.50 (Vernon 1981).

281. 822 S.W.2d 370 (Tex. App.—Dallas 1992, no writ).

282. *Id.* at 373.

283. TEX. R. CIV. P. 95 (Vernon 1979).

284. *Id.*

285. *Rea*, 822 S.W.2d at 373.

286. See *Brown v. Financial Savings*, 828 P.2d 412 (N.M. 1992) (deciding the case under Texas law pursuant to terms of the note, deed of trust and guaranty).

nership tendered to the lender a special warranty deed to the property with all interest due through the date of maturity of the note. This was also rejected by the lender. The court held that the borrower could not tender the real property without the express consent of the lender and stated "that absent an agreement to the contrary, tender of payment in a medium other than provided in the note will not constitute valid legal tender."<sup>287</sup> A tender is an unconditional offer by a borrower to pay "in current coin of the realm" a sum not less than the amount due on a specific debt.<sup>288</sup> Without an agreement to the contrary, requiring a maker of a promissory note to repay with money is the common commercial practice.<sup>289</sup>

#### 4. *When a Demand Note is not a Demand Note*

The Fifth Circuit distinguished *Conte v. Greater Houston Bank*<sup>290</sup> in *Bank One, Texas v. Taylor*.<sup>291</sup> In the case before the Fifth Circuit, each note contained a monthly payment schedule, an acceleration clause, and a demand clause. The demand clause stated that "this obligation is, as an alternative to the above-recited payment schedule, due and payable on demand."<sup>292</sup> The notes also contained an acceleration clause entitling the bank to accelerate payment "if default occurs in the punctual payment of any installment of principal or interest."<sup>293</sup> The court held that the provisions dealing with default and acceleration indicated that the instrument was not a demand note, but rather the note was an instrument that was payable upon demand only if the obligor failed to meet the installment obligations.<sup>294</sup> The court in *Bank One, Texas* specifically distinguished *Conte*, where it was held that the language "[payable] on demand, but if no demand is made: principal and interest shall be due and payable in monthly installments" created a demand instrument that was due at anytime upon the demand of the holder.<sup>295</sup> The intention manifested by the wording of the notes that they only became payable on demand if Taylor failed to meet installment obligations distinguishes the notes from those in *Conte*.<sup>296</sup>

#### 5. *Reasonableness of Exercising Acceleration and Insurity Clauses*

In *Hall v. RTC*<sup>297</sup> the borrower requested that the lender accept different collateral in substitution of existing collateral. The lender rejected the borrower's proposal. Expressing concern about the declining value of the existing collateral and other events, the lender exercised its rights under the

287. *Id.* at 414 (quoting *Arguelles v. Kaplan*, 735 S.W.2d 782, 784 (Tex. App.—Corpus Christi 1987, writ ref'd, n.r.e.)).

288. *Id.*

289. *Id.*

290. 641 S.W.2d 411 (Tex. App.—Houston [14th Dist.] 1982, writ ref'd n.r.e.).

291. 970 F.2d 16 (5th Cir. 1992).

292. *Id.* at 31.

293. *Id.*

294. *Id.*

295. *Id.*

296. *Id.* at 32.

297. 958 F.2d 75 (5th Cir. 1992).

security agreement to call for additional collateral. In response to this, the borrower stopped making loan payments. The court noted at the outset that under Texas law, "undisputed evidence of a significant impairment in the prospect of satisfaction of a debt establishes, as a matter of law, the reasonableness of invoking insecurity provisions under a security/loan agreement."<sup>298</sup> Since the evidence was undisputed that the borrower himself had provided information to the lender that the stock pledged by the borrower had dramatically declined in value, the lender's decision to call for more collateral was objectively reasonable and consistent with the terms of the agreement.<sup>299</sup>

In finding sufficient evidence that the lender did not act in good faith in accelerating the payment of a note, the Waco court of appeals noted in *American Bank v. Waco Airmotive, Inc.*<sup>300</sup> that the creditor's security is protected from impairment by the acts of debtors through the use of acceleration clauses.<sup>301</sup> Such clauses are not to be used for the commercial advantage of the creditor because acceleration is a harsh remedy.<sup>302</sup> Analysis of whether acceleration is in good faith is performed on a case-by-case basis.<sup>303</sup> Presumably, the court based its acceleration decision on the fact that the lender was aware of essentially all the facts leading to the acceleration at the time the lender accepted the note from the borrower in renewal of existing debt. The court also noted that the borrower's proposal for substitution of collateral did not satisfy the call for additional collateral.

## 6. Novation

The rule in Texas regarding novation of original indebtedness by the execution of a renewal note is well settled and was accurately stated by the court in *Allied Elevator, Inc. v. East Texas State Bank*:<sup>304</sup>

[T]he giving of a new note for a debt evidenced by a former note does not extinguish the old note unless such is the intention of the parties. Nor is there a presumption of the extinguishment of the original paper by the execution and delivery of a new note. The burden of proving a novation is on the person asserting it. . . . When renewal notes are involved, the holder may sue either on the original note or on the renewal note.<sup>305</sup>

The holder of the note sought a judgment on the original note, rather than the renewal note, because the makers had a possible defense to the renewal note. Because the original note in this case was stamped "CANCELLED BY RENEWAL" and the bank sent a past due notice for the renewal note, the court was unable to say that no fact issue existed for summary judgment

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298. *Id.* at 78.

299. *Id.*

300. 818 S.W.2d 163 (Tex. App.—Waco 1991, writ denied).

301. *Id.* at 172.

302. *Id.*

303. *Id.*

304. 965 F.2d 34 (5th Cir. 1992).

305. *Id.* at 37 (citations omitted).

purposes.<sup>306</sup> That evidence alone was sufficient to create a material issue of fact as to whether a novation occurred.<sup>307</sup>

### 7. *Missing Endorsements*

Because of the frequent receiverships of financial institutions in recent years and the resultant transfer of assets from failed institutions to new institutions, servicing companies and others, it is not uncommon for notes that were originally held by the failed institution to have missing endorsements in their chains of title. This produces inevitable proof problems for the holder who must sue to enforce collection. One such instance occurred in the case of *FDIC v. Selaiden Builders, Inc.*<sup>308</sup> The FDIC sought to enforce two promissory notes and the guaranties of those notes that were executed by several individuals. The notes and guaranties passed through several hands before landing with the FDIC. The endorsements on the notes did not track the alleged history of the various transfers. The issue was whether the summary judgment proof sufficiently established that the FDIC was the owner and holder of the notes. Affidavits of two employees of the FDIC to the effect that the FDIC was the owner and holder of the notes was the basis on which summary judgment was granted for the FDIC.<sup>309</sup>

In *RTC v. Camp*<sup>310</sup> the court acknowledged that mere possession of an unendorsed note did not establish that the possessor was the owner and holder.<sup>311</sup> In order to create a material fact issue for purposes of summary judgment, however, the person disputing the ownership of the note must show some evidence of a legitimate fear that the possessor is not the owner and holder of the note.<sup>312</sup> In the *Selaiden* case, since one of the notes bore an endorsement to an entity that was not in the chain of title, there was some evidence of a legitimate fear that the FDIC was not the owner and holder.<sup>313</sup> The FDIC argued that the endorsement merely failed to include the words "Association" or "F.S.A." to make the endorsement accurately name a party in the chain and that the entity actually named never existed. Had the FDIC presented summary judgment evidence that the entity never existed, then the court apparently would have upheld the summary judgment on both notes.<sup>314</sup>

In *Pineda v. PMI Mortgage Insurance Co.*<sup>315</sup> Pineda argued that there was no summary judgment proof of the transfer of the note to PMI's transferor. The note was endorsed, however, directly to PMI, the party suing on the note. This created an evidentiary presumption under sections 3.201 and

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306. *Id.*

307. *Id.*

308. 973 F.2d 1249 (5th Cir. 1992).

309. *Id.* at 1254-55.

310. 965 F.2d 25 (5th Cir. 1992).

311. *Id.* at 29.

312. *Id.*

313. *Selaiden Builders, Inc.*, 973 F.2d at 1254.

314. *Camp*, 965 F.2d at 29.

315. 843 S.W.2d 660 (Tex. App.—Corpus Christi 1992, no writ).

3.202 of the Code that PMI was the owner of the note.<sup>316</sup> Pineda failed to meet the burden of controverting PMI's evidence of ownership of the note.<sup>317</sup>

## I. LETTERS OF CREDIT

### 1. "Duly Honoring" a Draft as a Condition to the Issuer's Right of Reimbursement

*RTC v. Kimball*<sup>318</sup> involved three letters of credit, identical except that a different person was the account party on each. A draft by the beneficiary of the letters of credit was presented to the bank. The draft identified each letter individually, and the bank honored the draft, apportioning the amount of the draw equally among the three letters. Pursuant to agreement with the account parties, the payer of the draft then sought reimbursement from the account parties. The court held that under Texas law, the issuer of a letter of credit duly honors a draft presented to it by a beneficiary when the draft complies with the terms of the letter, without more.<sup>319</sup> In addition, the court held (i) that an account party has standing to raise the issue of whether the draft was duly honored as a defense to the issuer's claim for reimbursement, (ii) that the letters themselves need not be presented before any drafts can be honored where the letter states that a draft *may* be drawn by presenting the letter, and (iii) that absent affirmative terms to the contrary in the letters of credit, proration of the draw among the three letters as well as the inclusion of the three letters on one draft was permissible.<sup>320</sup> The court stated that as a general proposition, an issuer of a letter of credit must pay the beneficiary without inquiry into the transaction between the beneficiary and the account party.<sup>321</sup> Without regard to whether the issuer honored a draft, an account party must generally reimburse the issuer upon demand.<sup>322</sup> The court noted, however, that section 5.114(c) of the Code plainly makes the right of reimbursement contingent upon the *duly honoring* of the draft by the issuer. In order to interpret the term duly honored, the court looked to sections 5.114(c) and (b)(2), which, according to the court, "absolves [the] issuing bank from liability in the situation where it honors a draft despite notice 'of fraud, forgery or other defect not apparent on the face of the [draft]'"<sup>323</sup> The court stated that because the issuer's duty in honoring a beneficiary's draft is limited to a facial examination of the draft, then the issuer's statutory right of reimbursement merely requires that the issuer make payment only on presentations of drafts that conform with the requirements of the letter of credit.<sup>324</sup> The court supported its analysis with the

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316. *Id.* at 666.

317. *Id.*

318. 963 F.2d 820 (5th Cir. 1992).

319. *Id.* at 825.

320. *Id.* at 825-26.

321. *Id.* at 823.

322. *Id.*

323. *Id.* at 824.

324. *Id.*

language of section 5.109(b), which describes the issuer's duty to carefully examine drafts in order to ascertain that on their face they comply with the terms of the letter of credit.<sup>325</sup> Having satisfied this duty, the issuer assumes no liability or responsibility for the legitimacy of the documents.<sup>326</sup> Regarding whether an account party has standing to raise the defense of wrongful honor, the court stated that the plain terms of section 5.114(c) make it clear that the account party has such standing.<sup>327</sup>

## 2. Injunctions

Pursuant to section 5.114(b)(2) of the Code, the Amarillo court of appeals confirmed that there are three grounds upon which a court can enjoin the issuer of a letter of credit from honoring a draft.<sup>328</sup> Those grounds are: (1) where the beneficiary has committed fraud; (2) where one of the requisite documents is forged; and (3) where there is some defect not apparent on the face of the documents.<sup>329</sup> In *Goldome*, a bank issued a letter of credit to Goldome Credit Corporation authorizing it to draw \$150,000 against University Square's account. A few days later, Goldome's lawyer presented to the bank documentation necessary for payment under the letter of credit. In the meantime, University Square obtained a temporary restraining order enjoining the bank from honoring the letter of credit because it was concerned that Goldome no longer existed and thus it might have to pay twice. A temporary injunction was later granted based on evidence that the press reported that Goldome Savings Bank, Goldome's parent, had been seized by the FDIC. In this case the issue is whether the exercising party is Goldome or an authorized agent, not whether the false statement related to the contractual duty or whether University Squares was obligated to pay Goldome. Even though this fact might not reach the level of fraud, which would destroy the underlying agreement, denying the injunction would risk subjecting University Square to double payment on the debt, destroying the legitimate purposes of the bank's obligation to honor the letter of credit, and this doubt was sufficient to allow the court to enjoin the issuer based on a defect not apparent on the fact of the documents.<sup>330</sup> The court also noted that while under similar circumstances "a trial court may enjoin presentment of a letter of credit, the issuing bank 'acting in good faith may honor the demand for payment despite notification from its customer of fraud, forgery or other defects not apparent on the face of the documents.'"<sup>331</sup>

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325. *Id.*

326. *Id.* at 824-25.

327. *Id.* at 825.

328. *Goldome Credit Corp. v. Univ. Square Apartments*, 828 S.W.2d 505 (Tex. App.—Amarillo 1992, no writ).

329. *Id.* at 509.

330. *Id.* at 509-10.

331. *Id.* at 511 (citations omitted).

## J. ENFORCEMENT OF LIENS

1. *Repossession - Breach of Peace*

By a sharply split five to four vote, the Supreme Court of Texas held that section 9.503 of the Code imposes a nondelegable duty on a secured party pursuing nonjudicial repossession to do so without breaching the peace.<sup>332</sup> The facts of the case were so egregious that they possibly influenced the outcome. MBank hired an independent contractor to repossess an automobile. The owner confronted the contractor and demanded that the contractor cease its efforts to repossess the car. When the contractor refused to do so, the owner jumped into the car and locked the doors. The contractor proceeded to tow the car, at a high rate of speed, to the tow yard. The car was parked inside a fenced area, behind a padlocked gate and with a Doberman pinscher guard dog roaming loose in the yard. The owner of the car was ultimately rescued by her husband and the police. The court framed the issue as an attempt by a lender to avoid responsibility, which foretold the answer it would ultimately reach: "The issue in this case is whether a secured creditor may avoid liability for breaches of the peace by using an independent contractor to carry out repossession."<sup>333</sup>

The majority of the court relied upon section 424 of the SECOND RESTATEMENT OF TORTS to state the general rule as follows: "when a duty is imposed by law on the basis of concerns for public safety, the party bearing the duty cannot escape it by delegating it to an independent contractor."<sup>334</sup> The Restatement actually states the general proposition that one cannot delegate a duty to provide *specified* safeguards or precautions for the safety of others.<sup>335</sup> Section 9.503 of the Code does not set forth specified safeguards or precautions for the safety of others.<sup>336</sup> The Code imposes a general standard instead, leaving the specifics to be established by case law.<sup>337</sup>

2. *Duty of Preservation of Collateral*

Section 9.207 of the Code imposes the duty upon a secured creditor to "use reasonable care in the custody and preservation of collateral in his possession."<sup>338</sup> The Official Comment indicates that the duty is the same as the duty imposed by common law.<sup>339</sup> The court of appeals recently construed the language of section 9.207 in *Roquemore v. National Bank of Commerce*.<sup>340</sup> The court held, with respect to stocks held as loan collateral, that the bank did not breach its duty by failing to sell the stock when its value

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332. MBank El Paso, N.A. v. Sanchez, 836 S.W.2d 151, 151-52 (Tex. 1992).

333. *Id.* at 152.

334. *Id.* at 153.

335. RESTATEMENT (SECOND) OF TORTS § 424 (1965).

336. TEX. BUS. & COM. CODE ANN. § 9.503 (Tex. UCC) (Vernon Supp. 1992).

337. MBank El Paso, N.A., 836 S.W.2d at 154.

338. TEX. BUS. & COM. CODE ANN. § 9.207 (Tex. UCC) (Vernon Supp. 1992).

339. *Id.* at comment 1 (citing RESTATEMENT OF SECURITY §§ 17-18 (1941), which states, "[duty is] confined to physical care of the chattel, whether an objectionor a negotiable instrument or document of title.").

340. 837 S.W.2d 212 (Tex. App.—Texarkana 1992, no writ).

began to decline.<sup>341</sup>

In *United States of America v. Alphagraphics Franchising, Inc.*,<sup>342</sup> the Small Business Administration (SBA) acquired a loan by performing on its guaranty. Two significant pieces of collateral that it had in its possession were held for two years before they were sold. In the meantime, the collateral was not maintained by the SBA and deteriorated. When the SBA sued the guarantor under its guaranty for the deficiency, the guarantor raised as a defense the fact that the SBA failed to maintain the collateral during the period before it was sold, resulting in a lower price than could have been received had the collateral been maintained. The SBA countered by citing the terms of the guaranty, which provided that the SBA was not responsible for any "deterioration, waste, or loss by fire, theft or otherwise of any of the collateral, unless such deterioration, waste, or loss be caused by *the willful act or willful failure to act of [the SBA]*."<sup>343</sup>

The evidence established that the decline in the price of the collateral was caused by the failure of the SBA to maintain it. In order to succeed, however, the guarantor also was required to prove that the decline in the price of the collateral was caused by the willful failure of the SBA to act due to the provisions of the guaranty.<sup>344</sup> The court held that the SBA was not responsible for the deterioration because there was no evidence that it failed to maintain the collateral with the intent to cause it harm.<sup>345</sup> The word willful requires a showing of an act done with an intent to bring about the deterioration of the property.<sup>346</sup>

### 3. *Commercial Reasonableness of Foreclosure*

In *Greathouse v. Charter National Bank*,<sup>347</sup> the bank sued the borrower and guarantor for the deficiency, interest, and attorney's fees resulting from the foreclosure and sale of collateral securing a note. In its pleadings, the lender pled generally that "All conditions precedent had been performed or have occurred. All just and lawful credits, payments and offsets have been allowed."<sup>348</sup> The debtor answered with a general denial.

The Supreme Court held that a creditor must plead commercially reasonable disposition of collateral in a deficiency action.<sup>349</sup> The court held that commercially reasonable disposition was a condition to recovery because the creditor usually controls the disposition.<sup>350</sup> Since the reasonableness of disposition is not generally at issue, the creditor must specifically plead commercial reasonableness or generally aver that all conditions precedent were

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341. *Id.* at 216-17.

342. 973 F.2d 429 (5th Cir. 1992).

343. *Id.* at 130 (emphasis in original).

344. *Id.*

345. *Id.* at 431.

346. *Id.* at 430.

347. 35 Tex. Sup. Ct. J. 1017 (July 1, 1992).

348. *Id.*

349. *Id.* at 1020.

350. *Id.*

performed.<sup>351</sup> The creditor must prove reasonableness under a specific plea, but only needs to prove reasonableness under a general plea if the debtor denies the disposition was reasonable.<sup>352</sup>

The Texarkana court of appeals in *Roquemore*,<sup>353</sup> in addition to following *Greathouse*, held that the requirement that a secured creditor dispose of the collateral in a commercially reasonable manner is a condition to its recovery of a deficiency.<sup>354</sup> Transfer to a holder in due course does not extinguish the commercially reasonable disposition defense.<sup>355</sup> In addition the court held that a sale of stock can be commercially reasonable even if not sold at the most advantageous time.<sup>356</sup> The fact that a better price could have been obtained at a different time or in a different manner is not sufficient, standing alone, to establish that the disposition was not commercially reasonable.<sup>357</sup> The court also noted, that the Fifth Circuit has held the sale of collateral on a recognized market commercially reasonable as a matter of law under the Code.<sup>358</sup>

#### 4. *Deposit Accounts*

##### a. Equitable Exception to Enforcement of Consensual Security Interest

In *FDIC v. Golden Imports, Inc.*<sup>359</sup> the court considered whether the equitable exception to a bank's common law right of offset against a borrower's deposit account is also applicable to a bank's right to enforce a consensual security interest in a deposit account. The bank in this case applied funds in its borrower's account to the borrower's debt. A third party sued the bank for conversion, claiming that at least a portion of the funds that were offset belonged to it. According to the court, a conversion is

unlawful exercise of dominion, ownership or control by one party over the property of another to the exclusion of the exercise of the same rights by the owner, either permanently or for an indefinite time. Money is the subject of conversion only when it can be described specifically, as opposed to discharging a debt by payment of money generally. When a person designates a particular use for proceeds from a check, those proceeds are specific money capable of conversion.<sup>360</sup>

Texas recognizes an equitable exception that is applicable to the bank's right to setoff the funds on deposit in the account, whether the bank is exercising its common law right or is acting as a secured creditor holding a se-

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351. *Id.*

352. *Id.*

353. *Roquemore v. Nat'l Bank of Commerce*, 837 S.W.2d 212 (Tex. App.—Texarkana 1992, no writ).

354. *Id.* at 214.

355. *Id.*

356. *Id.*

357. *Id.* at 215.

358. *Id.*

359. No. 01-88-00307-CV, 1991 WL 204175 (Tex. App.—Houston [1st Dist.] Oct. 10, 1991).

360. *Id.* at 2.

curity interest in the account.<sup>361</sup> That being so, the bank was charged with the duty of inquiring as to the ownership of the funds and, once offset, would be required to pay the funds over to the rightful owner, unless the bank had changed its position to its detriment.<sup>362</sup> Further, even though the parties seemed to have an honest dispute over the bank's right to the funds relative to the claimants' right, the court held that the evidence was sufficient to show that the bank acted with malice and was, therefore, subject to punitive damages.<sup>363</sup> The only evidence of malice suggested, at best, a knowing conversion, but the court held that malice can be implied from a knowing conversion.<sup>364</sup>

#### b. Equitable Exception to Right of Offset

The equitable exception rule was also discussed and applied in a common law offset case.<sup>365</sup> According to that court, in reliance upon *National Indemnity Co. v. Spring Branch State Bank*,<sup>366</sup> the equitable exception to setoff requires a bank to return setoff funds it would otherwise be entitled to keep, despite the fact that the bank had no notice that the funds were held in trust.<sup>367</sup> The court noted that the exception is not limited to funds held pursuant to an express trust, but that it applies to any funds held in a fiduciary capacity.<sup>368</sup> The court relied on *Indemnity Co.* for the rule that a bank may not apply funds held in trust to the individual debt of the depositor if there has been no detrimental change in the bank's position and no superior equities have been raised in its favor.<sup>369</sup> In *Indemnity Co.*, the bank had no knowledge that funds in its depositor's account were held in trust. Nevertheless, the supreme court held that the equitable exception applied and that the funds must be returned by the bank.<sup>370</sup> Detrimental reliance is a defense to the equitable exception and here it appeared that the bank had detrimentally relied on its right to setoff because the bank obtained a judgment against the depositor on the underlying debt less the amount of the offset. The bank failed, however, to present this issue to the trial court and could not raise the issue for the first time on appeal. Thus, under the facts of this case, had the bank properly raised the defense of detrimental reliance, it could have kept the setoff funds.

#### c. Improper Pledge

In *Cushman v. RTC*<sup>371</sup> the bank allowed a husband to pledge accounts

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361. *Id.* at 3.

362. *Id.*

363. *Id.* at 7.

364. *Id.*

365. *First Nat'l Bank v. Arrow Oil & Gas, Inc.*, 818 S.W.2d 159 (Tex. App.—Amarillo 1991, no writ).

366. 348 S.W.2d 528 (Tex. 1961).

367. *See National Indemnity Co.*, 348 S.W.2d at 531.

368. *Id.*

369. *Id.*

370. *National Indemnity Co.*, 348 S.W.2d at 531.

371. 954 F.2d 317 (5th Cir. 1992).

that were in the names of the husband and the wife. They were each "and" accounts, rather than "or" accounts. Nevertheless, the bank permitted the husband to pledge the accounts without the joinder of the wife and proceeded to foreclose on the accounts when the debt was not paid. Not surprisingly, the court held that the pledges were invalid as were the foreclosures.<sup>372</sup> In addition, the court did not allow the bank to recast the foreclosures as offsets after the fact.<sup>373</sup>

#### d. Other Offset Cases

Mutuality of obligations is a requirement that must be met as a condition to a bank's common law offset rights. In *FDIC v. Projects American Corp.*<sup>374</sup> the borrower was a corporation, but the depositor was a defined benefit pension plan maintained by the corporation. When the bank failed, the corporation attempted to have the deposit accounts of the pension plan offset against its debt. The court held that there was no mutuality of obligations stating that mutuality exists where debts are owing between the same parties in the same right or capacity.<sup>375</sup> The debts must be such that the party asserting setoff could maintain an action on the debt, while the other party could claim his cause of action in the same suit as a setoff.<sup>376</sup>

The Austin court of appeals addressed the propriety of offsetting a borrower's account in *American Bank v. Waco Airmotive*.<sup>377</sup> The court noted that the relationship of a bank to a general depositor is a debtor/creditor contract which arises out of the depository contract.<sup>378</sup> Offset is authorized by the nature of the relationship, assuming proof of the amount owed, but an offset is not authorized without a mature or past-due debt owed by the depositor.<sup>379</sup> A depositor's remedy for wrongful offset is an action for breach of contract, and the remedy of return of the funds on deposit.<sup>380</sup> The court held that exemplary damages are not recoverable for wrongful offset because a wrongful offset action is in the nature of a breach of contract action.<sup>381</sup> Finally, the Texas Supreme Court held in *Bandy v. First State Bank*<sup>382</sup> that a bank does have an equitable right of setoff against assets of a decedent's estate, whether or not it is solvent, without following the claims procedures found in the Texas Probate Code.

### 5. Sufficiency of Security Agreement/Financing Statement

#### *In Austin Area Teachers Federal Credit Union v. First City Bank-North-*

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372. *Id.* at 327.

373. *Id.*

374. 828 S.W.2d 771 (Tex. App.—Texarkana 1992, writ denied).

375. *Id.* at 773-74.

376. *Id.* at 774.

377. 818 S.W.2d 163 (Tex. App.—Waco 1992, writ denied).

378. *Id.* at 170.

379. *Id.*

380. *Id.*

381. *Id.* at 176.

382. 835 S.W.2d 609 (Tex. 1992).

*west Hills N.A.*<sup>383</sup> a mother pledged a certificate of deposit she owned as collateral for a loan to her son. The certificate of deposit was issued by the credit union, and the loan to her son was made by the bank. The mother executed an assignment and a consent to pledge. The assignment failed to specify the account at the credit union being pledged by the mother, but the notice of assignment (which was signed by the bank) and the acknowledgment of the assignment (which was signed by an employee of the credit union) both specified the certificate by number. The notice and the acknowledgment were part of the assignment. In addition, the consent to pledge specified the particular certificate of deposit. The acknowledgment, which was signed by an employee of the credit union, stated that the mother could not withdraw any money from the assigned account. Contrary to that prohibition, the credit union allowed the mother to withdraw funds. When the son defaulted on the loan, the bank asked the credit union to release the certificate of deposit and sued the credit union for breach of contract when the credit union was unable to comply with the request. The credit union attacked the effectiveness of the assignment on five grounds:

- 1) it failed to designate the specific account being assigned
- 2) it purported to secure debt owed by the mother, not the son, and the mother had no debt to the bank
- 3) the credit union employee who signed the acknowledgment had no actual or apparent authority to do so
- 4) the certificate of deposit was not assignable by its terms
- 5) the bank had not perfected its security interest by taking possession of the certificate of deposit

The court read the assignment as a whole, including the notice and acknowledgment, which were part of the assignment, to find that the assignment adequately described the account being assigned. As to the claim that the assignment secured only debt of the mother, the court noted that the assignment secured all debt, liability, and obligation of the mother at any time owed to the bank.<sup>384</sup> The assignment and consent to pledge, in the opinion of the court, became obligations of the mother to the bank the moment the son defaulted on the loan from the bank.<sup>385</sup> Those obligations were, therefore, secured by the assignment. Addressing the issue of the authority of the credit union's employee, the court stated: "Actual authority of an agent may arise as a result of conduct by the principal that intentionally or negligently allows the agent to believe he or she has been given actual authority to represent the principal."<sup>386</sup> In this case, the evidence regarding the employee's work history and belief he was authorized supported the trial court's implied finding. The court of appeals believed it was the credit union's responsibility to ensure that proper personnel signed documents for the credit union, not the bank's responsibility.<sup>387</sup> Because the credit union

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383. 825 S.W.2d 795 (Tex. App.—Austin 1992, writ denied).

384. *Id.* at 799.

385. *Id.*

386. *Id.*

387. *Id.* at 799-800

failed to provide convincing evidence that the certificate was not assignable and because the assignment was acknowledged, the credit union also lost its argument that the account could not be assigned.<sup>388</sup> Finally, because the dispute was not between competing creditors claiming security interests in the same collateral, but a dispute over the credit union's contractual obligations, the credit union's argument that the security interest of the bank was not perfected was overruled.

The sufficiency of a financing statement to provide notice was the issue between competing third parties in *Continental Credit Corp. v. Wolfe City National Bank*.<sup>389</sup> In that case, Mr. Summers was the sole shareholder of Pawn Partners, Inc., which purchased Greenville Pawn Shop in January 1982. Days later, Pawn Partners, Inc. filed an assumed name certificate in Hunt County to do business as Greenville Pawn Shop. In 1983, Mr. Summers married Judy Owen who had pre-existing loans and accounts with Wolfe City National Bank. The Summers began doing business with Wolfe City using their name Summers coupled with the trade name of "Greenville Pawn Shop."

During the marriage, Mrs. Summers signed successive promissory notes payable to Wolfe City as well as three security agreements placing the inventory and accounts receivable of Greenville Pawn Shop as collateral for the Notes. Wolfe City filed two financing statements, one with the Secretary of State in Austin and one in Hunt County. In 1986, Continental Credit Corporation (Continental) purchased the assets of Pawn Partners, Inc. d/b/a Greenville Pawn Shop. Wolfe City National Bank claimed a superior interest in the inventory and accounts receivable and made demand upon Continental. Continental refused to return any of the assets it had purchased or the proceeds from the sale thereof. The court held that sufficient notice was not given to Continental by the filing of financing statements in the name of Judy Summers d/b/a Greenville Pawn Shop or Judy and Olan Summers d/b/a Greenville Pawn Shop, since the corporation and actual owner's name was Pawn Partners, Inc.<sup>390</sup> Even though the requirements for a perfected security interest allow minor errors, the errors must not be seriously misleading. Therefore, the critical inquiry in assessing whether the creditor has perfected a security interest is whether a reasonably prudent subsequent creditor would have discovered the prior security interest.<sup>391</sup>

## 6. Real Estate Foreclosures

### a. Notice

In *First National Bank Mansfield v. Nelson (In re Nelson)*<sup>392</sup> the court held that the lender did not give proper notice of the foreclosure sale of certain real estate, which was thus declared void, because the notice of fore-

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388. *Id.* at 800.

389. 823 S.W.2d 687 (Tex. App.—Dallas 1991, no writ).

390. *Id.* at 691.

391. *Id.* at 690-92.

392. 134 B.R. 838 (Bankr. N.D. Tex. 1992).

closure was posted in the late afternoon and the sale was conducted in the morning, just a few hours shy of the twenty-one full day requirement for notice.<sup>393</sup> The Texas Property Code requires notice of foreclosure to be given at least twenty-one days prior to the foreclosure sale.<sup>394</sup> Under Texas law a day means a twenty-four hour period; therefore, notice of the sale must be posted, filed with the clerk, and deposited in the mail at least twenty-one full twenty-four hour days prior to the sale to be valid.<sup>395</sup> Here, notice was posted, filed, and mailed at approximately 4:00 p.m., and the sale was conducted on the morning of the 21st day thereafter. The court held that notice was insufficient.<sup>396</sup>

Another court held that a real estate foreclosure sale was valid even though the notice of substitute trustee's sale was signed by the first substitute trustee but posted and filed by the second substitute trustee.<sup>397</sup> The court held a substitute trustee does not have to re-post notices of sale when the notices have been properly posted by a former trustee.<sup>398</sup> Each substitute trustee had the authority to act when he acted.<sup>399</sup>

#### b. Irregularities

A real estate foreclosure sale will not be set aside because the bid was inadequate unless coupled with irregularities in the sale process that caused or contributed to the inadequacy. In one case, irregularities sufficient to set aside the sale included (1) the property was posted by a substitute trustee hours before the substitute trustee was appointed; (2) the note was not in default; and (3) the notice of sale erroneously set January 2, 1989, as the date of sale, rather than January 2, 1990.<sup>400</sup> The bid price was approximately 10% of the value.

#### c. Post-Foreclosure Liability for Ad Valorem Taxes

The opinion in *Vista Development Joint Venture II v. Pacific Mutual Life Insurance Co.*<sup>401</sup> distinguished *Smart v. Tower Land & Investment Co.*<sup>402</sup> on the issue of liability for ad valorem taxes paid by the mortgagee after foreclosure. In December 1981, Pacific Mutual made a five year loan to Vista so Vista could purchase commercial real estate near El Paso. The loan was made under a standard commercial promissory note that was secured by a deed of trust. The deed of trust named Pacific as beneficiary. The loan only required interest payments during the five year life with a repayment of principal in December 1986. When Vista failed to pay the final installment, Pa-

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393. *Id.* at 848.

394. TEX. PROP. CODE ANN. § 51.002(b) (Vernon Supp. 1992).

395. *In re Nelson*, 134 B.R. at 847.

396. *Id.* at 848.

397. *Davis Chevrolet Inc. v. Texoma Fin. Corp.* (In re David Chevrolet, Inc.), 135 B.R. 29, 34 (Bankr. N.D. Tex. 1992).

398. *Id.*

399. *Id.*

400. *RTC v. C & E, Inc.*, No. MO-91-CA-002 (W.D. Tex. October 16, 1991).

401. 822 S.W.2d 305 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

402. 597 S.W.2d 333 (Tex. 1980).

cific gave the required notice, foreclosed its lien and sold the property through a non-judicial foreclosure sale that left a deficiency. At the time of foreclosure, 1985 and 1986 property taxes in the amount of \$109,323 were due and owing. Pacific sued Vista to recover the 1985 and 1986 property taxes, the 1987 taxes that Pacific had paid, collection expenses, attorney's fees and pre-judgment interest as provided for in the note. The non-recourse provision of the note included the following specific exemption:

It is further understood and agreed, however, that nothing contained in the preceding paragraphs shall in any manner or way release, affect or impair: . . .

(vii) the right of the payee or other holder of this Note after the occurrence of such an Event of Default to recover from Maker the amounts required to satisfy any taxes or other "Impositions" . . . with respect to the Mortgaged Property which were due but not paid by the Maker. . . .<sup>403</sup>

The deed of trust also provided a similar exception from personal liability as to:

(vii) the right of payee or other holder of this note after the occurrence of such an event of default and during the pendency of such default to recover from maker the amounts required to satisfy any taxes or other impositions. . . .<sup>404</sup>

The court held the note and deed of trust must be construed together and the note's terms provided for recovery of a personal deficiency for unpaid taxes against Vista, even though proceeds from the sale were first to be applied toward expenses, fees, and costs of foreclosures, then to payments of impositions and other costs necessary to release liens against property, except those extinguished by the sale.<sup>405</sup> The court distinguished *Smart v. Tower Land & Investment Company*,<sup>406</sup> cited by Vista as authority for the proposition that personal tax liability will not accrue to a mortgagor when reimbursement of tax liability is secured and payable similar to outstanding debt according to the note and deed of trust.<sup>407</sup> The court stated in Vista's case the note and deed of trust contained exceptions to the general release of the maker's liability for the indebtedness.<sup>408</sup>

Additionally, the court held that since Pacific was free to pursue any remedy, its discharge of the tax lien and subsequent action under the personal liability provision of the notes was proper. The court also stated:

[B]y the terms of the agreement, Pacific became equitably subrogated to the taxing authority's liens when it paid the property taxes. Even though the mortgagor-mortgagee relationship terminated upon foreclosure, payment of the outstanding taxes was made under the terms of the note, which specifically granted rights of recovery to the obligee.<sup>409</sup>

403. *Vista Development*, 822 S.W.2d at 307.

404. *Id.*

405. *Id.* at 307-08.

406. 597 S.W.2d at 333.

407. *Vista Development*, 882 S.W.2d at 307-08.

408. *Id.* at 307.

409. *Id.* at 308.

Under *Smart v. Tower Land & Investment Company*, Pacific was not a mere volunteer and thus was entitled to subrogation because Pacific was a "mortgagee and note holder and was conscientiously acting to preserve its title to the subject property."<sup>410</sup> Therefore Pacific was not a stranger to the foreclosure transaction.

#### d. Rights Transferred

In *Lindsey v. FDIC*<sup>411</sup> the Lindseys owned land upon which a peanut allotment was in effect. The bank foreclosed on the property, and the Lindseys sued seeking a declaratory judgment that they were the owners of the allotment. The deed of trust securing the note with the bank did not refer to the allotment. Additionally, the Lindseys did not orally or in writing reserve ownership in the allotment at the time they granted the deed of trust.

Citing the general rule from *Combustion Engineering, Inc. v. Norris*,<sup>412</sup> that where there is a transfer of ownership wherein the transferee acquires an entire farm, he necessarily receives the farm's allotments, unless such allotments are specifically reserved by the transferor, the court found that as transferee of the entire Lindsey parcel of 516 acres the bank acquired the peanut allotment along with the farm land.<sup>413</sup> Because under *Combustion Engineering* the allotment runs with the land when a transfer involves all of the land upon which the allotment is in effect, and because the bank had a security interest in the entire parcel, the bank's security interest included the allotment.<sup>414</sup> The court noted that "the allotment gave substantial value to the farmland and consequently to the security interest to which the bank and the Lindseys agreed."<sup>415</sup> The court found the allotment so important to the security interest that to withdraw the interest would substantially impair the bank's security interest.<sup>416</sup>

### K. LENDER LIABILITY

#### 1. Usury

Although it is frequently stated by courts that the Texas usury statutes are penal in nature and, therefore, should be strictly construed, a reading of usury cases could lead one to believe that the courts often fail to follow that directive. During the Survey period, on the other hand, the courts that considered usury cases seemed to be willing to apply the rule of strict construction and to take a more rational approach to what could be considered technical violations. In addition, usury savings clauses were cited with increasing frequency to save loan transactions from the terrible consequences of violating the usury statutes.

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410. *Id.* at 309.

411. 960 F.2d 567 (5th Cir. 1992).

412. 271 S.E.2d 813 (Ga. 1980).

413. *Lindsay*, 960 F.2d at 570.

414. *Id.*

415. *Id.* at 571.

416. *Id.*

a. Pleadings as the Basis for Charging Interest

At least insofar as a charge of prejudgment interest in a pleading is concerned, the Texas Supreme Court held that it cannot be the basis for a usury claim.<sup>417</sup> Carpet Services, a sub-contractor to Fuller Company, sued Fuller Company to recover sums owed to Carpet Services under its contract. In its original petition, Carpet Services sought prejudgment interest on a portion of the debt for a period before the debt was due. The trial court held that the petition was a usurious charge of interest in excess of twice the legal rate. The court of appeals reversed and held that a demand for usurious interest in a pleading is not a usurious charge of interest. The supreme court affirmed the judgment of the court of appeals.<sup>418</sup>

In this case, there was not an improper contract for interest, nor a situation where usurious interest was received. The sole issue was whether the pleading for prejudgment interest was a charge. Since the statute does not define what a charge of interest is, the court first looked to the declaration of legislative intent. It provides that:

It is the intent of the Legislature in enacting this revision [of the statute on interest] to protect the citizens of Texas from abusive and deceptive practices now being perpetrated by unscrupulous operators, lenders and vendors in both cash and credit consumer transactions . . . and thus serve the public interest of the people of this State.<sup>419</sup>

Because the legislature gave no indication that it intended the usury laws to be applied to pleadings, nothing mandated a holding that pleadings can constitute a charge of interest.<sup>420</sup>

The supreme court then distinguished *Moore v. Sabine National Bank*,<sup>421</sup> because in that case the combined statements of the creditor contained in the notice of intention to repossess the collateral, its original petition, and its sequestration affidavit together constituted a usurious charge of interest.<sup>422</sup> In discussing the purpose of pleadings, the court stated:

Usury statutes are designed to correct abusive practices in consumer and commercial credit transactions, not to serve as a trap for the unwary pleader in a court proceeding. Pleadings serve to give a party notice of the issues at trial. *Murray v. O & A Express, Inc.*<sup>423</sup> Pleadings are addressed to the court, and only demand that the court grant judgment. There is no demand on the opposing party.<sup>424</sup>

The court's holding was specifically limited to a claim for prejudgment interest, since it arises from the judicial process itself, rather than directly from a credit transaction, and a claim for prejudgment interest is best dealt

417. *George A. Fuller Company v. Carpet Services, Inc.*, 823 S.W.2d 603 (Tex. 1992).

418. *Id.* at 605.

419. Act of May 23, 1967, 60th Leg., R.S., ch. 24 § 1, 1967 Tex. Gen. Law 609 (declaring legislative intent to TEX. REV. CIV. STAT. ANN. arts. 5069-1.06(1), (2)).

420. *Fuller*, 823 S.W.2d at 604.

421. 527 S.W.2d 209 (Tex. Civ. App.—Austin 1975, writ ref'd, n.r.e.).

422. *Fuller*, 823 S.W.2d at 605.

423. 630 S.W.2d 633 (Tex. 1982).

424. *Id.*; See *Fibergrate Corp. v. Research-Cottrell, Inc.*, 481 F. Supp. 570, 572 (N.D. Tex. 1979).

with in the judicial process.<sup>425</sup>

The Fifth Circuit expressly expanded the holding in *Fuller* in its opinion in *FSLIC v. Kralj*.<sup>426</sup> The court based its decision on the purpose of the usury laws, which is to correct abusive practices in consumer and commercial credit transactions, and the purpose of pleadings, which is to notify a party of the issues at trial.<sup>427</sup> Although *Fuller* involved a claim for prejudgment interest, the court determined that the policy arguments are consistent, so long as the underlying documents are not usurious.<sup>428</sup> The court stated:

if the underlying documents are not usurious, then irrespective of the type of interest demanded in the pleadings, imposing a penalty for usury, based solely on a demand made in a pleading or interrogatory answer, does nothing to fulfill the purpose of usury law, which is to correct abusive practices in consumer and commercial credit transactions.<sup>429</sup>

On the last day of 1992, the Texas Supreme Court issued a per curiam opinion in *Brones v. Solomon*,<sup>430</sup> which, if anything, may indicate the court's willingness to expand its holding in *Fuller v. Carpet Services*.<sup>431</sup> Because the specifics as to the actual acts of charging interest were unclear, it is difficult to read very much from the case. It is clear that the acts related to letters written by the attorney for a judgment creditor to the judgment debtor to collect on the judgment. The appellate court opinion does not specify what the judgment debtor claimed was usurious about those letters. Nevertheless, the supreme court, without approving or disapproving any portion of the opinion of the court of appeals, held that a demand for post-judgment interest arises from the judicial process and is not a charging under the usury laws.

#### b. Other "Charging" Cases

The Austin court of appeals also considered what is meant by the provision of the usury statute that prohibits charging excessive interest. In the case of *McPherson Enterprises, Inc. v. Producers Cooperative Marketing Association, Inc.*,<sup>432</sup> that court found that a claim for interest on an unliquidated principal debt cannot be the basis for usury liability solely because the liquidated principal amount is less than the unliquidated amount claimed. In other words, at least in the case of a good faith disagreement regarding the amount owed, the lender does not violate the usury statute by demanding

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425. *Fuller*, 823 S.W.2d at 605.

426. 968 F.2d 500 (5th Cir. 1992).

427. *Id.* at 504.

428. *Id.*

429. *Id.*; see also, *Sumrall v. Navistar Financial Corporation*, 818 S.W.2d 548 (Tex. App.—Beaumont, 1992, writ denied) (decided before the Texas Supreme Court issued its opinion in *George A. Fuller Co.*); *RTC v. Ammons*, 836 S.W.2d 705 (Tex. App.—Houston [1st Dist.] 1992, no writ); *First South Savings Association v. First Southern Partners, II, Ltd.*, 957 F.2d 174 (5th Cir. 1992).

430. 842 S.W.2d 278 (Tex. 1992).

431. 823 S.W.2d 603, 605 (Tex. 1992).

432. 827 S.W.2d 94 (Tex. App.—Austin, 1992, no writ).

the higher unliquidated amount, even if the liquidated amount is determined to be less.<sup>433</sup>

In the case in point, Ronnie and Suzanne McPherson owned McPherson Enterprises, Inc., which purchased Bandera Feed and Garden Supply. In connection with the purchase, the corporation assumed certain debt owing to Producers. Later, when the corporation had difficulty paying the debt, the McPhersons transferred to Producers a promissory note that was owing to them individually. Although the note was for an amount less than the amount owed by the corporation to Producers, the McPhersons asserted that the agreement of the parties was that the note would be accepted in full satisfaction of the corporate debt. Producers, however, disagreed and sued the McPhersons for the difference between the amount of the debt owing by the corporation and the amount of the note transferred to Producers. Before doing so, Producers mailed the corporation a bill for the full amount owed, plus interest. In addition to the McPhersons' denial of personal liability for the corporate debt, the corporation raised a usury claim on the ground that the interest calculated on the full principal amount exceeded the maximum lawful amount that could be charged on the true, lesser amount.

The McPhersons cited *Steves Sash & Door Co. v. Ceco Corp.*,<sup>434</sup> in their support. The Austin court of appeals, to the contrary, found support for its holding that the actions of Producers were not usurious in the following statement from the supreme court's opinion: "Interest and principal are *synergistic* words which imply one another, and by necessity principal must be the amount that is used, forborne, or detained, and upon which the interest is charged."<sup>435</sup>

The rate of interest used by Producers was a lawful rate, but it was applied to the wrong principal amount. According to the court, the only complaint the corporation could have is that Producers charged too much principal.<sup>436</sup> By focusing on the synergism between the principal amount of a debt and the interest on that principal amount, the court held that the charge was not usurious.<sup>437</sup> In the opinion of the court, the amount of interest claimed could not be divorced from the incorrect principal amount on which it was calculated and then transferred to the proper principal amount that was owed in order to result in a usurious claim.<sup>438</sup> To do so would mean any claim of interest on an unliquidated principal amount would be subject to claims of usury.

In *Affiliated Capital Corp. v. Commercial Federal Bank*,<sup>439</sup> the lender accelerated the payment of the note and demanded payment of principal, interest, and a prepayment penalty, which was payable in accordance with the terms of the note whether the prepayment was voluntary or involuntary.

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433. *Id.*

434. 751 S.W.2d 473 (Tex. 1988).

435. *McPherson*, 827 S.W.2d at 96.

436. *Id.*

437. *Id.*

438. *Id.*

439. 834 S.W.2d 521 (Tex. App.—Austin, 1992, no writ).

The borrower's claim that the lender charged usurious interest was based on the argument that the accelerated balance is a separate contract on which the prepayment penalty would have been interest. Had the borrower paid the balance one day after it was accelerated, together with the prepayment penalty, the entire penalty would have been interest for one day only and would have exceeded the lawful amount of interest that could have been charged for that day. The court failed to cite or discuss earlier cases addressing the usury issues related to prepayment penalties as applied to voluntary prepayments<sup>440</sup> and failed to make clear whether it was holding that a prepayment penalty applied to an involuntary prepayment is "interest" as defined under Texas law or a penalty for the loss of originally contracted for interest on the initial loan.<sup>441</sup> The court characterized the prepayment penalty as the latter but then applied the spreading doctrine and the savings clause in determining that the charge was not usurious.<sup>442</sup> If the prepayment penalty was, in fact, a penalty and not interest, as defined under Texas law, which the court seemed to say, then it would not have been necessary to apply either the spreading doctrine or the savings clause to determine that the loan was not usurious as a result of the application of the penalty provision.

### c. Unauthorized Charges

The issue of unauthorized charges as a basis for usury came before at least two courts. The first, *Sunwest Bank of El Paso v. Gutierrez*,<sup>443</sup> involved the improper addition to the loan of a premium for vendor single interest insurance (VSI). The portion of the note that would have required the borrower to maintain insurance had not been completed. When the borrower failed to provide evidence of insurance, the lender purchased VSI and added it to the note amount, an entry that was later reversed when the borrower provided evidence of insurance and protested the charge. Despite the reversal, the borrower sued the lender. According to the court, in order to be usurious, the bank must have made an excessive charge for the use, forbearance, or detention of money.<sup>444</sup> If the VSI charge was not for the use, forbearance, or detention of money, then it was not interest. If it was not interest, then it could not be usurious. The court relied upon the supreme court opinion in *Texas Commerce Bank - Arlington v. Golding*,<sup>445</sup> for the proposition that "a lender [can] impose [a] fee which entitles a borrower to a distinctly separate and additional consideration, apart from the lending of money, [and which] is not and cannot be the basis of usury."<sup>446</sup> VSI is a distinctly separate and additional consideration. It provides the borrower the separate and addi-

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440. See, e.g., *Bearden v. Tarrant Sav. Ass'n*, 643 S.W.2d 247 (Tex. App.—Ft. Worth 1982, writ ref'd, n.r.e.) and the cases cited in that opinion.

441. *Affiliated Capital Corp.*, 834 S.W.2d at 525-26.

442. *Id.* at 526.

443. 819 S.W.2d 673 (Tex. App.—El Paso 1991, writ denied).

444. *Id.* at 675.

445. 665 S.W.2d 103 (Tex. 1984).

446. *Sunwest Bank*, 819 S.W.2d at 675.

tional consideration of the payment of the debt if the collateral is damaged or destroyed. The fact that the VSI was unauthorized did not cause the premium charge to become interest.<sup>447</sup>

In a case that may be far more important, *Brazosport Bank of Texas v. Oak Park Townhouses*,<sup>448</sup> the lender made a loan in connection with which it charged the borrower a "non-refundable commitment fee equal to \$35,000.00 as consideration for the issuance of" the commitment. Later, the lender renewed the loan and charged the borrower an additional two percent fee. The borrower claimed that the fees were unlawful loan fees by virtue of the provisions of TEX. REV. CIV. STAT. ANN. art. 342-508<sup>449</sup> and that the collection of interest in addition to the loan fees was usurious. The court read that statute to prohibit banks from charging fees for the granting of a loan unless the fees are authorized by law.<sup>450</sup> Charges that are authorized by law and not in violation of art. 342-508 include interest, bona fide commitment fees, and the fees expressly permitted by art. 342-508.<sup>451</sup> If the disputed charges were interest or an authorized charge, then the lender would not have violated the provisions of art. 342-508.<sup>452</sup>

The statute does not include a penalty for a violation, so the court first concluded that the penalty would be the disallowance of the fee, as opposed to the penalties imposed on a usurious loan.<sup>453</sup> The court next addressed the nature of the fees to see if they were authorized by law or not. The court upheld the trial court's finding that the first fee violated art. 342-508 and disallowed the fee because the evidence regarding the fee, did not establish it was a commitment fee or interest, either of which would have been an authorized charge.<sup>454</sup> Because the evidence established that the second fee was actually interest, it was an authorized charge and did not violate the statute.<sup>455</sup>

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447. *Id.*

448. 837 S.W.2d 652 (Tex. App.—Houston [14th Dist.] 1992, no writ).

449. TEX. REV. STAT. ANN. art. 342-508 (Vernon 1977). At the time in question, Art. 342-508 provided: "No bank shall charge or collect any loan fee or any other charge, by whatever name called, for the granting of a loan unless authorized by law. Provided, however, a bank may require an applicant for a loan or discount to pay the cost of any abstract, attorney's opinion or title insurance policy, or other form of insurance, and filing or recording fees or appraisal fee. Expenses necessary or proper for the protection of the lender, and actually incurred in connection with the making of the loan may be charged. In all loan transactions in which the amount loaned is \$100.00 or more and the loan period is one month or more, a bank may charge any borrower the reasonable value of services rendered in connection with the making of any loan, including the drawing of notes, the taking of acknowledgements and affidavits, the preparation of financial statements, and the investigation or analysis of the financial responsibility of the borrower or any endorser, surety or co-signer in an amount agreed upon, but not to exceed \$15.00 for each loan transaction, which shall be in lieu of all interest and other charges which could otherwise be collected in connection with the loan."

450. *Brazosport Bank*, 837 S.W.2d at 656.

451. *Id.*

452. *Id.*

453. *Id.*

454. *Id.*

455. *Id.*

#### d. Savings Clauses

A number of courts focused on contractual usury savings clauses to defeat usury claims and in at least one of those cases, the savings clause was relied upon even against a plausible argument that the loan document was usurious on its face.<sup>456</sup> The first court to give effect to a savings clause during the survey period did so in a case in which the borrower argued that somehow the existence of more than one prime rate caused the loan to be usurious.<sup>457</sup> Since usury is a matter of intention and the savings clause expressed the intent of the parties, it was given effect to correct any inadvertent or unintentional charges.<sup>458</sup> The Fifth Circuit also applied a savings clause in *Federal Deposit Insurance Corporation v. Claycomb*.<sup>459</sup>

In *First South Savings Association v. First Southern Partners, II, Ltd.*,<sup>460</sup> the lender made demand upon guarantors of a note jointly and severally for payment in full, even though each guarantor was contractually obligated to pay only one-half of the principal amount outstanding. When payment was not made, the lender sued the guarantors for full payment. In addition to other grounds for denying relief, the court believed that the guarantors were sophisticated businessmen and treated the erroneous demand and complaint as automatically remedied by the savings clause.<sup>461</sup>

Finally, *FSLIC v. Kralj*, may be authority that a savings clause might work, although the loan is usurious on its face, if the circumstances surrounding the transaction justify applying the savings clause.<sup>462</sup> *Kralj* argued that the note was usurious on its face because it called for interest to be calculated on a 360 day basis and provided for default interest at the rate of 18% per annum. This, according to *Kralj*, also provided a contingency by which the holder could receive more interest than that allowed by law. The lender argued, in effect, that the note had to be read as a whole and that the savings clause defeated a construction of the contract that would violate the state usury laws, even though one clause of the note may charge excessive interest. The court considered the authority that the mere presence of a savings clause will not rescue a note that is usurious on its face but decided that the savings clause should be given effect in light of the circumstances surrounding the transaction.<sup>463</sup> In this case, there was no evidence that the lender actually charged usurious interest. In effect, the court is saying that a note may be usurious on its face and the savings clause still given effect if the circumstances surrounding the transaction justify doing so.<sup>464</sup>

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456. *FSLIC v. Kralj*, 968 F.2d 500 (5th Cir. 1992).

457. *Edmondson v. First State Bank of Mathis*, 819 S.W.2d 605 (Tex. App.—Corpus Christi 1991, no writ).

458. *Id.* at 606.

459. 945 F.2d 853 (5th Cir. 1991) (noting that usury saving clauses defeat usury defenses).

460. 957 F.2d 174 (5th Cir. 1992).

461. *Id.* at 178.

462. *FSLIC v. Kralj*, 968 F.2d 500 (5th Cir. 1992).

463. *Id.* at 506.

464. *Id.*

e. Usury as a Defense to Guarantor Liability

The Fifth Circuit followed established Texas law in refusing to allow a guarantor to raise usury as a defense to liability on the guaranty, so long as the guaranty itself is not a usurious transaction.<sup>465</sup> As previously described, *First South Savings* was based, in part, upon an erroneous demand made upon the guarantors jointly and severally for full payment, contrary to the provisions of the guaranty, which limited their liability. Since the claim was based upon a charging of usurious interest directly against the guarantors and not a claim that the guaranteed loan was usurious as to the borrower, one might expect the court to have been inclined, if not persuaded, to rule in favor of the guarantors. Addressing the issue of the demand contained in the letter, the court first considered the statutory definition of the term interest as "compensation allowed by law for the use or forbearance or detention of money."<sup>466</sup> Since only the borrower receives the use, forbearance, or detention of money under a promissory note and not the guarantor, then a demand upon the guarantor for amounts owed by the borrower is not a demand for interest.<sup>467</sup> The court distinguished *Houston Sash & Door Co., Inc. v. Heaner*,<sup>468</sup> as a contracting for case and not a charging case since, in *Heaner*, the guarantor had agreed in writing to pay interest on the debt at a specified rate of interest exceeding the maximum lawful rate.<sup>469</sup>

f. Hypothetical Events as a Basis for Usury

Borrowers frequently argue that even though no usurious interest was actually charged or received, the promissory note as written entitled the lender to usurious interest under certain hypothetical occurrences. In other words, even though the lender committed no overt usurious act, the borrower claims that if a certain set of events had occurred (although it did not), then the loan would have entitled the lender to excess interest and, therefore, the promissory note is a contract for usurious interest. In *Affiliated Capital Corp. v. Commercial Federal Bank*,<sup>470</sup> the court also dealt with a borrower's claim that a hypothetical default early in the life of the transaction could have resulted in the acceleration of a relatively small amount of principal in comparison to the large prepayment penalty and that the penalty would have been usurious interest as calculated on the small amount of principal. The court seemed to retreat from statements in existing cases dealing with the possibility of contingencies which could result in usurious interest and applied the savings clause to the hypothetical facts in holding it was not usurious.<sup>471</sup> As stated by the court:

The [borrower] claims that the possibility of this contingency, although it never occurred, makes the Note usurious on its face and cannot be

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465. *First South Savings*, 457 F.2d at 174.

466. *Id.* at 177.

467. *Id.*

468. 577 S.W.2d 217 (Tex. 1979).

469. *First South Savings*, 957 F.2d at 177.

470. 834 S.W.2d 521 (Tex. App.—Austin 1992, no writ).

471. *Id.* at 526.

avoided by the savings clause in the Note which calls for a rebate of any amount of interest which would be usurious. That is not the law of this state. The law requires all provisions of a contract to be given full effect, and a provision that calls for the actual reduction of the interest paid, down to a legal amount, saves a contract from being usurious on its face.<sup>472</sup>

### g. Federal Preemption

*Moore v. United National Bank*,<sup>473</sup> presented an interesting argument construing the literal language of the federal preemption statute,<sup>474</sup> and the interest provisions of the National Bank Act.<sup>475</sup> The latter statute allows a national bank to receive interest at the higher of one percent over the discount rate and interest allowed by the laws of the state where the bank is located.<sup>476</sup> The statute goes on to say

except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. When no rate is fixed by the laws of the State . . . the bank may take, receive, reserve, or charge a rate not exceeding 7[%], or 1[%] in excess of the discount rate.<sup>477</sup>

The federal preemption statute, on the other hand, preempts state ceilings on certain loans secured by first liens on residential real estate.<sup>478</sup> The borrower argued that no rate is fixed by state law because of the preemption statute. Since no rate is fixed by state law, then section 85 limits a national bank to the higher of seven percent or one percent over the discount rate.

The court recognized that a literal reading of the statutes would require a result different from its holding, but that a literal reading would be inconsistent with the purposes of the law.<sup>479</sup> The intent was to allow national banks the ability to charge interest on loans at rates at least as high as those which state banks could charge in the same state.<sup>480</sup> Since state banks can charge an unlimited rate of interest on the types of loans in question, then national banks should be given the same privilege.<sup>481</sup>

## 2. Duty of Good Faith and Fair Dealing

Attempts by borrowers to hold lenders to a standard duty of good faith and fair dealing took a beating during the survey period. Courts devoted little discussion to the issue in *Pineda v. PMI Mortgage Insurance Com-*

472. *Id.*; see also *Kralj*, 968 F.2d at 502.

473. 821 S.W.2d 409 (Tex. App.—Fort Worth 1991, writ denied).

474. 12 U.S.C. § 1735-7(a)(1) (West 1989).

475. 12 U.S.C. § 85 (West 1989).

476. *Id.*

477. *Id.*

478. 12 U.S.C. § 1735-7(a)(1) (West 1989).

479. *Moore*, 821 S.W.2d at 411.

480. *Id.*

481. *Id.* (citing *Hiatt v. San Francisco National Bank*, 361 F.2d 504, 507 (9th Cir. 1986), cert. denied, 385 U.S. 948 (1966)); see also, *Pineda v. PMI Mortgage Ins. Co.*, 843 S.W. 2d 660 (Tex. App.—Corpus Christi 1992, no writ).

pany,<sup>482</sup> *Affiliated Capital Corp. v. Commercial Federal Bank*<sup>483</sup> and *Hall v. RTC*.<sup>484</sup> The courts followed existing Texas law, which does not recognize a duty of good faith and fair dealing in every contractual relationship, unless a special relationship exists between the parties.<sup>485</sup> Absent a special relationship, there is no duty of good faith and fair dealing in a debtor and creditor relationship.<sup>486</sup>

In *Affiliated Capital*, the lender refused to accept a proffered prepayment at a time when the note did not permit prepayment. Shortly thereafter, the lender accelerated payment and demanded collection of a prepayment penalty. As to the issue of breach of a duty of good faith, the court found that the insistence by one party upon strict adherence to the terms of a contract cannot be the basis for the violation of a duty of good faith.<sup>487</sup> The lender's reason for refusing to accept prepayment when offered by the borrower was irrelevant in this case because the lender had the contractual right to refuse the offer, even if the reason given may have been false.<sup>488</sup>

Similarly, in *Hall v. RTC*, the borrower asked to substitute new collateral for existing collateral, but the lender had no obligation to accept substitution under the loan documents. The court rejected the borrower's attempt to impose an implied duty of good faith and fair dealing in this context based on the fact that, "[u]nder Texas law, an 'agreement made by the parties and embodied in the contract cannot be varied by an implicit covenant of good faith and fair dealing'."<sup>489</sup> In addition, the court noted that there existed no special relationship of the type recognized by Texas courts upon which to base such a covenant under the circumstances.<sup>490</sup>

### 3. Deceptive Trade Practices Act

To be a consumer entitled to bring an action under section 17.50 of the Texas Deceptive Trade Practices Act (DTPA), one must seek to acquire goods (including real estate) or services and the complaint must be about the goods and services sought to be acquired. The Supreme Court of Texas held that money is not goods under the DTPA in *Riverside National Bank v. Lewis*.<sup>491</sup> It is a currency of exchange that enables one to acquire goods.<sup>492</sup> That being the case, one who merely seeks to borrow money and nothing more is not a consumer under the DTPA. This principle has been used time and again to shield banks from liability under the DTPA, but borrowers

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482. 843 S.W.2d 660 (Tex. App.—Corpus Christi 1992, n.w.h.).

483. 834 S.W.2d 521 (Tex. App.—Austin 1992, no writ).

484. 958 F.2d 75 (5th Cir. 1992).

485. *Affiliated Capital*, 834 S.W.2d at 527; *Hall*, 958 F.2d at 79.

486. *Hall*, 958 F.2d at 79.

487. *Affiliated Capital*, 834 S.W.2d at 527.

488. *Id.*

489. *Id.*

490. *Id.*; see also, *Manufacturers Hanover Trust Co. v. Kingston Inv. Corp.*, 819 S.W.2d 607 (Tex. App.—Houston [1st Dist.] 1992, no writ).

491. 603 S.W.2d 169 (Tex. 1980), *on remand*, 605 S.W.2d 954 (Tex. 1980).

492. *Id.* at 174.

continue to attempt to tie the loaning of money to the acquisition of some good or service as a way of breaking the shield.

In *Henderson v. Texas Commerce Bank*,<sup>493</sup> the borrower claimed that he was seeking not just a loan, but a complete banking relationship. However, he did not produce evidence of any service he was seeking from the bank. Further, even if he was seeking service and not simply a loan, he only complained about the transaction regarding the loan. Therefore, he failed to meet the test of a consumer under the DTPA.<sup>494</sup>

The borrowers in *Baskin v. Mortgage and Trust, Inc.*<sup>495</sup> tried to tie the loans to the lender's activity as the servicer of the loans. Even if that was a sufficient nexus, the court refused to apply the DTPA because no cause of action arising from the lender's servicing activity was alleged.<sup>496</sup>

In *Affiliated Capital Corporation*,<sup>497</sup> the borrower made two claims under the DTPA. The first, based on an alleged failure to disclose the lender's rights under the note was disposed of by construing the terms of the note as making the disclosure. The borrower apparently also argued that the actions of the lender in refusing prepayment when offered and shortly thereafter demanding prepayment at a time when the borrower was no longer able to do so, was an unconscionable action in violation of the provisions of section 17.50(a)(3) of the DTPA. The borrower narrowly construed the transaction between the lender and the borrower as a contract to loan money.<sup>498</sup> The borrower then used the money to build an apartment complex and mortgaged it to secure the loan. Because the borrower had only contracted with the lender for the use of money and had received the use of money, the fact that the lender's acceleration of the note and foreclosure of the apartment complex may have deprived the borrower of the value of its investment did not mean the lender had violated the DTPA.<sup>499</sup> The court did not specifically address the rule that the mere lending of money, coupled with nothing else, is not the sale or lease of a good or service. The result would have been the same, however, had that rule been applied.

Another borrower claimed that the bid price paid by the lender at the foreclosure sale under a deed of trust was grossly inadequate.<sup>500</sup> Even though there was no irregularity in the foreclosure proceedings which would invalidate it, the borrower claimed that bidding a grossly inadequate price was unconscionable conduct under the DTPA. This argument was also dismissed due to the lack of evidence as to the inadequacy of the price, but the court noted that the borrower was not a consumer who is entitled to bring an action under the DTPA because he did not seek to acquire any goods or

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493. 837 S.W.2d 778 (Tex. App.—El Paso 1992, writ denied).

494. *Id.* at 782.

495. 837 S.W.2d 743 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

496. *Id.* at 748.

497. 834 S.W.2d 521 (Tex. App.—Austin 1992, no writ).

498. No copy.

499. *Id.* at 529.

500. *FSLIC v. Kralj*, 968 F.2d 500 (5th Cir. 1992).

services.<sup>501</sup> Indeed, the lender was the purchaser at the foreclosure, not the borrower.<sup>502</sup>

A case that will be more than alarming to bank officers who take comfort in the *Riverside National Bank* rule is the case of *Walker v. FDIC*,<sup>503</sup> which leaves open the door for officer liability to bank customers under the DTPA, if a proper complaint can be made. In *Walker*, customers of a savings and loan brought suit against the institution and two officers for fraud and DTPA violations in connection with the institution's failure to fund a verbal loan commitment. After suit was filed, the institution was declared insolvent and the FDIC was substituted as defendant. Summary judgment was rendered in favor of the FDIC and the individual officers. While the court held that the customers of the failed institution were not consumers under the DTPA, because their sole complaint was the failure of the institution to fund the loan, it also held that the bank officers can be personally liable for their conduct.<sup>504</sup> The existence of directors and officers insurance makes it likely that debtors will add individual officers as defendants in future lender liability cases.

Finally, one plaintiff who was successful in framing a DTPA cause of action against a bank was not a borrower, but a depositor.<sup>505</sup> Coincidentally, he was also a former officer of the bank. He gave instructions to the bank to open an IRA account. The bank mistakenly opened a regular money market account. He later transferred funds from an IRA account into the account he thought was also another IRA account. The bank failed to send him the tax form required to be sent to a customer who transfers money from an IRA to a taxable account. Later, he discovered that the initial account had been incorrectly opened as a regular money market account and that he would have to pay taxes on the amount transferred into the money market account from his other IRA account. He sued the bank alleging breach of fiduciary duty, violations of the DTPA, and negligence. The court distinguished the *Riverside* decision by saying that in that case the plaintiff only sought a loan from the bank whereas, here, the customer sought the services of the bank as an IRA trustee.<sup>506</sup>

#### 4. *Fraud in the Inducement*

A case which arose before the effective date of section 26.02 of the Texas Business and Commerce Code,<sup>507</sup> is *T.O. Stanley Boot Co., Inc., et al. v. Bank of El Paso*,<sup>508</sup> in which a bank sued a borrower and a group of guarantors to collect a debt. The borrower and guarantors defended and counter-

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501. *Id.* at 507.

502. *Id.* at 508.

503. 970 F.2d 114 (5th Cir. 1992).

504. *Id.* at 122-23.

505. *McDade v. Texas Commerce Bank, N.A.*, 822 S.W.2d 713 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

506. *Id.* at 719.

507. Subsection (b) of section 2.02 provided that an agreement to make a loan in excess of \$50,000.00 is not enforceable if not signed and in writing.

508. 36 Tex. Sup. Ct. J. 259.

claimed on several bases, including a breach of contract theory, a fraud theory, and an impairment of collateral theory. Each was discussed separately by the court.

As grounds for the breach of contract claim, the borrower and guarantors claimed that they had an oral contract with the bank pursuant to which the bank would provide the borrower a \$500,000 line of credit. However, the court was unable to find any evidence of the essential terms of the contract.<sup>509</sup> As the court stated: “[i]n a contract to loan money, those essential terms will generally be: the amount to be loaned, the maturity date of the loan, the interest rate and the repayment terms.”<sup>510</sup> In this case, only the amount of the purported loan was supported by any evidence. Since the material terms of the contract had not been agreed upon, it could not be enforced.<sup>511</sup>

As to the fraud claim, the court required proof that the bank lacked intent to perform the act at the time promised, because the alleged representation involved a promise to do an act in the future.<sup>512</sup> The borrower and guarantors pointed to the fact that the bank denied ever having made the agreement as evidence that it never intended to perform its promise. The court recognized that denial of ever making the loan may be a factor showing the bank’s lack of intent to perform, but alone is not sufficient to show that the bank never intended to fulfill its promise.<sup>513</sup>

### 5. *Negligent Lending*

In *Baskin v. Mortgage and Trust, Inc.*,<sup>514</sup> the borrowers raised several claims, including one of negligent lending. The plaintiffs were forty-one homeowners who purchased homes in a subdivision that was allegedly traversed by a geological fault. The defendants were the homebuilder and the lender that financed the development of the subdivision. The plaintiffs alleged that the lender had actual knowledge of the fault during its involvement with the subdivision and failed to advise potential homebuyers (some of whom financed their homes through the same lender) of the fault’s existence. The lender was liable to the homeowners, according to the plaintiffs, either because it was a partner or joint venturer with the homebuilder in the project or it breached an independent duty of care to the homebuilders or it violated the DTPA. The elements of a joint venture or partnership are: (1) a community of interest, (2) an agreement to share profits, (3) an agreement to share losses, and (4) a mutual right of control or management of the enterprise.<sup>515</sup> Each of the elements must be met and the absence of any one of them defeats the claim that a joint venture or partnership exists. The lack of an agreement to share profits and losses alone defeated the claim in *Bas-*

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509. *Id.* at 220.

510. *Id.*

511. *Id.*

512. *Id.* at 262.

513. *Id.*

514. 837 S.W.2d 743 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

515. *Id.* at 747.

kin.<sup>516</sup> Furthermore, the court found no authority in Texas for a cause of action for negligent lending.<sup>517</sup> The Texas courts have, however, found an action for negligent misrepresentation in certain cases based on the Restatement of Torts.<sup>518</sup> In this case, however, negligent misrepresentation does not apply because the plaintiffs admitted that the lender made no representations, promises, guarantees, warranties, or statements regarding their homes and there was no showing of any circumstances that would give rise to a fiduciary relationship between the lender and homeowners.<sup>519</sup>

#### 6. *Negligent Misrepresentation*

In *Federal Land Bank Assoc. of Tyler v. Sloane*,<sup>520</sup> the Sloanes applied for a \$141,000.00 loan from the Federal Land Bank Assoc. of Tyler for the construction of chicken houses. About a month later, a bank officer informed them that the bank's board had approved the loan and that they could go forward with site preparation. The Sloanes testified that the officer said there was "no problem" and that "there was not any reason for them not to continue at that point."<sup>521</sup> The bank officer disputed this claim but the jury made findings of fact against the bank on this issue.

The issues before the appellate court were whether a claim for negligent misrepresentation is barred by the statute of frauds and whether the plaintiff may recover for lost profits based upon a claim of negligent misrepresentation. The court made a very technical distinction between a claim that the bank agreed to loan money to the plaintiffs and then breached that agreement and a claim that the bank did not agree to lend them money, but negligently represented that it had made such agreement.<sup>522</sup> The former claim is one for breach of contract and would be barred by the statute of frauds, section 26.01 the Texas Business and Commerce Code. Further, a claim for negligent misrepresentation cannot be used to circumvent the statute if the plaintiff's claim is for breach of the agreement to loan the money.<sup>523</sup> If, on the other hand, the claim is simply for negligently representing that the bank had agreed to lend the money, the claim is not barred.<sup>524</sup> The court adopted section 552b of the Second Restatement of Torts,<sup>525</sup> which disallows any

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516. *Id.*

517. *Id.*

518. *Id.* at 747-48; RESTATEMENT (SECOND) OF TORTS § 552 (1977) stating:

One, who in the course of his business, profession, or employment, or in a transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

519. *Baskin*, 837 S.W.2d at 748.

520. 825 S.W.2d 439 (Tex. 1992).

521. *Id.* at 441.

522. *Id.* at 442.

523. *Id.* (emphasis added).

524. *Id.*

525. RESTATEMENT (SECOND) OF TORTS § 552B (1977).

recovery for lost profits.<sup>526</sup> Since the claim was for negligent misrepresentation, the plaintiff only recovered the pecuniary losses he suffered in reliance upon the representation, which included substantial site preparation and related costs.<sup>527</sup>

Negligent misrepresentation can also be the basis for a claim against a bank by one who is not a customer, depositor, or borrower. For example, in *First Interstate Bank v. S.B.F.I., Inc.*,<sup>528</sup> the plaintiff gave substantial funds to a Texas resident (Ballard) for investment purposes. Without authority, Ballard transferred the funds to a different bank and under a different company name. He also used a different name for himself, "Bailey." A bank officer contacted the plaintiff regarding the account and failed to disclose certain information about the account, namely the fact that a person by the name of "Bailey" was the sole signatory on the account. In fact, when advised by the plaintiff that Ballard was the only person who should have authority on the account, the bank officer indicated that a person by that name also had authority on the account. When Ballard/Bailey absconded with the plaintiff's funds, the plaintiff sued the bank for negligence and negligent misrepresentation. Following a jury verdict for the plaintiff, the bank appealed. The court of appeals had to decide whether the bank owed a duty to the plaintiff such that it could be found liable for negligence and whether the bank could be liable for negligent misrepresentation. The appropriate test for determining whether a duty exists where one voluntarily assumes a duty to act is as follows: "[o]ne who voluntarily undertakes an affirmative course of action for the benefit of another has a duty to exercise reasonable care that the other's person or property will not be injured thereby."<sup>529</sup> The court felt that there was no evidence that the bank undertook a course of action for the benefit of the plaintiff.<sup>530</sup> In fact, the bank's interest in contacting the plaintiff was to obtain more business (i.e. to benefit the bank). The court did find, however, that there was evidence to support the claim of negligent misrepresentation because plaintiff testified that had he been told by the bank officer that only someone named Bailey had authority on the account, he would have immediately been aware that Ballard was attempting to steal his money.<sup>531</sup> Since the bank officer made an actual representation, which was relied upon by the plaintiff to his detriment (the funds were removed from the account shortly thereafter), the claim was valid.<sup>532</sup>

### 7. *Promissory Estoppel*

The borrower in *Henderson v. Texas Commerce Bank*<sup>533</sup> also sought to enforce a loan commitment based on a promissory estoppel argument. The

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526. *Id.*

527. *Id.* at 443.

528. 830 S.W.2d 239 (Tex. App.—Dallas 1992, no writ).

529. *Id.* at 244.

530. *Id.* at 244-45.

531. *Id.*

532. *Id.*

533. 837 S.W.2d 778 (Tex. App.—El Paso 1992, writ denied).

court refused to enforce the commitment since it was subject to certain unsatisfied conditions.<sup>534</sup> To make performance of a promise conditional, words such as "if," "provided that," "on condition that," or similar wording are necessary. Although the finding of a condition precedent is to be avoided when another reasonable construction of a contract is possible and although Texas courts do not favor conditions, here the loan commitment was "subject to" certain requirements that were not satisfied by the borrower.<sup>535</sup> Consequently, any duty of the bank was conditional on those requirements being met, and they were not.<sup>536</sup>

### 8. Guarantor Liability

Mention should be made, at least, of the unpublished opinion<sup>537</sup> in *Finch v. FDIC*.<sup>538</sup> That case involved the liability of a guarantor under a continuing guaranty. The court held the guarantor was not liable because the guaranteed note was materially altered.<sup>539</sup> It reasoned that "if the creditor and principal materially vary the terms of their contract, a new contract is formed and the guarantor is not bound thereby."<sup>540</sup> The court relied upon *Vastine v. Bank of Dallas*,<sup>541</sup> which was a case that apparently involved a specific guaranty. The guaranty in *Finch*, however, was a continuing guaranty. A continuing guaranty is not specific to particular debt, but guarantees all debt, both old debt and new debt. The formation of a new contract would not relieve the guarantor from liability under a continuing guaranty. The court dismissed this argument, saying "[a]lthough a continuous guarantee maintains the responsibility of a guarantor for changes occurring within the scope of his agreement, it will not bind a guarantor to a contract that was materially altered without his consent and to his detriment."<sup>542</sup>

## L. DEPOSIT ACCOUNTS

### 1. Joint Accounts

Situations continue to arise in which bank depositors disagree among themselves and sometimes with the bank regarding ownership of joint accounts. In *Bandy v. First State Bank*,<sup>543</sup> the Texas Supreme Court considered the circumstances where a bank may pay the funds in a joint account to the surviving party, whether or not it is a survivorship account, without subjecting itself to liability. In that case, the court held that unless a financial institution has received written notice that withdrawals in accordance with the terms of the account should not be permitted from any party able to

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534. *Id.* at 782.

535. *Id.*

536. *Id.*

537. Unpublished opinions are not to be cited as authority. See TEX. R. APP. P. 90.

538. No. 3-91-420-CV, (Tex. App.—Austin July 1, 1992, writ denied).

539. *Id.* slip op. at 4.

540. *Id.*

541. 808 S.W.2d 463 (Tex. 1991).

542. *Finch*, No. 3-91 - 420 - CV, slip op. at 4.

543. 835 S.W.2d 609 (Tex. 1992).

request present payment, then the institution will not be liable for paying in accordance with the terms of the account, regardless of the beneficial ownership of the account.<sup>544</sup>

A simple case decided by the Eastland court of appeals led to a holding that the mere addition of a typed name and signature on a bank signature card for an existing joint account with right of survivorship does not create a right of survivorship in the person added to the account pursuant to section 440 of the Texas Probate Code.<sup>545</sup> In 1981 a husband and wife deposited community funds with the bank and signed an account agreement establishing a joint account with right of survivorship. In 1986 the name Raymond Rogers was typed onto the bank signature card and Rogers signed the card. Rogers never contributed any of the funds to the account. The wife died in 1986, and the husband died in 1989. Rogers asserted that all of the funds passed to him at the death of the husband pursuant to the survivorship provision of the joint account.

When the husband and the wife opened the account they entered into a written agreement creating in favor of each of them a right of survivorship in the deposit funds should the other die. This written agreement was in conformity with section 439 of the Texas Probate Code for creating a right of survivorship.<sup>546</sup> Texas Probate Code section 440 contains the procedure for changing a properly established joint account with right of survivorship.<sup>547</sup> This section provides that in order to alter the written agreement for survivorship, a written order must be given by the party to the financial institution to change the form of the account.<sup>548</sup> This order or request must be signed by the party, received by the financial institution during the party's lifetime and not countermanded by other written order of the same party during his or her lifetime.<sup>549</sup> Mere addition of a name and signature to an account's signature card does not constitute a written order to change the form of the account as required by Texas Probate Code section 440.<sup>550</sup> Because there was no order request signed by the husband and the wife and received by the bank during the parties' lifetime to add Rogers as a joint owner with right of survivorship, their written survivorship agreement was not amended pursuant to section 440 and Rogers was not entitled to the funds upon the last to die of the husband and wife.<sup>551</sup>

The Houston court of appeals (14th District) decided two cases involving ownership interests in multi-party accounts. The first case, *Oadra v. Stegall*,<sup>552</sup> may have reached the correct conclusion but not necessarily for the correct reasons. In that case, the decedent and his mother (Grantor) put

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544. *Id.* at 622.

545. *Rogers v. Shelton*, 832 S.W.2d 709, 711 (Tex. App.—Eastland 1992, writ denied).

546. *Id.* at 710-11.

547. TEX. PROB. CODE ANN. § 440 (Vernon Supp. 1992).

548. *Id.*

549. *Id.*

550. *Rogers*, 832 S.W.2d at 711.

551. *Id.*

552. 828 S.W.2d 460 (Tex. App.—Houston [14th Dist.] 1992, writ granted).

funds in an account with the bank pursuant and subject to a revocable trust agreement provided by the bank and signed by the decedent and his mother as trustees with the decedent, his two children and his two grandchildren as beneficiaries. The decedent's mother signed the back of the account card as Grantor. The trust was revocable by the Grantor but would last until the death of the Grantor, if not revoked earlier. At termination, the remaining funds in the account were to be distributed in equal shares to the then living beneficiaries. The decedent was murdered two months after establishing this account. He was survived by his mother, his two children and his two grandchildren. The decedent's mother thereafter closed the account and moved the funds to another account with other individuals named with her on the new account. The legal analysis of the facts in this case is erroneously centered around the Texas Probate Code provisions governing joint accounts. The first line of the Revocable Trust Agreement signed by the decedent and his mother states that "[a] trust under the Texas Trust Act is hereby created by the undersigned Grantor(s) with respect to the funds in the account(s) identified on the reverse side hereof [the Account(s)]."<sup>553</sup> Following this statement is the statement that the Trustees and the Beneficiaries of the Trust are named on the reverse side of the account card and the trust's conditions are named below. The trust agreement stipulated investment powers, revocation procedures, and termination and distribution provisions. In short, the trust agreement fully outlined the trust and detailed its governance. The decedent and his mother signed the front of the account card as trustees, and the decedent's mother signed the back of the account card as Grantor. Therefore the first part of the legal analysis of this matter should have centered around whether this was a valid trust and, if a valid trust, what was to happen to the trust estate upon the decedent's death. The decedent and his mother were trustees with the mother signing as Grantor. The document stipulated that the Grantor could revoke the trust at any time and that, unless sooner revoked, the trust would continue in existence until the Grantor's death, and the trust assets would be distributed equally to the then living beneficiaries. The trust document itself is clear and there is no doubt that according to the face of this document the decedent's mother was the Grantor, and she had the right to revoke the trust by withdrawing the funds.

The dissent mentions that the decedent's mother testified that the funds belonged to the decedent, that he was the Grantor, and that she really had never had anything to do with the funds and didn't know what she was signing when the decedent brought the trust agreement home for her to sign. Therefore, there is a question of whether the decedent intended to gift these funds to his mother for her to gift into the trust as the Grantor or rather a mistake was made by having his mother sign as a Grantor rather than the decedent signing as Grantor. Nonetheless, this is a question of trust law. Section 438(c) of the Texas Probate Code does not create a right of survivor-

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553. *Id.* at 463.

ship between the trustees as suggested by the dissent.<sup>554</sup> A trustee is a fiduciary, holding legal title to property for the equitable benefit of a beneficiary. Neither the majority opinion nor the dissent recognize and focus upon that fact. If a trust were created, then the trustees were fiduciaries for the benefit of the beneficiaries and owned nothing on their own behalf — the question is not one of survivorship, it is one of successor trustee to continue to administer the trust for the equitable benefit of the beneficiaries. The dissent miscategorized this relationship by focusing on survivorship in joint accounts.<sup>555</sup>

It does appear that the majority correctly categorized this account as a trust account within the meaning of section 436(14) of the Texas Probate Code and that during the trustees' lifetime they own it beneficially in proportion to their contribution to the trust unless a contrary intent is shown.<sup>556</sup> However, there was a contrary intention evidenced. Even if the decedent was the actual owner of the funds prior to deposit, by asking his mother to sign the card as the Grantor, it is arguable that this is clear and convincing evidence of a different intent. Nonetheless, the court held that because she was a trustee, after the decedent's death the decedent's mother owned the entire trust account by virtue of section 438(a) because she was the only trustee remaining.<sup>557</sup> The court next makes an unexplainable jump to a conclusion that the decedent's mother is therefore entitled to the funds with no consideration of her role as a fiduciary on behalf of the beneficiaries.<sup>558</sup>

The court does finally decide that because the account card designated the mother as Grantor, parol evidence was inadmissible to prove otherwise.<sup>559</sup> Therefore, the terms of the agreement allowed her to revoke the trust and withdraw the funds.<sup>560</sup> The remainder of the majority decision exploring the joint account provisions is necessary only to the extent the beneficial ownership of the funds during lifetime or allocation of the funds on the death of the last trustee is in question.

The same court decided *Archer v. FDIC*,<sup>561</sup> which involved payment by a bank directly to a guardian despite a court order to turn the funds over to the ward. Upon the ward's eighteenth birthday, the probate court ordered that all institutions holding funds turn them over to the ward. The final accounting had yet to be approved, and the guardian was still serving as the ward's personal representative. The bank, subject to a safekeeping agreement, issued a check for the full balance of the guardianship account payable to the "Estate of Brenda Gail Archer, Lula Bell Hendrix Guardian."<sup>562</sup> The check was forwarded to the guardian's attorney, who in turn forwarded the check to the guardian. The guardian thereafter endorsed the check and mis-

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554. *Id.* at 468 (Brown, C.J., dissenting).

555. *Id.*

556. *Id.* at 465.

557. *Id.*

558. *Id.* at 466.

559. *Id.* at 467.

560. *Id.*

561. 831 S.W.2d 483 (Tex. App.—Houston [14th Dist.] 1992, no writ).

562. *Id.* at 484.

appropriated the funds. The court held that the bank acted in conformity with the Texas Probate Code so it did not wrongfully issue the check to the guardian.<sup>563</sup>

The pertinent statute is section 409 of the Texas Probate Code, which states the following:

Until the order of final discharge of the personal representative is entered in the minutes of the court, money or other thing of value falling due to the estate or ward while the account for final settlement is pending may be paid, delivered, or tendered to the personal representative, who shall issue receipt therefor, and the obligor and/or payor shall be thereby discharged of the obligation for all purposes.<sup>564</sup>

Because the guardian had not yet been discharged from her responsibilities as guardian, the account for final settlement was still pending when the bank issued the check and receipt was acknowledged, the bank was not therefore liable for the loss.<sup>565</sup> The court found that the statutory requirements contained in section 409 were met and, therefore, the bank was protected from liability.<sup>566</sup>

Despite the court's finding that the bank complied with the statute, the holding is of questionable protection to a bank. Texas Probate Code section 409 specifically states that at any time when the account for final settlement is pending and before the order approving such account and discharging the guardian is entered any "money or other thing of value *falling due* to the estate or to the ward . . . may be paid to the personal representative."<sup>567</sup> The plain meaning of falling due encompasses situations where a certificate of deposit, bond or other evidence of indebtedness matures, a note falls due, or a ground lease terminates with a reversion to the ward or her estate. In that situation, it is entirely appropriate for the property to be paid or delivered to the personal representative because he or she is the only party who may lawfully issue a receipt for such property before the estate is closed. It is an entirely different matter, however, for a bank that is subject to a safekeeping arrangement with a reduced bond to simply close out the guardianship account and pay the funds to the personal representative before final discharge. Under a safekeeping arrangement, such as the one here, the bank agrees to keep the funds safe, and in exchange for such agreement, the guardian's bond is reduced. The ward is literally relying on the bank to protect against this type of misappropriation. Obviously the ward's attorney did not do his job properly because before discharge he produced an order that the bank immediately pay any funds it was holding to the ward, which caused the bank to close the account and pay the account balance to the guardian. The bank was subject to a safekeeping arrangement, however, and should not have paid the account funds before the guardian's discharge. The safekeeping issue and agreement were not properly brought up, so the court may not

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563. *Id.* at 485.

564. TEX. PROB. CODE ANN. § 409 (Vernon 1980 & Supp. 1993).

565. *Archer*, 831 S.W.2d at 485.

566. *Id.*

567. TEX. PROB. CODE ANN. § 409 (Vernon 1980 & Supp. 1993) (emphasis added).

have had ample opportunity to analyze this issue. Nonetheless, the statute only applies to situations in which money falls due and closing out an account is not what one usually thinks of as falling due. Despite the holding, one may not wish to advise a client to follow this course of action.

The opinion in *Ephran v. Frazier*<sup>568</sup> addressed the question of the sufficiency of various writings to create a joint account with right of survivorship. In that case, the decedent opened a joint savings account and a joint checking account with the plaintiff. In each instance the parties executed a signature card and a depository agreement on a form provided by the bank reciting that the account was payable to the plaintiff or the decedent. The signature cards listed several types of accounts that could be opened including "Joint - with Survivorship" and "Joint - No Survivorship." Boxes appeared opposite each type of account and the depositor could mark the type that was desired, but none were marked to indicate the type of account opened. The savings account depository agreement with the bank contained the following clause:

"JOINT ACCOUNT — WITH SURVIVORSHIP. Each joint tenant intends and agrees that the account balance upon his death shall be the property of the survivor . . . ."<sup>569</sup>

The checking account depository agreement with the bank contained the following clause:

"JOINT ACCOUNT — WITH SURVIVORSHIP. Such an account is issued in the name of two or more persons each of you intend that upon your death the balance of the account . . . will belong to the survivor(s) . . . ."<sup>570</sup>

Neither the signature cards nor the depository agreements stated that the accounts were joint accounts with right of survivorship. The court held that the documents in question were not sufficient to create a joint account with right of survivorship.<sup>571</sup>

Texas Probate Code section 439(a) is very specific in its requirement that in order to create a joint account with right of survivorship, there must be a written agreement signed by the party who dies stating that the interest of such deceased party is made to survive to the surviving party or parties.<sup>572</sup> A survivorship agreement will not be inferred from the mere fact that the account is a joint account.<sup>573</sup> The statute and the cases interpreting the statute are very strict with regard to compliance with the requirements for creating a survivorship account.<sup>574</sup> This is due, in part, to an historical prejudice against survivorship arrangements.

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568. 840 S.W.2d 81 (Tex. App.—Corpus Christi 1992, n.w.h.).

569. *Id.* at 82.

570. *Id.*

571. *Id.* at 87.

572. TEX. PROB. CODE ANN. § 439(a) (Vernon 1980 & Supp. 1993).

573. *Ephran*, 840 S.W.2d at 85.

574. See *Kruger v. Williams*, 359 S.W.2d 48 (Tex. 1962); *Stauffer v. Henderson*, 746 S.W.2d 533 (Tex. App.—Amarillo 1988), *aff'd*, 801 S.W.2d 858 (Tex. 1990); *Dickinson v. Brooks*, 727 S.W.2d 652 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.); *Sawyer v. Lancaster*, 719 S.W.2d 346 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.); *Chopin v. First Bank Dallas NA*, 649 S.W.2d 79 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

The United States District Court for the Southern District of Texas addressed the sufficiency of writings in *Union National Bank of Texas v. Ornelas - Gutierrez*.<sup>575</sup> There the decedent opened a money market account with a bank. Later, the decedent invested \$5 million in certificates of deposit with the bank. This investment was given an identification number. In that same year the decedent reinvested the funds that had been in CDs in book-entry U.S. T-bills using the bank as his broker. The bank purchased the T-bills on the decedent's behalf from the Federal Reserve Bank in San Antonio. The T-bills were held for decedent in the bank's T-bill account at the Federal Reserve Bank. In order to keep track of the uncertificated T-bills, the bank continued to use the identification number it had previously used for the Cds. In exchange for this service the bank charged the decedent its usual brokerage and custodial fee. The bank gave the decedent a receipt signed by an officer of the bank and identifying the number and denomination of T-bills held for him, the maturity date, his identification number, and other relevant data including CUSIP number specifically identifying the T-bills held on his behalf. On the back of the receipt the bank stated the terms and conditions of its custodial agreement with decedent. The decedent was not required to and did not sign the receipt. The decedent instructed the bank to automatically reinvest on his behalf the funds held in the T-bills when they reached maturity. When certain T-bills reached their maturity date, the decedent instructed the bank to sell them and deposit their proceeds in his money market account.

In 1988 the decedent requested the bank to alter the custodial agreement for the T-bills in order to designate Maria Ornelas Gutierrez as a pay on death (P.O.D.) beneficiary of the T-bill investment. An officer of the bank explained the significance of this change. The decedent wrote out and signed an altered safekeeping receipt reflecting the arrangement and delivered it to the bank. Later in that same year the decedent again requested the bank to alter the custodial agreement to add Maria Tenorio Ornelas as a second P.O.D. beneficiary of the investment. The same process was followed, and a reinvestment receipt was issued reflecting this alteration. Five months later the decedent died. After the decedent's death, the bank continued to reinvest the T-bill funds, delivering the receipts to Gutierrez and depositing the proceeds of the partial sales to the money market account. Eight months after the decedent's death, Gutierrez presented legal proof of the decedent's death to the bank and directed that the T-bills be sold and the proceeds invested in United States Government securities under a repurchase agreement with the bank. The bank complied. After having contrary claims to this property, the bank interplead it into the registry of the court.

The court held that writing and signature were not required because the custodial arrangement involved in this case was neither a joint account under Tex. Prob. Code section 439 nor an account under Tex. Prob. Code section 436(1) that would require a writing in order to validate the P.O.D.

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575. 772 F. Supp. 962 (S.D. Tex. 1991).

designation under section 440.<sup>576</sup> Rather, the custodial arrangement may stipulate a P.O.D. beneficiary without a writing under section 450.<sup>577</sup> Therefore, even though the decedent did not sign anything evidencing the P.O.D. designation, the designation was nonetheless valid.<sup>578</sup>

In situations where parties create joint accounts, there are very good policy reasons for the Legislature to require fairly strict standards for creating survivorship rights in joint accounts. This is because many people add individuals to their accounts for convenience only, not with the intention of transferring title to the co-signator on the account.<sup>579</sup> Therefore, when creating survivorship rights in a joint account or when designating an individual to take the account upon death, the Texas Probate Code requires a writing.<sup>580</sup> This is due in part to Texas' long-standing prejudice against survivorship arrangements. Certain instruments such as insurance policies, employment contracts, bonds, mortgages and depository or custodial agreements or "any other written instrument effective as a contract," however, may pass to a person designated by the decedent in such instrument free of probate without a writing and signature by the decedent.<sup>581</sup> This is due in part to the nature of the transaction or instrument and the desire to facilitate the decedent's testamentary intention.

## 2. Garnishment of Accounts

Banks are frequently placed in the difficult position of having to decide immediately whether or not funds on deposit should be frozen in response to a writ of garnishment that indicates funds may belong to the judgment debtor even though the depositor of record is a different person or entity. The Texas Supreme Court addressed just such a situation in *Bank One, Texas, N.A. v. Sunbelt Savings, F.S.B.*<sup>582</sup> and relieved the bank of having to decide that issue. In this garnishment suit, Sunbelt had obtained a personal judgment against an individual who was also the sole shareholder, director, officer, and employee of a corporation. The corporation, but not the individual, maintained an account at the bank. Post-judgment discovery indicated that the individual had commingled personal funds with corporate funds in the account. Sunbelt obtained a writ of garnishment against the bank in order to collect the judgment debt and pled commingling in its application for the writ. The corporation, however, was not a judgment debtor. The bank responded to the writ by stating that it was not indebted to the individual. The funds in the corporate account were subsequently withdrawn, and Sunbelt sued the bank. The trial court granted summary judgment in favor of the bank. The court of appeals reversed the trial court's decision.

The supreme court held that a bank served with a writ of garnishment

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576. *Id.* at 964-66.

577. *Id.* at 966.

578. *Id.* at 967.

579. *Id.*

580. TEX. PROB. CODE ANN. § 439(a), 440 (Vernon 1980 & Supp. 1993).

581. *Id.* § 450.

582. 824 S.W.2d 557 (Tex. 1992).

may rely on its deposit agreements when determining to whom it is indebted.<sup>583</sup> The court stated that “[a] garnishee bank is not indebted to a judgment debtor unless some form of deposit agreement creates a debtor-creditor relationship between the bank and the judgment debtor.”<sup>584</sup> In this case, there was no deposit agreement between the bank and the judgment debtor.

The Texas Supreme Court also considered the proper test to be applied when a garnishee fails to answer a writ of garnishment and seeks a new trial after a default judgment is entered against it. In *Bank One, Texas, N. A. v. Moody*,<sup>585</sup> a default judgment in a garnishment proceeding was taken where a writ of garnishment was served on the bank, which then froze the account and, instead of filing an answer, submitted a check in the amount of the depositor’s funds to the court clerk. The bank filed a motion for new trial, which was denied. On appeal, the court applied its interpretation of the *Craddock* test to determine whether to grant a new trial after a default judgment was entered.<sup>586</sup> The supreme court held that “the court of appeals improperly treated the *Craddock* test as having four independent elements, and . . . that a mistake of law is one type of mistake that may satisfy the first element of the three element *Craddock* test . . . revers[ing] the judgment of the court of appeals.”<sup>587</sup>

The court reasoned that the trial court’s discretion in determining whether to grant a new trial after a default judgment must be referenced to a guiding principle or rule such as the *Craddock* test.<sup>588</sup> The test, when properly applied, has three parts. A default judgment should be set aside and a new trial ordered where “(1) the failure of the defendant to answer before judgment was not intentional, or the result of conscious indifference on [the defendant’s] part, but was due to a mistake or an accident; provided (2) the motion for new trial sets up a meritorious defense; and (3) is filed at a time when the granting thereof will occasion no delay or otherwise work an injury to the plaintiff.”<sup>589</sup> If the first element is divided into (1) whether the failure to answer was intentional or due to conscious indifference and (2) whether the failure was due to mistake or accident, the potential for a mistake of law to satisfy the first part of the three-part test is read out of the test.<sup>590</sup> Under the correct interpretation of the test, a mistake or accident may negate any intention not to file an answer, however, “if the test is interpreted as having four elements, a mistake or accident cannot negate the intent not to file an answer.”<sup>591</sup> In a four part test, “the requirement that the failure to answer not be intentional or due to conscious disregard and the requirement that the

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583. *Id.* at 558.

584. *Id.*

585. 830 S.W.2d 81 (Tex. 1992).

586. *Id.* at 81 (applying the test from *Craddock v. Sunshine Bus Lines*, 133 S.W.2d 124 (Tex. 1939)).

587. *Id.* at 81-82.

588. *Id.* at 82.

589. *Id.* at 82-83.

590. *Id.* at 82.

591. *Id.* at 83.

failure to answer be due to an accident or mistake must be met independently."<sup>592</sup> The court stated that the fact that most courts apply the *Craddock* test by focusing on whether the failure to answer was intentional or due to conscious indifference does not justify considering mistake or accident as a separate element of the test.<sup>593</sup>

Regarding whether mistake of law can satisfy the test, the court stated that mistake of law may be, but will not necessarily be, sufficient to satisfy the first element of the test.<sup>594</sup> The court was careful to say that not every act of a defendant that could be characterized as a mistake of law is a sufficient excuse to satisfy the first element of the *Craddock* test.<sup>595</sup>

The case of *Baca v. Hoover, Box & Shearer*,<sup>596</sup> while not really a garnishment case, included a long discussion of the nature of a garnishment proceeding. This discussion does not seem to be necessary to the decision and can be characterized as dicta, but it nevertheless has its troubling aspects. The Bacas were sued by their former attorneys for attorneys' fees. While that suit was pending, the former attorneys sought a pre-judgment writ of garnishment against Texas Commerce Bank in a separate suit. The bank answered by saying it was indebted to the Bacas. A summary judgment was entered in favor of the former attorneys and against the Bacas in the first suit. The Bacas then appealed that judgment and filed a cash deposit in lieu of a supersedeas bond. While the first case was on appeal and after the cash deposit had been made, the former attorneys and the bank entered into an agreed judgment in the garnishment suit pursuant to which the bank delivered \$32,000.00 of the Bacas' funds to the former attorneys. The court of appeals later reversed the summary judgment in the first case.<sup>597</sup> After it was remanded, one of the Bacas was granted a motion for partial summary judgment and filed a motion for restitution and for dissolution of the writ of garnishment. The former attorneys then moved to dismiss the case and the court entered an order doing so. The motion for restitution was denied.<sup>598</sup>

Since the garnishment action was between the former attorneys and the bank, whether or not the garnishment was proper seems to be irrelevant to the Bacas' desire to obtain reimbursement from their former attorneys. Nevertheless, in discussing the nature of a garnishment proceeding, the court made the following statements:

Further, it is a well-established and longstanding rule that the validity of judgment in a garnishment action rests upon the finality of the underlying debt judgment. If the underlying judgment has not reached that stage of the judicial process in which it is not subject to being set aside by the trial or appellate court, then the judgment in the ancillary garnishment action cannot stand. A garnishment is not an original suit,

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592. *Id.*

593. *Id.* at 84.

594. *Id.*

595. *Id.*

596. 823 S.W.2d 734 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

597. *Id.* at 737.

598. *Id.* at 738.

but ancillary to the main one, and for that reason takes its jurisdiction from the main suit. Thus, when the trial court loses jurisdiction in the main suit by reason of an appeal, it likewise loses jurisdiction in the ancillary garnishment proceeding. If the judgment in the main suit is affirmed, the trial court regains jurisdiction over the garnishment action. If the judgment in the main suit is reversed, the garnishment proceedings become a nullity and the writs issued thereunder are *functus officio*, or of no further force or authority.<sup>599</sup>

The statutory grounds for a writ of garnishment are set forth at section 63.001 of the Texas Civil Practice and Remedies Code. It can be pursued either as a pre-judgment or post-judgment remedy. If post-judgment, the underlying judgment is deemed final and subsisting for the purpose of the garnishment, unless a supersedeas bond has been approved and filed.<sup>600</sup> In either case, the applicant must swear to the existence of certain facts by affidavit.<sup>601</sup> If the garnishee answers the writ by stating it is indebted to the garnishor, then the garnishor is entitled to a judgment.<sup>602</sup> The alleged debtor must be served with the copy of the writ<sup>603</sup> and has the opportunity to contest it.<sup>604</sup> If the alleged debtor fails to do so and a judgment is entered ordering the garnishee to deliver the funds to the garnishor, what is the liability of the garnishee if (as the *Baca* opinion indicates) the court entering the order did so without jurisdiction or later loses jurisdiction or "the garnishment proceedings become a nullity and the writs issued thereunder are *functus officio*, or of no further force or authority?"<sup>605</sup> Neither the rules, nor the statute, mandate that jurisdiction bounce back and forth in a garnishment proceeding, nor is that a necessary finding before debtors such as the Bacas are entitled to restitution. The forgotten party in this is the garnishee, who now has an added worry over the jurisdiction of the court which orders it to deliver funds held by the garnishee.

### 3. *Wrongful Dishonor*

Considering the wrongful dishonor issues raised in *American Bank of Waco v. Waco Airmotive, Inc.*,<sup>606</sup> previously discussed, the court reasoned that under section 4.301 of the Texas Business and Commercial Code, the bank could make a valid decision to pay or dishonor an item at any time up to midnight of the next banking day after receipt of the item, if it had not previously completed the process of posting the item. On the other hand, if the bank earlier decided to pay a particular item or completed the process of posting that item, whichever occurred first, it lost the right to offset the account under section 4.301 as to the funds necessary to pay the item.<sup>607</sup> The

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599. *Id.* (citations omitted).

600. TEX. R. CIV. P. 657.

601. TEX. CIV. PROC. & REM. CODE ANN. § 63.001 (Vernon 1986); TEX. R. CIV. P. 658.

602. TEX. R. CIV. P. 668.

603. *Id.* at 663a.

604. *Id.* at 664, 664a.

605. *Baca*, 823 S.W.2d at 738.

606. 818 S.W.2d 163 (Tex. App.—Waco 1991, no writ).

607. *Id.* at 168.

court also stated that exemplary damages are recoverable if there is a finding that the bank acted with malicious intent or in reckless disregard of the rights of its depositor.<sup>608</sup> In addition, the court noted that the remedy of recovery of the face amount of a dishonored check is available to the payee of the dishonored item that the bank should have paid.<sup>609</sup> The court reasoned that, logically, recovery is not available to the maker of a wrongfully dishonored item because the amount of that item ordinarily remains in the account.<sup>610</sup>

#### 4. Duties of Bank as Escrow Agent

According to the Tyler court of appeals in *Pack v. First Federal and Loan Association of Tyler*,<sup>611</sup> a bank that agrees to act as an escrow agent takes on a fiduciary duty of loyalty, a duty to make full disclosure, and a duty to exercise a high degree of care to conserve the money in its possession.

### M. SURITIES AND GUARANTORS

The Texas Supreme Court addressed the theory of res judicata in a case where the defendant being sued to collect the debt was both a general partner of the borrower and a guarantor and was sued separately, in both capacities.<sup>612</sup> Barr was a partner in a partnership that executed a promissory note in favor of Sunbelt Federal Savings' predecessor in interest. Barr also executed a personal guarantee of the note. Sunbelt sued Barr in two lawsuits. In one lawsuit, Sunbelt claimed that Barr was liable personally on the note due to his execution of the guarantee. Barr moved and was granted summary judgment in that lawsuit. In the other suit, Sunbelt initially sued only the partnership on the note and the other partner on his guarantee. Sunbelt did not appeal the summary judgment in the first lawsuit, but rather amended its pleadings in the second lawsuit by adding Barr as a defendant based on his liability as a general partner. Barr moved for summary judgment on the basis of res judicata.

The court reaffirmed the transactional approach to res judicata first articulated by the court in *Gracia v. RC Cola—7-Up Bottling Co.*<sup>613</sup> The court specifically overruled the test set forth in *Griffin v. Holiday Inns of America*,<sup>614</sup> that held that res judicata did not prevent a subsequent suit based upon a different cause of action except as to issues of fact actually litigated and determined in the first suit.<sup>615</sup> The court stated that the transactional approach is substantially similar to the rule governing compulsory counterclaims.<sup>616</sup> That is, claims that "arise out of the transaction or occur-

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608. *Id.* at 176.

609. *Id.* at 175.

610. *Id.*

611. 828 S.W.2d 60 (Tex. App.—Tyler 1992, no writ).

612. *Barr v. RTC*, 837 S.W.2d 627 (Tex. 1992).

613. 667 S.W.2d 517 (Tex. 1984).

614. 496 S.W.2d 535 (Tex. 1973).

615. *Barr*, 837 S.W.2d at 630.

616. *Id.*

rence that is the subject matter of the opposing party's claim"<sup>617</sup> are compulsory counterclaims that must be asserted and will be barred in subsequent litigation.<sup>618</sup> The court noted that it made little sense to require the partner/guarantor to defend himself in separate lawsuits.<sup>619</sup> The court stated in a footnote that *res judicata* is really an application of merger and bar depending upon which party was successful in the prior litigation.<sup>620</sup> If the party pursuing the claim (i.e. breach of contract) is successful, the additional claim (i.e. quantum merit) is "merged" into the judgment and ceases to exist and if the party defending the claim is successful, the additional claim is barred in subsequent litigation.<sup>621</sup>

In a not surprising decision, the Fifth Circuit Court of Appeals held that the guarantor of a non-recourse note was liable for the payment of the debt.<sup>622</sup> As a general rule, the liability of a guarantor does not exceed the liability of the principal.<sup>623</sup> The guarantor, however, can agree to greater liability. Here, the guarantors guaranteed the payment of the indebtedness of the joint venture, and the note was an indebtedness of the joint venture even though the joint venture was not obligated for its payment. Moreover, the terms of the guaranties and the terms of the note made it clear that the guarantors were liable for the indebtedness, because the guaranties were expressly excluded from the operation of the non-recourse provision of the note.<sup>624</sup>

In *Simmons v. Compania Financiera Libano*,<sup>625</sup> the court considered the rights of one who pledged collateral for a loan to a borrower as against the borrower. The court held that a suretyship relationship existed stating that, "[a] surety is a party who promises to answer for the debt of another. . . , includ[ing] an 'endorser, guarantor, drawer of a draft which has been accepted, and every other form of suretyship, whether created by express contract or by operation of law'. A guaranty is a promise of a person to perform an act of the same kind and content as another is contractually bound to perform."<sup>626</sup> Pledging property as security for another's obligation creates a position of surety up to the amount of property pledged.<sup>627</sup> Upon liquidation of the pledged property, the surety obtains a right of action against the principal or the debt.<sup>628</sup>

In the *T.O. Stanley v. Bank of El Paso*<sup>629</sup> case discussed earlier, both the borrower and guarantors claimed they were entitled to a reduction in the

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617. TEX. R. CIV. P. 97.

618. *Barr*, 837 S.W.2d at 630.

619. *Id.* at 631.

620. *Id.* at 628 n.1.

621. *Id.*

622. *RTC v. Northpark Joint Venture*, 958 F.2d 1313 (5th Cir. 1992).

623. *Id.* at 1321.

624. *Id.*

625. 830 S.W.2d 789 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

626. *Id.* at 792 (citations omitted).

627. *Id.*

628. *Id.*

629. 36 Tex. Sup. Ct. J. 259 (Dec. 2, 1992).

amount owed equal to the amount of loss suffered as a result of the bank's impairment of the collateral. They claimed that the collateral had been damaged by exposure to the elements and by vandalism due to the bank's failure to maintain a security system. The court recognized that the guarantors were not entitled to assert the defense of impairment of collateral under section 3.606 of the Code, because the guaranties were not negotiable instruments and the guarantors were not parties to the promissory note, which presumably was a negotiable instrument.<sup>630</sup> The court, however, upheld the impairment claim under the common law.<sup>631</sup> Under the common law, a creditor has a duty to use ordinary care to secure and preserve collateral in its possession from waste, injury, or loss and if breached, the guarantor is discharged on the note to the extent of the loss.<sup>632</sup> In addition, because the bank failed to plead waiver as an affirmative defense to the impairment claim, the waiver provisions in the guaranty were ineffective to protect the bank from the guarantors' claim.<sup>633</sup>

## N. FEDERAL DOCTRINES AND STATUTES

### 1. *D'Oench, Duhme* and 12 U.S.C. Section 1823(e)

#### a. Alleged Tying Act Violations

12 U.S.C. section 1972 prohibits certain tying arrangements by banks.<sup>634</sup> For example, a bank can not require a customer to purchase a foreclosed property from the bank as a condition to that customer being granted a loan. In *NCNB Texas National Bank v. King*,<sup>635</sup> the borrower alleged that the predecessor institution violated the Tying Act by orally demanding that the borrower both cease doing business with any other bank and transfer all of the banking business of a separate company to the bank, in exchange for extending certain indebtedness. The Fifth Circuit held that the *D'Oench, Duhme* doctrine barred King's Tying Act claim.<sup>636</sup> The court noted that King's Tying Act claim was wholly dependent on oral promises made by the officers of the predecessor bank to King to provide financing for his other businesses. The court noted that: (1) the *D'Oench, Duhme* doctrine precludes a borrower from bringing defenses "against the collection efforts of the federal receiver of a failed bank, which are based on unrecorded agreements with the failed bank;" (2) the *D'Oench, Duhme* doctrine protects the assignees of the FDIC; and (3) *D'Oench, Duhme* also bars defenses framed as causes of action.<sup>637</sup>

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630. *Id.* at 263.

631. *Id.*

632. *Id.*

633. *Id.*

634. 12 U.S.C. § 1972 (1988).

635. 964 F.2d 1468 (5th Cir. 1991).

636. *Id.* at 1470.

637. *Id.*

### b. Written Side Agreements

*RTC v. Toler*<sup>638</sup> dealt with the application of the *D'Oench, Duhme* doctrine to a written side agreement. In that case, the borrowers executed a promissory note in favor of First City Savings Association. In addition, an irrevocable letter of credit, which expired the day after the note's maturity, was issued in favor of the failed financial institution and secured the note. The note's terms provided that upon maturity, the failed financial institution had the option of either drawing on the letter of credit or declaring the note immediately due and payable. The borrowers defaulted on the note when it matured, but despite a letter sent by the failed financial institution to the borrowers in which the failed financial institution stated its intention to draw upon the letter of credit if full payment was not received upon the note's maturity, the failed financial institution failed to draw on the letter of credit. A transferee of the FSLIC, which was acting as the receiver for the failed financial institution, acquired the note and instituted this suit against the borrower. Subsequently, the RTC, as conservator, was substituted as plaintiff for the transferee of the FSLIC, and it filed a Motion for Summary Judgment.

The district court concluded that the RTC proved all of the necessary elements to recover in an action for breach of contract, and, relying on the *D'Oench, Duhme* doctrine, the court rejected the borrowers' argument that the failed institution's failure to draw on the letter of credit constituted non-performance and impairment of collateral.<sup>639</sup> The court specifically stated that the terms of the note did not require the failed institution to draw on the letter of credit, rather such action was merely an option.<sup>640</sup> Furthermore, the court stated that the letter relied upon by the borrowers was unenforceable under the *D'Oench, Duhme* doctrine because the letter was a side agreement and was not part of the failed institution's record regarding the transaction, and the RTC was entitled to rely on the promissory note as a complete agreement between the failed institution and the borrowers.<sup>641</sup>

### c. Tort Claims

In *RTC v. Cook*,<sup>642</sup> the lender made a home improvement loan by taking an assignment of the contract between a homeowner and a contractor, subject to the Federal Trade Commission holder in due course rule, 16 C.F.R. 433.2.<sup>643</sup> The borrower sued for negligent infliction of emotional distress based on collection actions of the lender. The court held that *D'Oench*,

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638. 791 F. Supp. 649 (N.D. Tex. 1991).

639. *Id.* at 652.

640. *Id.*

641. *Id.*

642. 840 S.W.2d 42 (Tex. App.—Amarillo 1992, writ denied).

643. The notice on the contract as required by the rule read as follows: "Notice: Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder." *Id.* at 45.

*Duhme* does not apply to defeat a tort claim, but only agreements that are not in writing, executed by the parties, approved by the board or loan committee as reflected in its minutes, and continuously a part of the official records of the institution.<sup>644</sup>

d. Agreements with Other Than Financial Institutions

*RTC v. 1601 Partners, Ltd.*<sup>645</sup> involved an agreement made by the original payee of the note, but the original payee was not a financial institution. The original payee of the note released the borrowers from liability on the note and then transferred the note to an insured savings and loan association. After foreclosing on the collateral, the transferee's receiver, the RTC, sued the borrowers to recover the deficiency. The borrowers asserted that the transferee took the note subject to the release because the transferee was not a holder in due course since the note incorporated the deed of trust into the note by reference thereby destroying the unconditional promise to pay required of a negotiable instrument. The RTC relied upon the *D'Oench, Duhme* doctrine and the provisions of 12 U.S.C. § 1823(e) to abrogate the borrowers' defense based on its agreement with the prior holder of the note. The court held that *D'Oench, Duhme* does not apply to agreements entered into between private, non-financial institution parties and is not available to an insured financial institution that acquires the note and later fails, unless possibly the agreement is somehow the product of a scheme or arrangement likely to mislead bank examiners.<sup>646</sup>

e. Oral Agreements Unrelated to the Loan

The Fifth Circuit stated in *Texas Refrigeration Supply v. FDIC*<sup>647</sup> that the *D'Oench, Duhme* doctrine is very broad and may be used by the FDIC to protect itself against a claim based on any unwritten agreement between the insolvent bank and borrower, even if the agreement is unrelated to the loan in question. Despite the doctrine's breadth, a lender's obligations regarding proper acceleration and disposal of collateral are implicit in every promissory note and cannot be said to be secret and unwritten.<sup>648</sup>

f. Federally Assisted Transactions

In *Cockrell v. Republic Mortgage Insurance Company*,<sup>649</sup> the holder of a note sought the protection of *D'Oench, Duhme* as the assignee of an insolvent institution prior to its merger with another institution in a merger assisted by the FSLIC. The appellate court held that the *D'Oench, Duhme* doctrine does not protect a federally insured institution from a liability when

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644. *Id.* at 48. The court also held that the FTC holder in due course rule, 16 C.F.R. 433, permits a refund of payments from the holder of the contract, whether or not the holder is the person to whom the payments were made. *Id.* at 49.

645. 796 F. Supp. 238 (N.D. Tex. 1992).

646. *Id.* at 240.

647. 953 F.2d 975 (5th Cir. 1992).

648. *Id.* at 981.

649. 817 S.W.2d 106 (Tex. App.—Dallas 1991, no writ).

the institution and not the FSLIC acquires a potential liability. The court noted that the notes at issue were assigned to Republic Mortgage Insurance Co. (RMIC) before the FSLIC assisted merger occurred. The court further noted that the *D'Oench, Duhme* doctrine was designed "to aid the FDIC's ability to protect the assets of failed [financial institutions] in purchase and assumption transactions. It was not designed to let every lending institution escape liability for possible fraudulent acts. . . ." <sup>650</sup> Accordingly, the appellate court held that since the FSLIC never acquired the notes, the *D'Oench, Duhme* doctrine did not protect RMIC as the assignee of the insolvent institution. <sup>651</sup>

g. Enforcement by FDIC of Oral Agreement

An interesting turn of events was addressed in *Allied Elevator, Inc. v. East Texas State Bank of Buna* <sup>652</sup> when the FDIC attempted to enforce an alleged oral agreement. In that case, several makers executed a renewal note that was the last in a long line of renewal notes. One of the makers initialed a request on the face of the renewal note requesting credit life insurance. The premium for the insurance was added to the amount of the note, but the insurance was never obtained by the bank. As luck would have it, the maker for whom credit life insurance was requested died. The makers sued the bank for breach of an agreement to provide credit life insurance. The FDIC, as successor to the lender, counterclaimed for judgment on the original note, not the renewal note. This was done, apparently, because the request for credit life insurance was on the renewal note and not on the original note. Summary judgment in favor of the FDIC was reversed and remanded by the Fifth Circuit. <sup>653</sup>

Regarding the allegation of the makers that the bank had breached an obligation to obtain credit life insurance, the court applied the rule of contract law that whenever a party commits a material breach, the other party is excused from performance. <sup>654</sup> It remanded the case for the trial court to consider whether the bank's failure was a material breach. <sup>655</sup> The FDIC claimed the issue was moot because any agreement to obtain credit life insurance was oral and unenforceable under the *D'Oench, Duhme* doctrine. That argument was dismissed by the court because the provision in question was not oral but was written on the face of the note. <sup>656</sup> The FDIC then wanted to enforce an alleged side agreement to the effect that the party to be insured did not actually want insurance and invoked the *D'Oench, Duhme* doctrine to entitle the FDIC to enforce an oral side agreement that protects a failed bank's depositors and creditors. The court refused to allow the FDIC to do

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650. *Id.* at 115.

651. *Id.*

652. 965 F.2d 34 (5th Cir. 1992).

653. *Id.* at 35.

654. *Id.* at 38.

655. *Id.*

656. *Id.*

so.<sup>657</sup>

#### h. Summary Judgment

The issue before the court in *Stiles v. RTC*<sup>658</sup> was whether, to avoid summary judgment, a borrower has the burden to demonstrate that the *D'Oench, Duhme* doctrine and section 1823(e) of the U.S. Code do not estop him from asserting affirmative defenses. The court held that the *D'Oench, Duhme* doctrine and 12 U.S.C. § 1823(e) mandate that, to avoid summary judgment, a borrower alleging affirmative defenses that would defeat the RTC's right, title, or interest in a promissory note acquired from a failed financial institution has the burden to demonstrate that the *D'Oench, Duhme* doctrine and section 1823(e) do not estop him from asserting those defenses.<sup>659</sup>

The sufficiency of the borrower's evidence to overcome the RTC's motion for summary judgment was the issue in *Park Club, Inc. v. RTC*.<sup>660</sup> The critical issue to the court was whether or not the board of directors of the failed institution had approved a side letter agreement with the borrower. Section 1823(e) sets forth that no such agreement is valid against the RTC unless it was "approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee."<sup>661</sup> The court noted that on their face the board minutes did not reflect the approval of a permanent loan as set forth in the side letter agreement. However, the court said that the testimony of a member of the loan committee to the effect that the usual practice of the board was to approve a permanent loan at the time the interim loan was approved just barely satisfied the summary judgment standard.<sup>662</sup>

#### i. Raising *D'Oench, Duhme* on Appeal

During the Survey period, state and federal courts further defined the ability of government agencies to assert *D'Oench, Duhme* defenses for the first time on appeal. For example, in *Larson v. FDIC*,<sup>663</sup> the Texas Supreme Court had to decide whether or not FIRREA enabled the FDIC, as receiver, to step in after an adverse judgment against the failed financial institution, which judgment resulted in voiding the asset at issue, and assert substantive federal defenses for the first time on appeal. The Texas Supreme Court

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657. *Id.*

658. 831 S.W.2d 24 (Tex. App.—Dallas 1992, no writ).

659. *Id.* at 28.

660. 967 F.2d 1053 (5th Cir. 1992).

661. 12 U.S.C. § 1823(E) (1988).

662. *Id.* at 1057.

663. 835 S.W.2d 66 (Tex. 1992); *see also* *F & A Equipment Leasing v. FDIC*, 835 S.W.2d 74 (Tex. 1992); *Gray v. FDIC*, 841 S.W.2d 72, 81 (Tex. App.—Houston [1st Dist.] 1992, no writ) (holding that when the federal common law defenses are not available at the trial court level to a failed financial institution subsequently taken over by a federal agency, the federal common law defenses "cannot be raised for the first time on appeal to eviscerate or otherwise disturb a Texas state trial court judgment that adjudicates the respective rights of the institution and the other parties and that is rendered before the receivership, regardless of whether that judgment is rendered in favor of or against the institution.").

noted that FIRREA does not give the FDIC the absolute new substantive right to assert *D'Oench, Duhme* defenses for the first time on appeal.<sup>664</sup> The court further stated that FIRREA may well provide the FDIC with an opportunity to raise an argument for the first time on appeal because it never had the opportunity in the first instance.<sup>665</sup> The supreme court, however, held that if the judgment was adverse to the failed financial institution and said judgment resulted in the voiding of an asset, then the FDIC may not raise such defenses to set aside the judgment voiding the asset.<sup>666</sup> Accordingly, because the failed financial institution lost at the trial court level and the judgment rendered voided the asset at issue, the supreme court held that the court of appeals erred in permitting the FDIC to assert *D'Oench, Duhme* defenses for the first time on appeal under FIRREA.<sup>667</sup>

In *Gray v. FDIC*<sup>668</sup> the appellate court expanded upon the *Larson* opinion. Specifically, the appellate court faced the issue left open by the *Larson* opinion as to whether or not the FDIC may assert its *D'Oench, Duhme* defenses for the first time on appeal when, although the trial court should have awarded judgment against the failed financial institution, the trial court judgment is in favor of the failed financial institution. Relying in part on dictum in *Larson*, the court held that when the federal common law defenses are not available at the trial court level to a failed financial institution subsequently taken over by a federal agency, the federal common law defenses "cannot be raised for the first time on appeal to eviscerate or otherwise disturb a Texas state trial court judgment that adjudicates the respective rights of the institution and the other parties and that is rendered before the receivership, regardless of whether that judgment is rendered in favor of or against the institution."<sup>669</sup>

In *5300 Memorial Investors, Ltd. v. RTC*<sup>670</sup> the Fifth Circuit permitted the RTC to raise its *D'Oench, Duhme* defenses for the first time on appeal. In this case, the trial court rendered judgment in favor of 5300 Memorial Investors, Ltd., but both parties appealed. The Houston court of appeals (first district) rendered an opinion, reversing the judgment of the trial court and remanding the case for a new trial. While a writ of error was pending before the Texas Supreme Court, the financial institution failed and the RTC was appointed as its receiver. The RTC then removed the action to federal district court, which adopted the judgment of the Texas appellate court as its own, prepared the record for appeal and forwarded it to the Fifth Circuit for review. Before the Fifth Circuit, the RTC argued that it was entitled to assert its rights under *D'Oench, Duhme* and its codification. The Fifth Circuit held that because the RTC urged *D'Oench, Duhme* and section 1823(e) in support of the federal district court's judgment, which adopted the judg-

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664. *Id.* at 74.

665. *Id.*

666. *Id.*

667. *Id.*

668. 841 S.W.2d 74 (Tex. App.—Houston [1st Dist.] 1992, no writ).

669. *Id.* at 81.

670. 973 F.2d 1160 (5th Cir. 1992).

ment of the Texas appellate court reversing the trial court's judgment and remanding the case for a new trial, the RTC, on remand, could assert the defenses afforded by *D'Oench, Duhme*.<sup>671</sup> Apparently, the court recognized that on remand, the RTC would be a party to the actual trial, and, thus, the RTC could unquestionably assert its *D'Oench, Duhme*-type defenses.

j. Limited Guaranty as Unenforceable Side Agreement

Based on the opinion in *RTC v. Oaks Apartment Joint Venture*,<sup>672</sup> limited guarantors of a note could become fully obligated, depending on how the failed institution maintained its records. In 1984, five individuals, as partners, formed the Oaks Apartments Joint Venture and borrowed \$2 million from Meridian Service Corporation. The partnership used the money to purchase land and construct an apartment complex. At the time the note was executed, the partners also executed a personal guaranty for the loan with Meridian. The guaranty limited each partner's liability to twenty percent of the amount outstanding. In 1986, the loan defaulted, Meridian foreclosed on the property, leaving a deficiency of \$755,249.06. Suit was filed for this amount in 1988. After suit was filed, the RTC took over Meridian. The RTC contended that the personal guaranty had no effect on the loan because of the *D'Oench, Duhme* doctrine and that each partner was jointly and severally liable for the deficiency amount. It argued that since the note itself did not mention the limitation on liability, the note should stand alone as a separate agreement. The district court disagreed, and the RTC appealed.

The Fifth Circuit stated that the *D'Oench, Duhme* doctrine does not require that agreements between lenders and borrowers be confined to the face of one particular document.<sup>673</sup> It is important, if not determinative, to ascertain whether the guaranty was part of the integral loan transaction files associated with the note or if it was filed separately because "[w]ithout this information, [the court] cannot determine if the Guaranty was a secret side agreement . . . [or] a valuable asset kept in tandem with the Note to ensure payment."<sup>674</sup> If on remand, it is determined that the guaranty was not kept with the loan, then the *D'Oench, Duhme* doctrine applies.<sup>675</sup> If this is the case, the district court "should then determine whether or not the liability limitation clause amounts to a contractual obligation on the part of [the failed financial institution] which was not performed."<sup>676</sup> If it turns out that the guaranty was a mutual obligation not performed by the lender, then the *D'Oench, Duhme* doctrine would not bar the partners' defense.<sup>677</sup>

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671. *Id.* at 1163-64.

672. 966 F.2d 995 (5th Cir. 1992).

673. *Id.* at 1000.

674. *Id.*

675. *Id.*

676. *Id.*

677. *Id.* at 1001.

k. Preemption of D'Oench, Duhme and Federal Holder in Due Course Rule

The Fort Worth court of appeals, in *Jones v. RTC*,<sup>678</sup> ruled that the codification of the *D'Oench, Duhme* doctrine and the federal holder in due course doctrine does not preempt their common law counterparts.<sup>679</sup> The court could find no case holding that the codified law preempted the common law *D'Oench, Duhme* doctrine, and, in fact, the Fifth Circuit has made clear that it does not.<sup>680</sup> The federal holder in due course doctrine is also not preempted by codified law.<sup>681</sup>

2. Federal Holder in Due Course and Other Common Law Defenses

a. Negotiability

After first determining that the note in issue was not a negotiable instrument, the court in *RTC v. 1601 Partners, Ltd.*<sup>682</sup> considered whether the RTC could nevertheless take advantage of the federal holder in due course doctrine. The court ruled it could not with the following statements:

In *Campbell Leasing, Inc. v. FDIC*, the Fifth Circuit held that the FDIC may be a federal holder in due course without meeting the technical state law requirements for holder in due course status. Negotiability, however, is not a requirement the Fifth Circuit has been willing to relax. In *Sunbelt Sav., FSB v. Montross*, the court expressly refused to "extend federal holder in due course status to the FDIC or its successor in cases in which it acquires non-negotiable instruments through purchase and assumption transactions."<sup>683</sup>

b. Knowledge of Defenses

The Fifth Circuit first held in *FSLIC v. Mackie*<sup>684</sup> that, in order to defeat the federal holder in due course doctrine, a borrower had to prove that the FSLIC had actual knowledge of the defenses to a note at the time the FSLIC took the note as a receiver. The court withdrew that opinion, however, and issued a new opinion that did not discuss the knowledge issue.<sup>685</sup>

c. Usury

The Fifth Circuit Court of Appeals held in *FDIC v. Claycomb* that the state usury statute is punitive in nature and cannot be applied to the FDIC inasmuch as the FDIC was created to serve the public interest.<sup>686</sup> According to the court, to apply the usury penalties to the FDIC would have "no

678. 828 S.W.2d 821 (Tex. App.—Fort Worth 1992, writ denied).

679. *Id.* at 823.

680. *Id.*

681. *Id.*

682. 796 F. Supp. 238 (N.D. Tex. 1992).

683. *Id.* at 241 (citations omitted).

684. 949 F.2d 818, 821 (5th Cir. 1992).

685. *FSLIC v. Mackie*, 962 F.2d 1144 (5th Cir. 1992).

686. 945 F.2d 853, 861 (5th Cir. 1992).

deterrent effect, and would only serve to punish innocent creditors of the failed institution by diminishing available assets."<sup>687</sup> A Texas appellate court held in *RTC v. Ammons* that the federal common law and federal holder in due course doctrine bar a borrower from asserting personal defenses such as usury against the RTC.<sup>688</sup>

In the same vein, the United States District Court for the Northern District of Texas held that even assuming that a usury violation occurred, the FDIC was immune from usury penalties under the sovereign immunity doctrine.<sup>689</sup> The court noted that the doctrine of sovereign immunity shields the United States and its several agencies from suit, except to the extent that Congress has waived such immunity.<sup>690</sup> Furthermore, the court stated that this immunity extends to the imposition of punitive fines, such as those imposed by the Texas usury laws.<sup>691</sup> Because the defendants failed to establish that Congress had expressly authorized the imposition of usury penalties against the FDIC, the court held that the FDIC was immune from the penalties imposed by the Texas usury laws.<sup>692</sup>

#### d. Punitive Damages

According to a state court, the FDIC as receiver for a failed bank is subject to an award of punitive damages.<sup>693</sup> In that case, the bank failed and the FDIC was appointed its receiver after a judgment had been entered against the bank but while it was still on appeal. The court took issue with a contrary ruling in *FSLIC v. T.F. Stone - Liberty Land Associates*.<sup>694</sup> The Fifth Circuit held that punitive damages and additional treble damages are not recoverable against the FDIC in its receivership capacity in *Bank One, Texas v. Taylor*.<sup>695</sup> In that case, each note contained a monthly payment schedule, an acceleration clause and a demand clause. The demand clause stated that "this obligation is, as an alternative to the above-recited payment schedule, due and payable on demand."<sup>696</sup> The notes also contained an acceleration clause entitling the bank to accelerate payment "if default occurs in the punctual payment of any installment of principal or interest."<sup>697</sup> The court held that the provisions dealing with default and acceleration indicated that the instrument was not a demand note but rather was an instrument that was payable upon demand only if the obligor failed to meet the installment obligations.<sup>698</sup> The court specifically distinguished *Conte v. Greater*

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687. *Id.*

688. *RTC v. Ammons*, 836 S.W.2d 705, 708 (Tex. App.—Houston [1st Dist.] 1992, no writ).

689. *FDIC v. Southwest Motor Coach Corporation*, 780 F. Supp. 421, 423 (N.D. 1991).

690. *Id.*

691. *Id.*

692. *Id.*

693. *FDIC v. Golden Imports, Inc.*, No. 01-88-00307-CV, 1991 WL 204175 at \*20 (Tex. App.—Houston [1st Dist.] Oct. 10, 1991).

694. 787 S.W.2d 475, 492 (Tex. App.—Dallas 1990, writ dismissed).

695. 970 F.2d 16, 34 (5th Cir. 1992).

696. *Id.* at 31.

697. *Id.*

698. *Id.* at 32.

*Houston Bank*, wherein it was held that the language payable "on demand, but if no demand is made: principal and interest shall be due and payable in monthly installments" created a demand instrument that was due at anytime upon the demand of the holder.<sup>699</sup>

MBank's motion for new trial and to modify the judgment, which was on file at the time of MBank's failure, was adopted by the FDIC and presented to the federal district judge once the case was removed. Taylor argued that the FDIC could not assert its claim of sovereign immunity to avoid punitive damages when it intervenes post-judgment. The court disagreed, relying principally upon the fact that MBank's motions were on file before the time for filing a notice of appeal had expired and the issue in question had been raised in the trial court at a time when there was no final unappealable judgment.<sup>700</sup> The situation would have been remarkably different had the FDIC intervened when the judgment was final and unappealable.<sup>701</sup> The court stated that sovereign immunity was a jurisdictional prerequisite that may be asserted at any stage of the proceedings, either by the parties or by the court on its own motion.<sup>702</sup>

#### e. Transferee Liability

In a long awaited case, the Fifth Circuit held that the federal holder in due course status of a transferee of the FSLIC, as receiver for a failed financial institution, does not shield the transferee from the maker's personal defenses on a promissory note that was non-negotiable from its inception.<sup>703</sup> The court, however, cautioned that the maker must base his personal defenses on documents of the failed financial institution at the time of its insolvency and not upon agreements unenforceable under the *D'Oench, Duhme* doctrine.<sup>704</sup>

### 3. Removal

In *RTC v. Eugenio*, the United States District Court for the Northern District of Texas held that the ninety day removal period for the RTC commences upon the date that the RTC is appointed as receiver, rather than the date the RTC formally substitutes itself as a party.<sup>705</sup> In that case, Sunbelt Savings, FSB filed suit against the Eugenio on August 2, 1990, in the state district court in Nueces County, Texas. On April 25, 1991, the Office of Thrift Supervision (OTS) declared Sunbelt insolvent and appointed the RTC as receiver. The OTS also created Sunbelt Federal Savings, FSB on the same day and placed it under the conservatorship of the RTC. On July 22, 1991, the Eugenio filed counterclaims against Sunbelt. On August 21, 1991, the RTC, as receiver of Sunbelt, substituted itself in the case and removed the case to the District Court for the District of Columbia. On September 5,

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699. 641 S.W.2d 411, 412 (Tex. App.—Houston [14th Dist.] 1982, writ ref'd n.r.e.) .

700. *Id.* at 34.

701. *Id.*

702. *Id.*

703. *RTC v. Montross*, 944 F.2d 227, 228 (5th Cir. 1991).

704. *Id.* at 228-29.

705. 790 F. Supp. 686, 689 (N.D. Tex. 1991).

1991, the Eugenios filed a motion to remand. On September 30, 1991, the District Court for the District of Columbia transferred the case to the Northern District of Texas.

This case pre-dated the decision of the Fifth Circuit in *FDIC v. Loyd*, where the court held that the FDIC's removal period commences upon the date the FDIC becomes a party to the action.<sup>706</sup> It is unclear from the decision in this case as to whether the *Loyd* decision would affect the court's interpretation of the RTC's removal deadline. A strong argument can be made that the *Loyd* decision would have no effect on this case since the statutes involved are totally different. Here, 12 U.S.C. §§ 1421-1446 governs actions involving the RTC. Section 1441a(1)(3) provides that "The removal of any action, suit, or proceeding [in which the RTC is a party] shall be instituted— (A) not later than 90 days after the date the Corporation is substituted as a party, or (B) not later than 30 days after the date suit is filed against the Corporation, if such suit is filed after August 9, 1989."<sup>707</sup> The court focused upon the question as to when the RTC is substituted as a party to the action. More specifically, the court addressed the issue of whether the RTC had to formally substitute itself into the case before it was substituted as a party under the statute. The court decided that the RTC was substituted on the date of receivership or conservatorship and that, therefore, the ninety day time period began to run on April 25, 1991, in this case.<sup>708</sup> Accordingly, the ninety day period had expired by the day the RTC filed its removal. The court reasoned that to hold otherwise would allow the RTC to manipulate the removal of cases.<sup>709</sup> Significantly, the court noted that it had been previously held that the RTC could remove cases without formal substitution, thus implying that since the RTC could be a party without formal intervention into the suit, it would be unfair to allow the RTC to later decide to remove the case.<sup>710</sup>

The really interesting part of this case is that Judge Sanders summarily dismissed the notion that the filing of the counterclaims by the Eugenios gave the RTC a second chance at removing the case even if the RTC had filed to timely remove the suit under section 1441a(1)(3)(A).<sup>711</sup> Keep in mind that the Eugenios did not file their counterclaims until July 22, 1991. So until that date there had been no "suit . . . filed against the Corporation" as set forth in section 1441a(1)(3)(B). It seems that the removal was timely under this section of the statute since the RTC removed the case within 30 days of the date of the counterclaims. In any event, it appears now that the RTC and the FDIC have different timetables regarding removal.

In *FDIC v. Loyd*,<sup>712</sup> First RepublicBank, the predecessor to NCNB Texas National Bank and the Federal Insurance Corporation as Receiver, filed suit

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706. 955 F.2d 316, 329 (5th Cir. 1992).

707. 12 U.S.C. § 1441a (1)(3)(1988).

708. *Eugenio*, 790 F. Supp. at 691.

709. *Id.* at 690.

710. *Id.*; see *United Savings Bank v. Rose*, 752 F. Supp. 506, 508 (D.D.C. 1990).

711. *Id.* at 688.

712. 955 F.2d 316 (5th Cir. 1992).

against the defendants in 1985. On July 29, 1988, the Comptroller of the Currency declared First RepublicBank insolvent and appointed the FDIC as Receiver. On that same date, the FDIC executed a Purchase and Assumption Agreement with NCNB whereby NCNB obtained the affirmative claims of Republic and the FDIC retained the liabilities for the counterclaims. On September 28, 1989, NCNB entered an appearance in the state court litigation. On November 4, 1989, the FDIC intervened and simultaneously removed the case to federal court. Following removal, the parties engaged in discovery and filed motions for summary judgment. On April 27, 1990, the federal district judge *sua sponte* questioned the timeliness of removal under 28 U.S.C. § 1446(b) and required letter briefs on the issue. On August 2, 1990, the district court remanded the case to state court on its own motion. The Fifth Circuit court of appeals concluded that the federal district court could not *sua sponte* remand a case based upon a procedural defect after the expiration of thirty days from the date of removal; the thirty day time limit for removal set forth in 28 U.S.C. § 1446(b) applies to the FDIC and that the thirty day time limit begins to run upon the appearance of the FDIC as a party to the litigation.<sup>713</sup>

Timeliness of removal was also addressed in *NCNB Texas National Bank v. P&R Investments No. 6*.<sup>714</sup> In that case, NCNB sued P & R to recover a deficiency on a note. On November 30, 1991, NCNB assigned the note and cause of action to the FDIC. On December 17, 1991, the FDIC intervened in the action and filed a notice of removal in the United States District Court. The federal district court remanded the case because under 12 U.S.C. § 1819(b)(2)(A) and 28 U.S.C. § 1446(b) the FDIC was required to remove an action within thirty days after receipt of a pleading or document from which it could first determine the case was removable which, in this case, was the date on which the loan was transferred to the FDIC. However, the filed papers did not specify the date of the transfer.

The Fifth Circuit citing the December 19, 1991 amendment to section 1819(b)(2)(B) allowed removal at any time before the end of the ninety day period beginning on the date the action is filed against the FDIC or the FDIC is substituted as a party.<sup>715</sup> The court applied the amendment and noted that the notice of removal did state the date the FDIC intervened and became a party.<sup>716</sup> Deciding, also, that the amendment was procedural, not substantive, the court had no trouble applying it retroactively to the pending case.<sup>717</sup>

The Fifth Circuit decided two cases regarding the ability of the FDIC to remove a state court appellate proceeding. The removal took place in *FDIC v. Meyerland Co.*,<sup>718</sup> before an appellate opinion was issued. Although remanded by the federal district court, the court of appeals considered the

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713. *Id.* at 322.

714. 962 F.2d 518 (5th Cir. 1992).

715. *Id.* at 519.

716. *Id.*

717. *Id.*

718. 960 F.2d 512 (5th Cir. 1992).

plain language of 12 U.S.C. § 1819(b)(2)(B) to afford the FDIC the absolute right to remove the state court proceeding that was at the state appellate stage.<sup>719</sup> That statute allows the FDIC to "remove any action, suit or proceeding from a State court to the appropriate United States district court."<sup>720</sup> The key to this question was whether the state proceeding has reached the point of a final judgment. The court stated that a state court action was final "(1) if it is an effective determination of litigation in that it is not an interlocutory or intermediate judgment and (2) when it is subject to no further review or correction in any other state tribunal."<sup>721</sup> This means that, assuming the parties have filed appeals or motions for rehearing timely, the right to remove a case continues until the state court of last resort overrules the motion for rehearing.<sup>722</sup>

The twist in *5300 Memorial Investors, Ltd. v. RTC*<sup>723</sup> was that the state appellate court had already issued an opinion when the removal occurred, but while a writ of error was pending. The Fifth Circuit saw no reason to distinguish its earlier opinion in *FDIC v. Meyerland Co.*, so long as the state appellate proceedings had not been exhausted when the removal was effected.<sup>724</sup> Once removed, the federal district court took the proper action of adopting the judgment, preparing the record for appeal and forwarding it to the proper federal appellate court for review.<sup>725</sup>

#### 4. Federal Statute of Limitations

In *Davidson v. Mills*,<sup>726</sup> the debtor filed a Motion for Temporary Restraining Order and Preliminary Injunction against the FDIC, seeking to prohibit the FDIC from taking action on a debt and related property. The plaintiff's primary argument in support of his motion was that the statute of limitations had expired and, therefore, the FDIC could not pursue its rights against the debt or the property at issue. For purposes of the court's ruling, the court assumed that the cause of action on the debt and the property at issue accrued on April 4, 1984. On June 4, 1987, the FDIC was appointed as receiver for the failed financial institution. On April 4, 1988, the state law limitations period expired. In August 1989, Congress enacted FIRREA, which included the six-year statute of limitations for contract claims contained in section 1821(d)(14).<sup>727</sup> The court ruled that the federal statute applies and preempts state law when a claim is not barred by state law at the

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719. *Id.* at 514.

720. 12 U.S.C.A. § 1819(b)(2)(c) (West Supp. 1992).

721. *Meyerland*, 960 F.2d at 516.

722. *Id.* at 517.

723. 973 F.2d 1160 (5th Cir. 1992).

724. *Id.* at 1162-63.

725. *Id.* at 1163.

726. 789 F. Supp. 845 (W.D. Tex. 1992); *see also* *FDIC v. Wheat*, 970 F.2d 124 (5th Cir. 1992) (holding that where government acquires derivative claim, "that claim is not barred by the state statute of limitations at the time the government acquires the claim, the federal statute of limitations controls and the state statute ceases to run against the government at the time of acquisition; however, if state limitations period had expired, action by government is time-barred.")

727. 12 U.S.C. § 1821(d)(14) (1988).

time of the receiver is appointed.<sup>728</sup>

Two different state courts addressed the question regarding the application of the federal statute of limitations to transferees of the FDIC. In *Thweatt v. Jackson*,<sup>729</sup> Jackson executed a promissory note on January 4, 1984, in favor of a failed financial institution. On May 3, 1984, the note matured, and Jackson failed to pay the amount due, thereby defaulting on the note. On April 18, 1985, the FDIC was appointed receiver for the failed institution. Also on that same day, the FDIC, in its corporate capacity, acquired Jackson's note from the FDIC, as receiver. On May 3, 1988, the four-year statute of limitations contained in Section 16.004 of the Texas Civil Practice & Remedies Code expired.<sup>730</sup> On December 28, 1988, the FDIC sold Jackson's note to Thweatt. After making demand upon Jackson for payment of the note, Thweatt brought suit against Jackson on the note on April 15, 1991.

The Austin appellate court held that the six-year statute of limitations contained in section 1821(d)(14) of FIRREA applies to transferees of the FDIC.<sup>731</sup> The court first recognized that the federal courts have unanimously given Section 1821(d)(14) retroactive effect. Furthermore, the court stated that because an assignee of a promissory note obtains the "rights, title and interest that the assignor had at the time of the assignment," Thweatt stood in the shoes of the FDIC and had the right to assert the claim on the promissory note to the same extent as the FDIC.<sup>732</sup> Because the FDIC had until April 18, 1991 to sue Jackson on the note, so did Thweatt. Accordingly, the court held that Thweatt's cause of action against Jackson on the promissory note was not barred by limitations.<sup>733</sup>

In *RTC v. Boyar, Norton & Blair*,<sup>734</sup> the RTC, as receiver for a failed financial institution, filed suit against attorneys who had represented the institution in connection with alleged malpractice arising from two different loan transactions. The state statute of limitations had expired before the RTC acquired the claim. The RTC argued that 12 U.S.C. § 1821(d)(14) governs any claim brought by the RTC on behalf of a failed institution, whether or not the state statute of limitations may have expired when the RTC acquired the claim. The court held otherwise and adopted a two step analysis.<sup>735</sup> The first step is to determine if the applicable state statute of limitations had expired when the RTC or FDIC acquires a claim.<sup>736</sup> The second step would apply only if the claim was still alive under state law and that would be to determine if the applicable federal limitations period had

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728. *Davidson*, 789 F. Supp. at 847.

729. 838 S.W.2d 725 (Tex. App.—Austin, 1992, no writ).

730. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004 (Vernon 1986).

731. *Thweatt*, 838 S.W.2d at 727.

732. *Id.*

733. *Id.* at 728; see also *Pineda v. PMI Mortgage Ins. Co.*, No. 13-91-239-CV 1992 Tex. App. WL 11606 (Tex. App.—Corpus Christi Nov. 19, 1992, n.w.h.).

734. 796 F. Supp. 1010 (S.D. Tex. 1992).

735. *Id.* at 1015.

736. *Id.* at 1013.

expired before the date suit was filed.<sup>737</sup>

## O. MISCELLANEOUS CASES

### 1. *Mandatory Stay*

In *Nation v. RTC*,<sup>738</sup> the federal district court considered whether the mandatory stay provided by 12 U.S.C. § 1821(d)(12) runs for ninety days after the appointment as receiver for an insured institution or ninety days after the date on which the receiver files a motion to suspend. Under the latter construction, the receiver could request a stay at any time, permitting the stay to be effective for more than ninety days after the receiver's appointment. This court held that the receiver was entitled to request suspension at any time within ninety days after its appointment and would be automatically entitled to the stay upon doing so.<sup>739</sup> The stay, however, could not remain in effect for more than ninety days after the appointment.<sup>740</sup>

### 2. *Injunctions against Receiver*

In *Ward v. RTC*,<sup>741</sup> the plaintiff bid on a piece of surplus government property that was currently held by the RTC as receiver for a failed financial institution. The RTC rejected the plaintiff's offer on the property. Before the plaintiff could submit a new bid, he discovered that the RTC had contracted to sell a large package of surplus government property to a third party, including the property in question. Believing that the property was to be sold under the agreement, the plaintiff filed an emergency Motion for Relief and sought to enjoin the sale of the property to the third party. The federal district court held that the RTC as receiver must remain free to perform its congressionally mandated functions, such as the liquidation of receivership assets, without the encumbrances of possible injunctions.<sup>742</sup> The court noted that 12 U.S.C. § 1821(j) specifically states that "[n]o court may take any action . . . to restrain or affect the exercise of powers or functions of [the RTC] as a conservator or a receiver."<sup>743</sup> Accordingly, the court concluded that injunctive relief against the RTC as receiver, when it performs its mandated functions, is prohibited.<sup>744</sup>

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737. *Id.*

738. 791 F. Supp. 1152 (N.D. Tex. 1992).

739. *Id.* at 1154.

740. *Id.*

741. 796 F. Supp. 256 (S.D. Tex. 1992).

742. *Id.* at 259.

743. *Id.* at 258.

744. *Id.* at 259; *See also* William C. Davidson, P.C. v. Mills, 789 F. Supp. 845, 847-48 (W.D. Tex. 1992) ("The FDIC . . . clearly cannot be enjoined from committing an act within its legal authority.").