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BANKING LAW DEVELOPMENTS 1990

by

Peter G. Weinstock*

This is the first year the survey has devoted a chapter solely to financial institutions law. This topic makes its debut during the most extensive restructuring of the banking industry since the Great Depression. Although this chapter is devoted to legal issues arising in the State of Texas, in light of the economic developments in the state's banking industry, such issues have assumed a national significance. In each of the last three years, Texas has led the nation in bank failures; and overall, nine of the state's ten largest bank holding companies have been acquired. Moreover, the most noteworthy transactions under the Southwest Plan involved savings and loan associations domiciled in the State of Texas. Perhaps most significantly, the demands such events have placed on the decades-old system of Federal-deposit insurance led to the enactment, on August 9, 1989, of the Financial Institutions Reform Recovery and Enforcement Act of 1989 (FIRREA).¹ These developments have spawned case law precedents for the remainder of the nation to follow.

I. CASE LAW

A. Jurisdiction

1. Bankruptcy Court

The deteriorating financial condition of MCorp, Inc. (MCorp) resulted in two significant decisions during the survey period. In *MCorp v. Board of Governors of the Federal Reserve System*,² the bankruptcy court considered a conflict between the provisions of the Bankruptcy Code and the dictates of the Board of Governors of the Federal Reserve System (the Federal Reserve).

On March 27, 1989, MCorp filed for bankruptcy.³ Two days later,⁴ the regulatory authorities closed all but five of MCorp's twenty-five bank subsidi-

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1. Financial Institutions Reform Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 212, 103 Stat. 183, 222 (1989).

2. 1990 WL 52582 (5th Cir. (Tex.)), — F.2d —. This decision considered the justiciability doctrine of exhaustion of remedies as well as the jurisdiction of the bankruptcy court over bank holding companies.

3. *Court Tells Fed to Go to Bankruptcy Court to Enforce Actions Against MCorp*, [Jan.-June] Banking Rep. (BNA) No. 52, at 1289 (June 12, 1989).

4. *Id.*

iarities.⁵ Contemporaneously, the Federal Reserve commenced two administrative actions against MCorp. In the first action, the Federal Reserve alleged that MCorp violated the Federal Reserve's Source of Strength Policy Statement. This policy statement provides that bank holding companies are required to serve as a "source of strength" to their subsidiary banks.⁶ The violation reputedly arose because MCorp had failed to inject over \$400 million⁷ in cash, which it then held at the holding company level, into its subsidiary banks. The Federal Reserve sought to require MCorp to devise a capital plan that would provide for all of MCorp's assets to be used to recapitalize its subsidiary banks.⁸ In the second action, the Federal Reserve alleged that MCorp violated Section 23A⁹ of the Federal Reserve Act (the statute restricting transactions between a bank and its affiliates). The alleged violation arose when the former MBank Houston and MBank Preston made "unsecured extensions of credit"¹⁰ to MBank Management, a nonbank subsidiary of MCorp.

MCorp sought to avail itself of the protections afforded debtors under the Bankruptcy Code in order to avoid the Federal Reserve's assessment of administrative penalties. Specifically, MCorp contended that the bankruptcy court possessed exclusive jurisdiction over all property of MCorp. Moreover, MCorp asserted that either the automatic stay in bankruptcy barred actions against MCorp's estate or, if the Federal Reserve were exempt from the automatic stay, that MCorp was entitled to an injunction to protect its property. The district court agreed and held that the bankruptcy action had precedence over the Federal Reserve's administrative proceeding.¹¹ The court stated that such a result did not preclude the Federal Reserve from

5. 1990 WL at 52586.

6. Policy Statement: Responsibility of Bank Holding Companies to Act as Sources of Strength to Their Subsidiary Banks, 52 Fed. Reg. 15,707-08 (1987) [hereinafter Source of Strength Policy Statement]. For a discussion of the Source of Strength Policy Statement, see Weinstock, "Source of Strength" Policy May Weaken Holding Companies, 171 The Bankers Magazine May-June 1988, at 34.

7. *MCorp Assets in Tug-of-War*, Dallas Morn. News, October 18, 1988 at 1D, col. 10.

8. 1990 WL at 52586.

9. Section 23A of the Federal Reserve Act and its companion provision § 23B govern transactions between a bank and its affiliates. Among other things, § 23A restricts the aggregate amount of transactions with both any one affiliate or all affiliates together as a percentage of capital and requires extensions of credit by a bank to an affiliate to be secured by collateral with a market value equal to at least 100 percent of the loan amount. For a general discussion of this topic see Weinstock, *Transactions with Affiliates: Outline of Section 23A and New Section 23B of the Federal Reserve Act*, [Jan.-June] Banking Rep. (BNA) No. 52, at 387 (Feb. 13, 1989).

10. The Federal Reserve Banks impute an extension of credit from a bank to its holding company whenever the holding company has received a benefit for which such Federal Reserve Bank believes the bank was not sufficiently compensated. Imputing an "extension of credit" would cause a violation of Section 23A because such credit would be unsecured. 12 U.S.C. § 371c (c).

11. The district court enjoined the Federal Reserve's administrative process. 101 Bankr. 483 (Bankr. S.D. Tex. 1989). The court noted that MCorp's reorganization could be jeopardized if it were required to defend both the Federal Reserve's administrative action and the parallel bankruptcy proceeding. *Id.* at 487. Moreover, the court stated that the bankruptcy court is intended to possess authority over all of the debtor's assets in order to provide for an effective reorganization plan. *Id.*

raising its claims in the bankruptcy court forum.¹²

On appeal, the Federal Reserve asserted that 12 U.S.C. § 1881(i)¹³ provided it with exclusive jurisdiction over regulatory actions until a final order is issued. Alternatively, the Federal Reserve argued that actions of bank regulators were not the type of actions that section 1334(b)¹⁴ of the Bankruptcy Code was intended to enjoin.

The Court of Appeals for the Fifth Circuit stated that section 1334(b) only provides the bankruptcy court with concurrent, not exclusive, jurisdiction. The court stated that "the [Federal Reserve] Board has not sought control over the property of MCorp's estate . . . [but] only the opportunity to go forward in its administrative proceedings."¹⁵ Accordingly, "the plain language of Section 1818(i) deprive[d] the district court of jurisdiction to enjoin the [Federal Reserve] Board's administrative proceedings if the Board's actions [did] not exceed the authority Congress granted to it."¹⁶

MCorp asserted three respects in which the Federal Reserve's administrative action exceeded its statutory authority: (i) the Federal Reserve lacked authority over MCorp's relationship with MCorp's former bank subsidiaries under FDIC receivership, (ii) the Federal Reserve was using an alleged violation of Section 23A as a pretext to assist the FDIC Receiver to obtain damages, and (iii) the Source of Strength Policy Statement lacked any statutory foundation.¹⁷

The *MCorp* court addressed each of these arguments in turn. The court stated that the Federal Reserve was entitled to determine whether transac-

12. Apparently, the FDIC heard the district court's message to bring any claims it might have in the bankruptcy forum. After the district court decision, the FDIC filed a claim in MCorp's bankruptcy proceeding for \$847 million. *FDIC Seeking \$847 Million from MCorp*, Wall St. J., Sept. 14, 1989, at A5, col. 1. Among other reasons, the FDIC's claim was based upon actions MCorp or its remaining subsidiaries engaged in that harmed the banks for which the FDIC was appointed receiver and thus increased the resolution costs of such banks. In addition, Bank One, Texas, N.A., the bridge bank that acquired the former MCorp subsidiary banks from the FDIC as receiver (the FDIC Receiver), filed a claim for over \$557 million against MCorp for, among other things, alleged overpayment of dividends to MCorp and MCorp's allegedly improper acquisition of trust operations from its bank subsidiaries. *Bridge Bank Seeks \$557 Million from MCorp Companies, Failed Bank & Thrift Litigation Rep.*, Sept. 27, 1989, at 10,259.

13. 12 U.S.C. § 1818(i)(1) (1988) provides:

The appropriate Federal banking agency may in its discretion apply to the United States district court . . . within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under [§ 1818], and such courts shall have jurisdiction and power to order and require compliance herewith; but except 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.* (emphasis added).

14. Section 1334(b) provides:

Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts 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.

15. *MCorp v. Board of Governors of the Fed. Reserve System*, 1990 WL at 52593.

16. *Id.* at 52594.

17. *Id.*

tions between the failed MBanks and MCorp Management were impermissible. On the Section 23A issue, the court stated that the Federal Reserve possesses the authority to require MCorp to take affirmative action to remedy a violation of that statute. The court then turned to the validity of the Source of Strength Policy Statement.

The Federal Reserve asserted that Sections 3(a) and (c)¹⁸ and 5(b)¹⁹ of the Bank Holding Company Act of 1956 (the Bank Holding Company Act) provided the authority upon which the Source of Strength Policy Statement was based. Section 3(a) of the Bank Holding Company Act requires the Federal Reserve's prior approval of a company's application to acquire a bank or a company that controls a bank. Section 3(c) requires the Federal Reserve to consider, among other things, the prospects for and the resources of the bank involved. Section 5(b) permits the Federal Reserve to issue such orders as are necessary to enable it to effect the purposes of the Bank Holding Company Act. The Federal Reserve also noted that it possesses the authority to cause a bank holding company to cease and desist an "unsafe or unsound practice."²⁰

The court held that "[t]he Bank Holding Company Act does not grant the Board authority to consider the financial and managerial soundness of the subsidiary banks, after it approves the application" to acquire control over a bank.²¹ In addition, the court stated that the Federal Reserve does not possess authority to regulate the day-to-day affairs of subsidiary banks.²² The court also noted that section 5(b) is not an independent grant of authority, but, instead only permits the Federal Reserve to enforce the provisions of the Bank Holding Company Act. Lastly, the court considered whether the Source of Strength Policy Statement was based on the Federal Reserve's authority to remedy unsafe or unsound practices by bank holding companies.²³ The court noted that:

Generally speaking an 'unsafe or unsound practice' encompasses any

18. Section 3(a) and (c) of the Bank Holding Company Act provide:

(a) It shall be unlawful, except with the prior approval of the Board, (1) for any action to be taken that causes any company to become a bank holding company

.....

(c) [When reviewing an application to become a bank holding company,] the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.

12 U.S.C. § 1842(a) and (c) (1988).

19. Section 5(b) of the Bank Holding Company Act provides: "The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof." 12 U.S.C. § 1844(b).

20. Financial Institutions Supervisory Act of 1966, 12 U.S.C. § 1818(b)(1) and (3) (1988).

21. 1990 WL at 52598-99.

22. *Id.* at 52599 (citing *Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234 (1978)).

23. The Court of Appeals for the Fifth Circuit also addressed the Federal Reserve's contention that judicial review of the Federal Reserve's action was not ripe until after the administrative process had been exhausted. The court stated that exhaustion of remedies was not necessary because there were no factual issues in dispute. *Id.* at 52595. Thus, the court implicitly characterized the question of whether an action was "unsafe or unsound" as a legal issue.

action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk of loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.²⁴

The court stated that requiring MCorp to make a capital injection of its funds would require MCorp to disregard its own separate corporate status.²⁵ This would constitute a wasting of corporate assets and a breach of duty to MCorp's shareholders. Congress, in adopting Section 23A of the Federal Reserve Act, specifically defined the permissible relationship between banks and their affiliates, including their parent holding companies. Congress, however, never mandated that holding companies inject capital into their subsidiary banks. The court noted that Congress empowered the bank regulators to issue capital directives to the institutions under their supervision, but did not provide the Federal Reserve with the authority to issue such directives to bank holding companies. The court decided that a bank holding company's failure to inject its resources into a subsidiary bank is not an unsafe or unsound practice. Thus, the court dispatched each of the Federal Reserve's asserted bases of statutory authority. Consequently, the Federal Reserve exceeded its powers when it adopted the Source of Strength Policy Statement.²⁶

The *MCorp* decision has eliminated the Federal Reserve's asserted authority to mandate that existing bank holding companies use their available resources to recapitalize their subsidiary banks. Management and the directors of bank holding companies have now regained the discretion to allocate corporate resources in a manner that will preserve the most value for shareholders. Not only did the court invalidate the Source of Strength Policy Statement, but it stated that the Federal Reserve lacks the authority to consider, outside the application context, the managerial and financial condition of subsidiary banks. It is now an open question whether the Federal Reserve can require bank holding companies to take affirmative action to remedy any problems experienced by their subsidiary banks.

The court suggested an alternative for the Federal Reserve to use to replace the now defunct Source of Strength Policy Statement. The court noted in a footnote²⁷ that the Federal Reserve could require applicants to execute a capital maintenance agreement as a condition of regulatory approval for a company to acquire a bank. The court observed that such agreements were a prerequisite for an acquisition of a thrift.²⁸ It would not be surprising if the Federal Reserve heeds the court's passing comment, and begins requiring capital maintenance agreements for new applications. Regardless, the Federal Reserve's authority over existing holding companies has been significantly reduced.

Since MCorp filed for bankruptcy, other financial institution holding com-

24. 1990 WL at 52599-600.

25. *Id.* at 52600.

26. *Id.* at 52601.

27. *Id.* at 52601 n.5.

28. *Id.* (citing 12 C.F.R. § 574.7(a)(2) and (3)).

panies not only followed MCorp's lead, but have sought to prevent the regulators from closing their subsidiaries while the holding company was in bankruptcy. One institution has been able to prevent the FDIC from taking action regarding its savings and loan association subsidiary.²⁹

2. Exhaustion of Remedies

Another significant issue decided during this survey period concerns the adjudicative powers of the deposit insurance corporations. The United States Supreme Court, in *Coit Independence Joint Venture v. FSLIC*,³⁰ held that the *Hudspeth* rule,³¹ which required creditors of an insolvent savings and loan association to exhaust the administrative process established by the FSLIC before they sought limited review of the FSLIC's determination in court, was insupportable in law.³²

The Court of Appeals for the Fifth Circuit in *Hudspeth* had held that the courts lack subject matter jurisdiction to adjudicate claims against the FSLIC as receiver (FSLIC Receiver) for an insolvent savings and loan association³³ because the FSLIC was deemed to possess exclusive jurisdiction over such causes of action.³⁴ Furthermore, claimants against FSLIC Receiver can only appeal to the district court once they exhausted the administrative process.³⁵ Claimants who make it to court can only cause an adverse decision by the FSLIC to be overturned if such decision were arbitrary and capricious.³⁶

In *Coit Independence Joint Venture (Coit)*³⁷, Coit brought suit against FirstSouth, F.A. (FirstSouth), a federal savings and loan association for, among other things, usury and breach of contract. Subsequently, the Federal Home Loan Bank Board (the FHLBB) declared FirstSouth insolvent and appointed the FSLIC as receiver. Thereafter, FSLIC Receiver was substituted for FirstSouth and, upon the FSLIC's motion, the case was dismissed for want of subject matter jurisdiction.³⁸ The United States Supreme Court granted *certiorari* to resolve a conflict between the circuits.³⁹

The United States Supreme Court stated that Congress did not intend to

29. *Court Decision May Help S&Ls Put Off RTC*, Am. Bankr., Oct. 31, 1989, at 2, col. 4 (Deltacorp sought an injunction to prevent the regulators from seizing its subsidiary, Colonial Savings Bank of New Rochelle, N.J.).

30. 27 Fed. Banking L. Rep. (CCH) ¶ 87,616, at 94,751 (Mar. 24, 1989).

31. The *Hudspeth* rule was originally promulgated in *North Mississippi Sav. & Loan Ass'n v. Hudspeth*, 756 F.2d 1096 (5th Cir. 1985), *cert. denied*, 474 U.S. 1054 (1986).

32. 27 Fed. Banking L. Rep. (CCH) ¶ 87,616, at 94,751.

33. 756 F.2d at 1103.

34. *Id.* at 1102-03.

35. *Id.*

36. *Id.*

37. Fed. Banking L. Rep. (CCH) ¶ 87,616, at 94,751.

38. *Id.* at 94,753.

39. *Id.* at 94,754. The conflict between the circuits developed when the Court of Appeals for the Ninth Circuit held, in *Morrison-Knudsen Co. v. CHG Int'l, Inc.*, 811 F.2d 1209 (9th Cir. 1987), that FSLIC lacked exclusive authority over claims against FSLIC Receiver. 27 Fed. Banking L. Rep. (CCH) ¶ 87,616, at 94,754.

grant the FSLIC exclusive jurisdiction to resolve claims.⁴⁰ The Supreme Court noted that the *Hudspeth* decision was based, in part, upon two statutory provisions—12 U.S.C. § 1729(d)⁴¹ and 12 U.S.C. § 1464(d)(6)(C).⁴² The Supreme Court interpreted these provisions differently than the Fifth Circuit had in *Hudspeth*. The Supreme Court stated that receivers traditionally possess the power “to ‘settle, compromise, or release’ claims,” but that such authority is distinguishable from, and to some degree inconsistent with, the power to adjudicate claims.⁴³ The Court noted that if FSLIC Receiver possessed the authority to adjudicate claims, it would possess little incentive to compromise and settle claims.⁴⁴ The Supreme Court also stated that the limited scope of 12 U.S.C. § 1464(d)(6)(c) is to prohibit both untimely challenges to the appointment of the receiver and attempts to enjoin the receivership functions.⁴⁵ In addition, the Court declared that adjudication of claims whether by the FSLIC or by the district courts would not restrain the receiver’s operations.⁴⁶ Thus, the Supreme Court concluded that creditors are entitled to a *de novo* hearing of their claims by a district court.⁴⁷ The Supreme Court did not need to address Coit’s constitutional arguments because it determined that the statutory authority for the *Hudspeth* rule did not authorize the FSLIC to adjudicate claims against the receivership.⁴⁸

The Supreme Court then considered whether claimants against FSLIC Receiver must exhaust the FSLIC’s administrative process before bringing suit in district court. The Court decided that the statutory mandate for resolving insolvent savings and loan associations could extend to authorizing a process requiring claimants to notify the FSLIC Receiver of their claim and provide the FSLIC Receiver with a reasonable time, before suit may be filed, to determine what course of action to pursue to resolve such claims.⁴⁹ Nonetheless, the Supreme Court held that the specific process established by the FHLBB exceeded its statutory authority and was flawed for two reasons.⁵⁰ First, the FHLBB’s regulations attempted to empower the FSLIC

40. 27 Fed. Banking L. Rep. (CCH) ¶ 87,616, at 94,756.

41. 12 U.S.C. § 1729(d) (1988) provided:

[FSLIC] shall have power to carry on the business of and to collect all obligations to the insured institutions, to *settle, compromise, or release claims* in favor of or against the insured institutions, and to do all other things that may be necessary in connection therewith, subject only to the regulation of the Federal Home Loan Bank Board, or, . . . other public authority having jurisdiction over the matter (emphasis added).

42. 12 U.S.C. § 1464(d)(6)(c) (1988) provided: “[e]xcept as otherwise provided in this subsection, *no court may take any action* for or toward the removal of any conservator or receiver, or, except at the instance of the Board [FHLBB], restrain or affect the exercise of powers or functions of a conservator or receiver.” (emphasis added).

43. 27 Fed. Banking L. Rep. (CCH) ¶ 87,616, at 94,756 (quoting Morrison-Knudson Co. Inc. v. CHG Int’l, Inc., 811 F.2d 1209, 1219 (9th Cir. 1987)).

44. *Id.*

45. *Id.*

46. *Id.* at 94,757.

47. *Id.*

48. *Id.* The Supreme Court also noted in dictum that the claims asserted by Coit were the type traditionally reserved for consideration by an Article III judge. *Id.* at 94,758.

49. *Id.* at 94,761.

50. *Id.*

to adjudicate claims that purportedly could not be reviewed by a court on a *de novo* basis.⁵¹ Second, such regulations failed to restrict the duration of the FSLIC's review process.⁵² The Court noted that Coit's claim already had been under consideration by the FSLIC for thirteen months without the FSLIC even making an initial determination of liability.⁵³ As a result, Coit's claims could become barred by the statute of limitations without Coit ever receiving any judicial consideration of its claims.⁵⁴ In addition, the lack of a deadline for resolution of claims could cause claimants to settle in situations in which they might otherwise not be so inclined.⁵⁵ The Court concluded that a claimant is not required to exhaust a process that is inadequate.⁵⁶ Accordingly, the Court decided that there could be a FSLIC review process, but that the then-current system was impermissible.⁵⁷

FIRREA authorizes the FDIC to establish an administrative process for consideration of claims against an insolvent financial institution.⁵⁸ Essentially, under FIRREA, the FDIC could require an initial administrative determination of claims against insolvent financial institutions.⁵⁹ Thereafter, the claimant could bring suit, on a *de novo* basis, in district court or request an administrative review of the FDIC's initial determination.⁶⁰

To date, the FDIC has not promulgated regulations providing for an administrative review of claims. As discussed below, after *Coit* overruled *Hudspeth* but before FIRREA was adopted, the FSLIC sought to dispose of claims against the receivership estate on a summary basis. Accordingly, during this period, the FSLIC continued to move for summary judgment in such cases, but shifted the theoretical basis for such motions from exhaustion of remedies to mootness. The success the FSLIC achieved in disposing of claims against receiverships based on mootness may have obviated the FDIC's desire to institute its own regulatory process for resolving claims against its receiverships.

3. Mootness

In the typical purchase and assumption (P&A) transactions involving savings and loan associations in the State of Texas, deposit liabilities and secured obligations exceed the institution's assets.⁶¹ Such claims are assumed

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. Pub. L. No. 101-73, § 212, 103 Stat. 183, 222 (1989).

59. *Id.*

60. *Id.*

61. The FDIC or the FSLIC, in their receivership capacities, do not honor every claim against the assets of an insolvent financial institution. Prior to FIRREA, the FDIC would honor claims against a failed financial institution in accordance with the depositor preference statute contained in the Texas Banking Code of 1943, as amended (Texas Banking Code). Tex. Rev. Civ. Stat. Ann. art. 342-803a (Vernon 1990). The depositor preference statute provides a hierarchy of classes of claims against a failed financial institution's assets. *Id.* Before any

by a new healthy institution, which also purchases certain of the institution's assets. The FSLIC Corporate provides purchasers with funds in order to equalize the amount of the assets being purchased and the liabilities being assumed, in exchange for which, the FSLIC Corporate receives the assets that were not purchased. The unsecured claims are not assumed because such claims would not be honored in a liquidation. Thus, the unsecured creditors are left with a claim against an institution totally devoid of assets. A number of courts have dismissed these remaining unsecured claims against the FSLIC Receiver on the basis that even if such claims should prove to be successful, the receivership estate will never possess any assets with which to satisfy such claims.⁶²

In *FSLIC v. Locke*,⁶³ the FSLIC Corporate sued Larry Locke (Locke) to collect on four promissory notes purchased from the FSLIC as receiver for State Federal Savings and Loan Association (State Savings); Locke counter-claimed. The district court granted summary judgment to the FSLIC Corporate on the grounds that each of Locke's claims was precluded by either the *D'Oench Duhme* doctrine⁶⁴ or mootness.⁶⁵

On December 19, 1985, the FHLBB declared State Savings insolvent and appointed the FSLIC as receiver. The regulatory authorities chartered a new association—State Federal Savings and Loan Association (New State). Thereafter, FSLIC Receiver sold substantially all the assets of State Savings, including the Locke notes, to New State. In June 1986, New State and Locke negotiated a renewal of the notes with a provision for additional advances to Locke. In their pleadings, the parties disagreed regarding whether they had ever reached a definitive agreement. New State contended that Locke never met its conditions for renewing and restructuring the loan.

claims of a creditor in a lower class may be paid, the claims of all creditors in the preceding class must be honored in full. *Id.* If the claims of creditors in any class cannot be paid in full, such claims are paid on a pro rata basis from the assets remaining after paying the claims of creditors in the preceding class, yielding nothing for creditors of the remaining lower classes. *Id.*

The depositor preference statute prefers the claims of depositors and secured creditors to the claims of unsecured creditors. In the majority of situations involving an insolvent financial institution, the institution's deposits and secured obligations exceed the value of the institution's assets. Accordingly, unsecured creditors would not receive anything on their claims. Consequently, the FDIC or FSLIC in their receivership capacity, in structuring transactions to transfer the assets to a new institution, will transfer only the deposit and secured claims. Typically, the FDIC and the FSLIC in their corporate capacities (the FDIC Corporate or the FSLIC Corporate) will provide funds to the receiver to equalize the value of the assets being purchased and the liabilities being assumed. Thus, creditors who have their claims transferred receive 100 cents on the dollar, while creditors whose claims are not transferred are left with a claim against an institution completely devoid of assets.

The nature of the P&A transaction was at the core of several cases decided during the survey period. Such transactions will change in the future because FIRREA authorizes the FDIC to prefer creditors within the same class. Pub. L. No. 101-43, § 212, 103 Stat. 183, 222 (1989). The constant in the method of structuring such transactions should continue to be that unless a claim is assumed or can be asserted against the FDIC Corporate, the claimant will be left with a claim against an institution devoid of assets.

62. See *infra* note 70.

63. 718 F. Supp. 573 (W.D. Tex. 1989).

64. See *infra* text accompanying notes 81-114.

65. 718 F. Supp. at 576.

New State never advanced additional funds, and Locke failed to repay the loans. Consequently, New State sold the real estate serving as collateral for such loans at a foreclosure sale. The price paid at foreclosure left a deficiency balance on each of the four Locke notes. Subsequently, the FHLBB declared New State insolvent, and FSLIC Receiver sold substantially all of the insolvent association's assets to MeraBank Texas FSB (MeraBank). FSLIC Corporate later acquired all four notes and filed suit against Locke.

Among other assertions, Locke claimed that the former president of State Savings defrauded him. Specifically, Locke contended that he would have neither purchased the raw land nor entered into the loans without the assurance of continued funding from State Savings' former president. Moreover, Locke asserted that New State reaffirmed State Savings' agreement to provide him with continued funding, but it too allegedly failed to abide by its commitments. Locke also alleged Deceptive Trade Practices Act (DTPA) and wrongful foreclosure claims.

The district court noted that FSLIC Corporate and FSLIC Receiver are distinct legal entities.⁶⁶ As noted above, FSLIC Corporate was the holder of Locke's notes. Locke sought to offset his common law claims against his obligations under those notes. The district court, however, stated that the claims for wrongful foreclosure could not be raised against FSLIC Corporate.⁶⁷ Instead, the court held that such claims only could be brought against FSLIC Receiver because they were based on actions of the former New State.⁶⁸ Thus, Locke could not raise defenses to FSLIC Corporate's collection action.⁶⁹ Because FSLIC Receiver was totally devoid of assets, Locke could not recover on such claims, even if such claims were valid.⁷⁰

66. *Id.* at 579. FSLIC Corporate represents the interests of the insurance fund that insures the deposits of savings and loan associations. *Cf.* Weinstock, *Directors and Officers of Failing Banks: Pitfalls and Precautions*, 106 *BANKING L.J.* 434, 445 n.4 (1989). The FSLIC Receiver is the receiver for the failed savings and loan associations. *Id.* As noted earlier, § 205 of FIRREA eliminated the FSLIC. Consequently, the insurance fund for savings and loan associations was placed under the auspices of the FDIC.

67. 718 F. Supp. at 585.

68. *Id.* at 580. The district court, painting with a broad brush, stated that "[n]either FSLIC Corporate nor an acquiror like MeraBank is required to assume liabilities that are related to the assets they agree to purchase, and neither FSLIC Corporate nor the acquiror can be held liable for obligations they have not assumed." *Id.* (citing *Trigo v. FDIC*, 847 F.2d 1499, 1502 (11th Cir. 1988)).

69. *Id.* at 587.

70. In *Triland Holdings & Co. v. Sunbelt Sav. Corp.*, Fed. Banking L. Rep. (CCH) ¶ 87,811, at 95,475 (Oct. 13, 1989), the Court of Appeals for the Fifth Circuit did not dismiss a claim against FSLIC Receiver based on mootness. The *Triland* court, however, indicated that it would be willing to dismiss, but the record did not provide a sufficient basis for determining whether the claims were moot. *Id.* at 95,477. The *Triland* court stated:

FSLIC [argued] . . . that there will *never* be any assets with which to satisfy a judgment against Sunbelt Savings nor any means to collect from any other party, including FSLIC. If true, this contention would justify dismissal of these actions on prudential grounds. But on the record before this court, we are unable to determine that there will never be any possibility of satisfying a favorable judgment. We are unable to conclude that all potential forms of relief are permanently precluded.

Id. (court's emphasis). See *Sunbelt Sav. FSB v. Walker Square Ltd.*, No. 88-1597-R (W.D. Okla. Feb. 7, 1989) (summary judgment for FSLIC because no assets remained in receivership).

Consequently, the district court dismissed Locke's claims as moot.⁷¹

B. Litigation Between Creditors of a Failed Financial Institution and the FSLIC or the FDIC

1. Setoff

In *FDIC v. Texarkana National Bank*,⁷² the Court of Appeals for the Fifth Circuit addressed the issue of whether a creditor of an insolvent institution could validly setoff its obligations against obligations owed to it by the former institution. This question in effect determines whether the creditor will receive anything on its claim. If the unsecured creditor is not entitled to a setoff, then its claim is against a receivership usually devoid of assets. Under *Locke*, such claims would then be dismissed as moot.

Guaranty Bond State Bank (GBSB) failed in 1982. The FDIC as receiver transferred most of GBSB's assets to First Bank & Trust Company of Redwater (FBTC), in exchange for which FBTC assumed certain of GBSB's liabilities. FDIC Receiver simultaneously transferred the remaining assets to FDIC Corporate in exchange for cash. FDIC Receiver used such funds to equalize the value of the assets purchased by and liabilities assumed by FBTC.

The assets FDIC Corporate purchased from FDIC Receiver included: (i) two certificates of deposit issued by Texarkana National Bank (TNB), in favor of GBSB, in the aggregate amount of \$200,000; (ii) GBSB's participation interest in loans originated by TNB and (iii) the portion of certain fees paid by GBSB in connection with an automatic teller machine (ATM) sharing arrangement. The FDIC brought an action to collect upon these assets. TNB, however, contended that such funds were no longer owed because it had setoff such obligations against the following obligations owed TNB by GBSB: (i) two participations in nonexistent loans originated by GBSB to Adam Bell (Bell) and Cecil Gunther (Gunther) in the aggregate amount of \$200,000; (ii) ten subordinated debentures (the GBSB Debentures) issued by GBSB, in the aggregate amount of \$100,000; (iii) several participations in fifteen loans actually extended by GBSB in the aggregate amount of \$317,120; and (iv) additional amounts owed under the ATM agreement. The district court had ruled in favor of TNB, thereby permitting the setoff.

The Court of Appeals for the Fifth Circuit considered the appropriateness of the setoff in the case of each asserted obligation. The court first deter-

estate); *Merabank v. Bates*, No. CA-5-88-272-C (N.D. Tex. Feb. 1, 1989) (case dismissed because the FHLBB determined receivership possessed no assets); *Stevenson v. FSLIC*, 716 F. Supp. 981, 982 (S.D. Tex. 1989) (claim must be dismissed as moot after FHLBB determines receivership estate devoid of assets, unless such determination is arbitrary and capricious, and FHLBB later determines assets do exist). *But see Veitch v. FSLIC*, 729 F. Supp. 54 (E.D. Tex. 1989) (Mere fact that an institution is insolvent and is in receivership is not a sufficient basis for dismissal; the record must demonstrate that there will never be any assets with which to satisfy a judgment).

71. 718 F. Supp. at 589.

72. 874 F.2d 264 (5th Cir. 1989). Curiously, the decision was written by Judge Jerre Williams, who also dissented from the part of the opinion regarding the applicability of *D'Oench Duhme*. *Id.* at 271.

mined that setoff was inappropriate in the case of the participation interests TNB purchased in the fictitious loans.⁷³ GBSB had never made the loans to Gunther and Bell. Accordingly, there were no loans for TNB to participate in. Thus, TNB was left with a claim for reimbursement, in light of GBSB's fraud, of the funds advanced for the participation interest. The court held that TNB's reimbursement claims, however, were barred by the *D'Oench Duhme* doctrine, with the result that there was no enforceable obligation under the participations to setoff.⁷⁴ Next, the court denied setoff of the GBSB Debentures, holding that a subordinated creditor may not enhance his position at the expense of other creditors.⁷⁵ Moreover, the court held that "as a matter of law, the subordinated debentures do not meet the test of mutuality of obligations," which is one of the prerequisites for setoff.⁷⁶

The court held FDIC Corporate liable for the additional amounts that TNB claimed under the ATM agreement.⁷⁷ The FDIC had contended that such claims, if valid, should be brought against FDIC Receiver and not FDIC Corporate. The court originally stated in summary form, however,

73. *Id.* at 266-67.

74. *Id.* at 267-68. For a discussion of the *D'Oench Duhme* aspects of this case, see *infra* text accompanying notes 94-103. The *D'Oench Duhme* doctrine, as it was originally formulated by the United States Supreme Court, precludes a borrower from asserting a possible defense to collection of an obligation if the borrower "lent himself to a scheme or arrangement whereby the banking authority on which the respondent [the FDIC] relied in insuring the bank was or was likely to be misled." 315 U.S. 447, 460 (1942).

The FDIC also argued that setoff was inappropriate because mutuality, a prerequisite for setoff, was nonexistent. Specifically, the FDIC claimed that FDIC Corporate held the right to collect on TNB's obligation to GBSB while TNB's claim for reimbursement was a claim against the FDIC Receiver. In addition, the FDIC argued that "rescission based on fraud" is not an appropriate basis for setoff. 874 F.2d at 268 n.5. The court did not need to reach these issues because it barred TNB's claims under the *D'Oench Duhme* doctrine.

The dissent would have held that TNB's claim for rescission survived *D'Oench Duhme*. See *infra* text accompanying notes 101-103. Accordingly, the dissent considered the FDIC's other arguments. The dissent implied that mutuality did exist, stating that only the balance after setoff is an asset of the receivership. 874 F.2d at 274. Accordingly, the FDIC Receiver could not have transferred GBSB's entire claims against TNB to FDIC Corporate. Instead, only the balance of such claims after deducting TNB's claim for reimbursement was conveyed to FDIC Corporate. *Id.*

The dissent also would have held that setoff is proper in the case of rescission based on fraud. *Id.* at 272. The dissent cited *Interfirst Bank Abilene v. FDIC*, 777 F.2d 1092 (5th Cir. 1985), for the proposition that rescission of a participation in light of fraud was an appropriate basis for setoff if: (i) the claim for rescission exists prior to the bank's insolvency and does not depend upon contractual relationships that arise thereafter; (ii) the claim is certain in amount, and liability is absolute when suit is filed; and (iii) the claim is asserted "well before" the assets are distributed other than a distribution pursuant to a P&A agreement. 874 F.2d at 272. The dissent would have held that TNB met the test espoused in *Interfirst Bank Abilene*.

75. 874 F.2d at 269.

76. *Id.*

77. *Id.* The *Texarkana Nat'l Bank* case also determined the effect upon a participation when the FDIC Receiver, as the lead bank, purchases collateral at a foreclosure sale. *Id.* at 270. The FDIC purchased the collateral at a foreclosure sale for \$75,000, which was the amount outstanding on the loan. Subsequently, the FDIC sold the property to a third party for \$70,000. The Court of Appeals for the Fifth Circuit decided to ignore the initial purchase by the FDIC at the foreclosure sale. *Id.* According to the court, the FDIC's purchase was merely "a paper transaction" that "represented a bookkeeping entry." *Id.* Thus, the participant was not entitled to share in the proceeds until the property was sold by the FDIC to a third party.

that FDIC Corporate is liable when FDIC Receiver does not provide for unassumed claims.⁷⁸ The court subsequently withdrew this aspect of its opinion. The reissued opinion stated, again in summary form, that TNB's claims could properly be setoff.⁷⁹

2. D'Oench Duhme Doctrine and 12 U.S.C. Section 1823(e)

The FSLIC and the FDIC use justiciability arguments in tandem with certain other legal theories to move for dismissal without a determination on the merits. The *D'Oench Duhme* doctrine and 12 U.S.C. section 1823(e) are the two most potent arrows in the FDIC's quiver. In *Beighley v. FDIC*⁸⁰ the court discussed the necessary showings both to comply with 12 U.S.C. section 1823(e)'s requirement of a writing and to overcome *D'Oench Duhme*'s preclusion of claims based on oral agreements.⁸¹

Beighley borrowed funds from First City National Bank of Hobbs, New Mexico (FCNB), secured by two parcels of real estate (the Collateral). The loan was to be repaid principally from the sale of the Collateral.⁸² Beighley contended that FCNB agreed to finance the sale of the Collateral and thus the repayment of Beighley's indebtedness, provided Beighley could produce a creditworthy buyer for the Collateral. To that end, FCNB assisted in the negotiations with, issued loan commitment letters to, and caused its attorney to draft the documents needed for the sale of one of the two parcels serving as the Collateral.

The day before closing on such property, however, FCNB notified the parties that it would not fund the loan.⁸³ Beighley filed suit against FCNB alleging, among other things, breach of contract. FCNB subsequently failed and FDIC Receiver was substituted as defendant in the litigation. In addition, FDIC Corporate, which had acquired the Beighley notes pursuant to the resolution of FCNB, intervened and prosecuted its claim for payment.

The *Beighley* court granted FDIC Corporate's summary judgment motion on its claim on the notes⁸⁴ stating that 12 U.S.C. section 1823(e)⁸⁵ barred Beighley's defenses. The court noted that under 12 U.S.C. section 1823(e)

78. *Id.*

79. *Id.*, see *MBank New Braunfels, N.A. v. FDIC*, 721 F. Supp. 120, 124 n.2 (N.D. Tex. 1989).

80. 868 F.2d 776 (5th Cir. 1989).

81. *Id.* at 782.

82. Beighley sent a letter discussing his commitment to liquidate the Collateral in order to pay down the balance of his indebtedness.

83. Beighley contended that FCNB failed to fund in order to avoid a legal lending limit violation.

84. 868 F.2d at 779 n.7, 783.

85. *Id.* at 782. 12 U.S.C. § 1823(e) (1988) provides:

No agreement which tends to diminish or defeat the right, title or interest of the [FDIC] in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the [FDIC] unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4)

an agreement that tends to defeat or diminish the FDIC's interests is not enforceable unless, among other things, it is in writing.⁸⁶ The court could find no writing that evidenced the FCNB's agreement to loan funds to enable a creditworthy party to purchase the Collateral.⁸⁷ The court stated that although the circumstances, including FCNB's issuing of loan commitment letters to prospective purchasers, might give rise to an inference that FCNB agreed to finance a purchaser for the Collateral, such an inference is not sufficient to overcome the statutory writing requirement.⁸⁸

The *Beighley* court also held that 12 U.S.C. section 1823(e) is not available to the FDIC Receiver.⁸⁹ Accordingly, if *Beighley's* claims were to be precluded, such preclusion had to result from the application of the *D'Oench Duhme* doctrine.⁹⁰ The *Beighley* court stated that *D'Oench Duhme* applies even when the underlying transaction is not fraudulent or when the borrower did not intend to deceive the regulators.⁹¹ The court stated that the "alleged oral agreement to finance future loans [was] not clearly evidenced in [FCNB's] records, and would not be apparent to bank examiners; [s]uch an unwritten, unrecorded agreement is 'simply [a] secret side agreement[. . . .]'"⁹² Thus, *Beighley's* claims were barred by *D'Oench Duhme*.⁹³

As noted previously, the *Texarkana National Bank* case also involved the application of the *D'Oench Duhme* doctrine to certain fictitious loans. Apparently, GBSB fabricated loans to Bell and Gunther and sold participations in such loans to TNB.⁹⁴ To do so, GBSB created loan documentation that purportedly was signed by Bell and Gunther.⁹⁵ The district court found that GBSB had represented to TNB that the signatures of Bell and Gunther were genuine and that GBSB's officers had inspected the property serving as collateral.⁹⁶ Upon GBSB's failure, TNB had setoff its claims under the participation. As noted previously, the Court of Appeals for the Fifth Circuit held that such set off was invalid because TNB's claims under the participations were barred under *D'Oench Duhme*.⁹⁷

The *Texarkana National Bank* court stated that 12 U.S.C. section 1823(e), which codified *D'Oench Duhme*, requires an agreement that "tends to diminish or defeat the [FDIC's] right, title or interest" in an asset to be, among other things, in writing to be enforceable.⁹⁸ The court found that

shall have been, continuously, from the time of its execution, an official record of the bank.

86. 868 F.2d at 782.

87. *Id.*

88. *Id.* at 783.

89. *Id.* Section 217 of FIRREA provides that the provisions of 12 U.S.C. § 1823(e) also apply to the FDIC Receiver. Pub. L. No. 101-73, § 217, 103 Stat. 183, 254.

90. 868 F.2d at 783.

91. *Id.* at 784.

92. *Id.*

93. *Id.*

94. 874 F.2d at 267.

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

GBSB's representations that the signatures were genuine and that the property had been inspected were part of an agreement that tended to diminish or defeat the FDIC's rights.⁹⁹ The court indicated that "[b]y failing to get the representations in writing, TNB participated in an arrangement likely to mislead the FDIC."¹⁰⁰ Thus, TNB's claims under the participations were barred by both 12 U.S.C. section 1823(e) and *D'Oench Duhme*.

Judge Williams, dissenting, would not have applied either the bars of *D'Oench Duhme* or 12 U.S.C. section 1823(e). According to the dissent, the fraudulent scheme was already complete before TNB became involved.¹⁰¹ Thus, TNB could not have contributed to a scheme to deceive the FDIC. The dissent stated that it was the fictitious loans themselves, and not the participations therein, that misled the FDIC.¹⁰² Presumably, the FDIC still would have been deceived by the fictitious loans, even if neither TNB nor anyone else had participated in such loans. The dissent then would have proceeded to hold TNB's setoff was valid.¹⁰³

The Court of Appeals for the Fifth Circuit in *Olney Savings & Loan Association v. Trinity Banc Savings Association*,¹⁰⁴ also examined 12 U.S.C. section 1823(e) and *D'Oench Duhme* issues asserted for the first time on appeal. Olney Savings & Loan Association (OSLA), now AmWest Savings Association, obtained a judgment against Bright Banc Savings Association (formerly Trinity Savings & Loan Association and Trinity Banc Savings Association (Trinity)) and Bright Mortgage Company (formerly STM Mortgage Company (STM)) for fraud in connection with STM-serviced participations that OSLA had purchased from Trinity. The transactions in question concerned two townhouse developers who had arranged loans from Trinity for their customers. After credit was extended, the purchasers would deed the property back to the developers. In this manner, the developers, who otherwise were not creditworthy, were able to obtain financing. Trinity would then sell ninety percent participations to OSLA, and STM would service the loans. The borrowers all defaulted on the loans, and STM bid the loan amount at foreclosure, thereby precluding a deficiency action.

The district court determined that Trinity made certain misrepresentations to OSLA: that one-half of the purchasers would live in the townhouses; the purchasers would make downpayments; and the townhouses were generally in good condition. Accordingly, Trinity and STM were found liable for fraud and the judgment included an award of punitive damages. The district court entered the judgment, and Trinity and STM filed a supersedeas bond and otherwise perfected their appeal. Thereafter, the FSLIC was appointed conservator.

The FSLIC contended that *D'Oench Duhme* can be raised at any time, even when it was not available to the financial institution against which a

99. *Id.* at 268.

100. *Id.*

101. *Id.* at 271.

102. *Id.*

103. *Id.* at 274.

104. 885 F.2d 266 (5th Cir. 1989).

judgment has been rendered. The Court of Appeals for the Fifth Circuit acknowledged that the misrepresentations made by Trinity and STM were secret agreements, and thus, ordinarily would be barred by *D'Oench Duhme*.¹⁰⁵

The court decided, however, that *D'Oench Duhme* was not available to the FSLIC in this case.¹⁰⁶ The court stated that *D'Oench Duhme* applies only to assets acquired by the FSLIC.¹⁰⁷ Trinity and STM had already posted a supersedeas bond when the FSLIC entered the case;¹⁰⁸ accordingly, such funds no longer represented part of the receivership estate. Moreover, the lower court's decision had rendered the participation agreements void. Thus, the court reasoned that no rights of the FSLIC would be diminished by the misrepresentations.¹⁰⁹

The Court of Appeals for the Fifth Circuit also stated that one purpose of *D'Oench Duhme* and 12 U.S.C. section 1823(e) is to prevent collusion between parties who deal with a financial institution and the institution's own employees.¹¹⁰ The court concluded that when parties have litigated an issue to a final judgment, the likelihood of collusion seems remote.¹¹¹

The FSLIC also contended that it was entitled under FIRREA to raise *D'Oench Duhme* and 12 U.S.C. section 1823(e) for the first time on appeal. Section 212 of FIRREA provides that the receiver or conservator on appeal will "have all the rights and remedies available to the insured depository institution (before the appointment of such conservator or receiver) and the Corporation in its corporate capacity, including removal to Federal Court and all appellate rights"¹¹² The court, however, stated that this provision authorizes the FSLIC to pursue all appeals even though prior to the adoption of FIRREA only FSLIC Corporate could pursue such appeals.¹¹³ The provision does not entitle the FSLIC to raise *D'Oench Duhme* for the first time on appeal.¹¹⁴ Thus, Olney's judgment survived challenge.

3. Operations of the Receiver

Previously, we have discussed the powers and rights of the FDIC, and the former FSLIC, when they litigate a suit that arose as a result of the actions of the failed financial institution. The following cases concern challenges to actions by the FDIC or the FSLIC.

105. *Id.* at 274-75.

106. *Id.* at 275.

107. *Id.*

108. The FSLIC also contended that punitive damages may not be assessed against an instrumentality of the United States, such as the FSLIC. The court of appeals stated that once the financial institution posts the supersedeas bond, the funds representing the bond are no longer assets of the financial institution, and accordingly, do not become subject to the control of the FSLIC. *Id.* at 274.

109. *Id.* at 275.

110. *Id.*

111. *Id.*

112. Pub. L. No. 101-73, § 212, 103 Stat. 183, 222 (1989).

113. 885 F.2d at 275.

114. *Id.* But see *FSLIC v. Stone-Liberty Land Assocs.*, No. 05-88-03125-CV (Tex. App.-Dallas, Mar. 9, 1990).

a. Inequitable Distribution

*MBank New Braunfels, N.A. v. FDIC*¹¹⁵ was another case that arose out of the FDIC's resolution of the majority of MCorp's bank subsidiaries. MBank New Braunfels, N.A. (MNB) brought suit against the FDIC claiming that the FDIC had not provided a ratable distribution of funds to creditors of MBank Dallas, N.A. (MBank Dallas). MNB also asked the court to order the FDIC to rectify its continuing violation of the requirement to effect a ratable distribution of the receivership estate.¹¹⁶ The district court treated such request as if MNB had asked the court to issue a writ of attachment against the assets of the bridge bank (the Bridge Bank)¹¹⁷ to which MBank Dallas' assets had been transferred, in order to provide the means to satisfy a judgment.¹¹⁸

MNB, one of MBank Dallas' sister-banks, sold federal funds to MBank Dallas pursuant to an agreement under which MNB could withdraw such funds at any time. On March 27 and 28, 1989, MNB demanded the repayment of all federal funds sold. MBank Dallas never responded to such demands. Instead, after business hours on March 28, 1989, the Comptroller declared MBank Dallas insolvent and appointed the FDIC as receiver. FDIC Receiver entered into a P&A agreement with the Bridge Bank, pursuant to which the Bridge Bank assumed all of MBank Dallas' liabilities for federal funds purchased, except for the federal funds purchased from sister-banks.

The district court stated that the standard for granting a writ of attachment is the same as that for granting a preliminary injunction.¹¹⁹ Accordingly, MNB needed to demonstrate:

- (1) a substantial likelihood [of success] . . . on the merits;
- (2) a substantial threat that irreparable injury will result if the [writ] is not granted;
- (3) the threatened injury to the plaintiff outweighs any damage to defendant from issuance of [the writ] and
- (4) granting the [writ] will not disserve the public interest.¹²⁰

The district court addressed each of these factors.

The district court stated that the National Bank Act of 1864, as amended (the National Bank Act), required a receiver to make a ratable distribution¹²¹ of the assets of the receivership.¹²² The FDIC contended that MNB received its pro rata share of the receivership estate because the FDIC had been prepared to pay MNB the same amount as MNB would have received if MBank Dallas had been liquidated. The district court held that it was not

115. 721 F. Supp. 120 (N.D. Tex. 1989).

116. See *infra* text accompanying notes 119-120.

117. 12 U.S.C. § 1821(i) (1988) provides the FDIC with the authority to establish a bridge bank in order to facilitate the resolution of a failed bank.

118. 721 F. Supp. at 121.

119. *Id.* at 122.

120. *Id.*

121. 12 U.S.C. § 194 (1988) (made applicable to the FDIC by 12 U.S.C. § 1821(d) (1988)).

122. 721 F. Supp. at 123.

a ratable distribution to provide MNB with its pro rata share while others who sold federal funds to MBank Dallas had their claims honored 100 percent, as a result of such claims being assumed by the Bridge Bank.¹²³

The FDIC also argued that, under the National Bank Act, a court cannot issue the writ against a national bank.¹²⁴ The district court, however, stated that the bar on issuing the writ was limited to preventing creditors from taking action against bank property before a final judgment is rendered.¹²⁵ The district court, however, stated that property that was held but not owned by a national bank could still be attached.¹²⁶ Moreover, a court could enjoin action to protect the creditors of property held by a national bank until resolution of the controversy.¹²⁷ Nonetheless, the district court decided that the requested writ did not request property held by a bank, but instead was an impermissible request for attachment of the FDIC's property.¹²⁸ The district court further determined that MNB did not demonstrate that it would be irreparably harmed by the failure to issue the writ.¹²⁹ Thus, although the district court determined that MNB probably would prevail on the merits, the court refused to issue the writ because MNB did not satisfy the other prerequisites for it.¹³⁰

The *MBank New Braunfels* decision calls into question the regulators' "strategy"¹³¹ in declaring insolvent allegedly healthy bank subsidiaries owned by First RepublicBank Corp. and Texas American Bankshares, Inc. Two provisions of FIRREA, however, will probably enable the FDIC to prevent similar challenges in the future. First, section 206 of FIRREA makes federally-insured institutions liable to the FDIC if one of their sister-institutions fails.¹³² Thus, FIRREA effectively adopts elements of the Federal Reserve's Source of Strength Policy Statement.¹³³ Second, section 212 of FIRREA eliminates the requirement that the FDIC provide creditors with a ratable distribution. Instead, FIRREA authorizes the FDIC to prefer creditors in different classes.¹³⁴ An open question is whether such authority

123. *Id.* at 124. The district court also held that MNB would be entitled to interest from the date the other creditors received a distribution, namely when the Bridge Bank assumed such indebtedness. *Id.* at 125.

124. The FDIC based its argument on 12 U.S.C. § 91 (1988), which provides: "[N]o attachment, injunction, or execution, shall be issued against [a national bank] or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court."

125. 721 F. Supp. at 125.

126. *Id.* at 126.

127. *Id.*

128. *Id.* (citing 12 U.S.C. § 1819(a) (1988)).

129. 721 F. Supp. at 127.

130. *Id.*

131. *Judge Says FDIC Broke the Law in Forcing Texas Bank Failures*, Am. Bankr., Sept. 7, 1989, at 1, col. 3.

132. See Pub. L. No. 101-73, § 206, 103 Stat. 183, 195. The FDIC has already employed the authority contained in § 206 of FIRREA. According to John Douglas, former FDIC general counsel, the FDIC sent out its "first 'bill' under the . . . cross-guarantees provision" on September 1, 1989. *FDIC Issues First Cross-Guarantees Bill, General Counsel Douglas Says*, [July-Dec.] Banking Rep. (BNA) No. 53, at 375-76 (Sept. 18, 1989).

133. See *supra* text accompanying note 6.

134. Pub. L. No. 101-73, § 212, 103 Stat. 183, 222.

will be given retroactive effect.

b. Purchase and Assumption Transaction as a Fraudulent Conveyance

*Valley Ranch Development Co. v. Sunbelt Savings, FSB*¹³⁵ concerned whether the FSLIC's disposition of the assets of a failed savings and loan association violated the Texas Uniform Fraudulent Transfer Act (TUFTA).¹³⁶ The FSLIC had transferred all of the assets but not all of the liabilities of several savings and loan associations, including Sunbelt Savings Association (Old Sunbelt), to a newly chartered savings and loan association (New Sunbelt). The only liabilities transferred to New Sunbelt were the claims of depositors and secured creditors. The plaintiffs, who were unsecured creditors of Old Sunbelt, claimed that the transaction was a fraudulent conveyance.

The district court held that the broad authority provided to FSLIC to settle the affairs of insolvent savings and loan associations preempted application of the TUFTA to such institutions.¹³⁷ The district court stated that it is not fraudulent for the FSLIC to distribute assets in accordance with federal banking laws.¹³⁸

The then applicable banking regulations required the FSLIC to honor priorities established under state law for disposition of assets of a failed savings and loan association.¹³⁹ The Texas "depositor preference" statute¹⁴⁰ details the order in which the claims of the different classes of an insolvent financial institution's creditors must be honored. The amount of Old Sunbelt's deposit and secured liabilities exceeded the amount of its assets. Thus, the unsecured creditors of Old Sunbelt would have received nothing if Old Sunbelt had been liquidated. The court held that such creditors could not improve their position because the FSLIC opted for another method to dispose of Old Sunbelt's affairs.¹⁴¹

135. 714 F. Supp. 817 (N.D. Tex. 1989).

136. TEX. BUS. & COMM. CODE ANN. § 24 (Vernon 1987).

137. 714 F. Supp. at 818. The district court dismissed another claim in an almost identical opinion. See *Gulley v. Sunbelt Sav., FSB*, 714 F. Supp. 819 (N.D. Tex. 1989).

138. 714 F. Supp. at 818-19.

139. *Id.*

140. TEX. REV. CIV. STAT. ANN. art. 342, 803a (Vernon Supp. 1990).

141. 714 F. Supp. at 818-19. The result in *Valley Ranch Dev. Co.* might make it less difficult to engage in open-bank assistance transactions under § 13(c) of the Federal Deposit Insurance Act. 12 U.S.C. § 1821 (1988). In 1987, the Texas Legislature added a provision that made the deposit preference statute applicable to open-bank transactions. TEX. REV. CIV. STAT. ANN. art. 342, § 803a (Vernon Supp. 1990). Practitioners, however, have hesitated to structure open-bank transactions, because they feared that under the TUFTA the claims of unsecured creditors, including contingent claims, would follow the insolvent institution's assets to the solvent purchaser of such assets. Presumably, the holding in *Valley Ranch Dev. Co.* should also apply to open-bank transactions because the financial institution must be insolvent before the FDIC will render financial assistance. See FDIC Policy Statement on Open-Bank Assistance, 51 Fed. Reg. 44,122 (1988). Thus, *Valley Ranch Dev. Co.* should preclude claimants from relying on the TUFTA in an action against purchasers of an insolvent financial institution in an open-bank assistance transaction.

c. *Transfer of Trust Accounts*

Two cases during the survey period addressed whether the FDIC, in its receivership capacity, possesses the authority to transfer the trust department of a failed bank without the need to comply with the requirements of state trust law. In *First National Bank of Andrews v. FDIC*,¹⁴² the district court held that the provisions of the Texas Banking Code of 1943,¹⁴³ as amended (the Banking Code), governing liquidation of failed state banks, preempted the provisions of the Texas Trust Code of 1983, as amended (the Texas Trust Code),¹⁴⁴ concerning designation of replacement trustees.

The First National Bank of Andrews (FNB-Andrews) had entered into a P & A agreement, pursuant to which it purchased the assets and assumed the liabilities, of Permian Bank, a failed state bank, from FDIC Receiver. The P&A agreement purported to vest in FNB-Andrews all rights of the Permian Bank as fiduciary. Subsequently, FNB-Andrews sought a declaratory judgment to invalidate the P&A agreement because it allegedly violated the provisions of the Texas Trust Code. Specifically, the Texas Trust Code requires court appointment of a successor trustee when such successor is not designated in the trust instrument.¹⁴⁵

The district court held that the Texas Banking Code's exclusive structure for disposition of the affairs of an insolvent state bank mandated the court's decision that the Banking Code provisions supersede the requirements of the Texas Trust Code.¹⁴⁶ The district court stated that its holding only required a "limited intrusion of the banking liquidation procedures into matters of trust law."¹⁴⁷

The *First National Bank of Andrews* court also held that FNB-Andrews had not assumed the liabilities of Permian Bank for breach of fiduciary duty.¹⁴⁸ The district court stated that this aspect of its decision, among other things, was supported by the lack of provisions in the P&A agreement addressing such issue,¹⁴⁹ the Texas Trust Code's provision that a successor trustee is liable only for breaches of duty of which it knows or should know and the lack of a provision in the Banking Code covering such issue.¹⁵⁰

In *NCNB Texas National Bank v. Cowden*¹⁵¹ the district court extended the *First National Bank of Andrews* decision to a situation in which the FDIC is appointed receiver for a failed national bank. Obviously, in such a case, the provisions of the Texas Banking Code are not applicable. The *Cowden* court noted, however, that the Federal Deposit Insurance Act¹⁵² pro-

142. 707 F. Supp. 265 (W.D. Tex. 1989).

143. TEX. BANKING CODE art. 342-801 to 342-816 (Vernon Supp. 1990).

144. TEX. PROP. CODE ANN. § 113.083(a) (Vernon 1983).

145. *Id.*

146. 707 F. Supp. at 269.

147. *Id.* at 268 (court's emphasis).

148. *Id.* at 271.

149. *Id.*

150. *Id.*

151. 712 F. Supp. 1249 (W.D. Tex. 1989), *aff'd*, 895 F.2d 1488 (5th Cir. 1990).

152. 12 U.S.C. §§ 1811-1832 (1988).

vides a comprehensive scheme governing when the FDIC is appointed as receiver for a failed bank.¹⁵³ The district court concluded that Congress had intended by such provisions to preempt state law (the Texas Trust Code).¹⁵⁴

Section 217 of FIRREA enables the FDIC to transfer the trust business of a failed bank, including its fiduciary appointments, to another institution.¹⁵⁵ Thus, FIRREA, by codifying the *Cowden* and *First National Bank of Andrews* decisions, should eliminate challenges to the FDIC's ability to transfer the trust business together with the remainder of the failed institution.

4. Control

The case of *Gaubert v. United States*¹⁵⁶ considered the extent of authority the FHLBB must exercise over a savings and loan association before the FHLBB will be deemed liable for the association's activities. Thomas Gaubert (Gaubert) was the largest shareholder and chairman of the board of Independent American Savings Association (IASA). The FHLBB desired that IASA merge with Investex Savings (Investex), a failing savings and loan association. Gaubert's anticipated involvement in the resulting association, however, concerned the FHLBB. Accordingly, the FHLBB and the Federal Home Loan Bank of Dallas (the FHLB-Dallas) asked Gaubert to agree to a "neutralization" agreement, pursuant to which Gaubert would not participate in the resulting association's affairs. Gaubert was also requested to guarantee that the resulting association's capital ratios were consistent with regulatory requirements. Gaubert pledged real estate with a value of \$25 million in order to secure such "guarantee."

The regulators then assisted IASA in drafting its proxy statement to obtain shareholder approval for the merger. In addition, the regulators provided both financial and regulatory advice to IASA. All this regulatory action occurred even though IASA was not subject to any regulatory agreement, administrative action, or conservatorship. The FHLBB simply advised IASA to engage in such actions.

In addition, the FHLB-Dallas informed IASA that IASA must elect or appoint certain individuals chosen by the FHLB-Dallas to serve as IASA's officers and directors. Otherwise, IASA would be closed. The FHLB-Dallas released Gaubert from the neutralization agreement in exchange for Gaubert's agreeing to persuade the IASA board to resign. A former FHLB-Dallas employee was selected as IASA's new chief executive officer. FHLB-Dallas played an increasingly active role in IASA's affairs. Specifically, FHLB-Dallas selected a consulting company for IASA, advised IASA regarding the manner in which to cause certain of its subsidiaries to file for bankruptcy, mediated salary disputes for IASA employees, and urged IASA to convert to a federal charter in order to provide the FHLB-Dallas with exclusive supervisory authority over IASA.

153. 712 F. Supp. at 1253-56.

154. *Id.*

155. Pub. L. No. 101-73, § 217, 103 Stat. 183, 254.

156. 885 F.2d 1284 (5th Cir. 1989).

The new IASA board announced that IASA's net worth was negative \$500 million. This was in contrast to IASA's reported net worth of approximately \$75 million just a few months before. Ultimately, IASA became insolvent, with the result that Gaubert lost his entire stock investment and the real estate he had pledged pursuant to the neutralization agreement. Gaubert filed suit asserting that FHLB-Dallas had negligently selected IASA's board of directors and had negligently engaged in IASA's daily affairs.

The Court of Appeals for the Fifth Circuit stated that instrumentalities of the Federal Government, such as FHLBB and FHLB-Dallas, are generally protected from liability by the doctrine of sovereign immunity.¹⁵⁷ Congress previously adopted the Federal Tort Claims Act (FTCA),¹⁵⁸ in order to waive such immunity when a government agency has acted negligently.¹⁵⁹ The FTCA, however, still bars a cause of action when the governmental authority exercises or fails to exercise a "discretionary function . . . whether or not the discretion involved [is] abused."¹⁶⁰ The district court held that Gaubert's suit failed to survive this discretionary function exception.¹⁶¹

The *Gaubert* court stated that only policy decisions, in contrast to operational actions, are protected by the discretionary function exception.¹⁶² The court determined that the decisions to merge IASA, enter into a neutralization agreement, and replace the IASA board of directors were all policy decisions; and thus, were protected from suit.¹⁶³ In contrast, the *Gaubert* court concluded that the FHLB-Dallas' advice regarding retaining a consultant and converting to a Federal charter were operational decisions.¹⁶⁴ The court of appeals then decided that Gaubert may have standing to bring such an action because he suffered a personal injury not shared by IASA's shareholders.¹⁶⁵ The court stated that Gaubert possessed standing to pursue his loss of the real estate he pledged pursuant to the neutralization agreement.¹⁶⁶ The court then remanded the action for a determination regarding whether Gaubert would have a valid claim for the value of such real estate.¹⁶⁷ The court stated, however, that Gaubert did not possess standing to bring a claim for the diminution of his stock ownership.¹⁶⁸

157. *Id.* at 1286.

158. *Id.* (citing 28 U.S.C. § 1346(b) (1988)).

159. 885 F.2d at 1287.

160. *Id.* (quoting 28 U.S.C. § 2680(a) (1988)).

161. *Id.*

162. *Id.* at 1289.

163. *Id.* at 1290. *Cf.* *FSLIC v. Locke*, 718 F. Supp. 573, 583 (W.D.Tex. 1989) (the FSLIC's actions as conservator of savings and loan association did not constitute dominion and control; thus, the FSLIC was not barred from raising *D'Oench Duhme*).

164. 885 F.2d at 1290.

165. *Id.* at 1291.

166. *Id.* at 1292.

167. *Id.*

168. *Id.* Generally, shareholders of financial institutions do not possess standing to sue for their lost investment. Such causes of action belong to the institution, itself, or if the institution has failed, to the receiver for the institution. *See* Weinstock, *supra* note 66, at 444-45.

*C. Corporate Law Issues**1. Inheriting Criminal Liability*

In *United States v. Central National*,¹⁶⁹ a case of first impression in the Fifth Circuit and likely the entire country, Alamo Bank of Texas (Alamo Bank) was held liable for criminal violations committed by its merger partner—Central National Bank (CNB). CNB was accused of violating the Bank Secrecy Act by failing to file currency transaction reports (CTRs)¹⁷⁰ between February 1983 and April 1984. In 1987, CNB merged with and into Alamo Bank under Alamo Bank's charter with a branch at the former CNB banking facilities. Prior to the merger, Alamo Bank received some assurance that the Comptroller¹⁷¹ would not pursue a criminal referral to the Treasury for civil money penalties as a consequence of the failure to file the CTRs. Nonetheless, the Justice Department brought an action on its own asserting that Alamo Bank, as the successor-in-interest to CNB, assumed all claims against CNB including criminal liabilities. The district court noted that both the federal and state statutes that authorize bank mergers provide that the resulting institution is responsible for the obligations of all of the merging banks.¹⁷² The district court held that such statutes were broad enough to encompass liabilities resulting from criminal activities.¹⁷³

Before a party may be convicted under the Bank Secrecy Act, the United States government must prove that a financial institution knowingly failed to file CTRs.¹⁷⁴ Alamo Bank argued before the Fifth Circuit that only CNB, and not Alamo Bank, possessed sufficient intent. Accordingly, Alamo Bank contended that to impose liability upon Alamo Bank for CNB's crimes violated its constitutional right to due process.

The Court of Appeals for the Fifth Circuit reasoned that the real issue in the case was whether CNB actually ceased to exist when it merged with Alamo Bank. "The United States contends that it did not prosecute Alamo [Bank] for the actions of another; rather, the United States is seeking to hold CNB responsible for its crimes, and CNB still exists under the name Alamo. . . . If this is correct Alamo's contentions are moot."¹⁷⁵ The court of appeals held that the federal statute that authorizes bank mergers pro-

169. 705 F. Supp. 336 (S.D. Tex. 1988), *aff'd*, 880 F.2d 828 (5th Cir. 1989).

170. 31 U.S.C. §§ 5313, 5322(b) (1988). CNB was also allegedly engaged in a conspiracy to avoid filing CTR in violation of 18 U.S.C. § 371 (1988).

171. LaBoon & Paulsen, *Thinking About a Merger? Remember the Alamo Case*, 2 BANKING L. REV. 5 (1989). According to the authors, the Comptroller "acknowledged violations in a letter," but concluded that "[b]ased on the information [now] available, a recommendation to Treasury for assessment of civil penalties will not be pursued, provided the Bank, in good faith, makes prompt efforts to correct the violations." *Id.* at 5-6. Only the Justice Department, however, and not the federal banking agencies, may prosecute criminal cases. Villa, *Banking Crimes - Fraud, Money Laundering and Embezzlement* 1, 1-6 (1987).

172. 705 F. Supp. at 337.

173. *Id.*

174. 31 U.S.C. §§ 5313, 5322(b) (1988).

175. 880 F.2d 828, 829 (5th Cir. 1989).

vides that "the resulting State bank shall be considered the same business and corporate entity as the national banking association"¹⁷⁶ Accordingly, Alamo Bank was found to be a continuation of CNB, and thus, liable for the violations committed by CNB.¹⁷⁷

The result of the *Central National Bank* holding is that institutions pursuing a bank merger must consider possible criminal violations when they perform their due diligence. Institutions should be hesitant of relying solely on assurances, as Alamo Bank did, that criminal actions will not be pursued. Accordingly, whenever possible, such institutions should contract for indemnification from sellers. In addition, acquirors might consider using a holding company as a vehicle for acquiring a bank, and delay merging the banks, at least until the limitations period has run.

2. *Employment Agreements*

The National Bank Act¹⁷⁸ enables the board of directors of a national bank to dismiss the officers of such bank "at pleasure."¹⁷⁹ Although national banks may enter into employment agreements with their officers,¹⁸⁰ such agreements have been held to be voidable at the bank's option without compensation.¹⁸¹ Prospective officers of national banks, who desire to limit the board's authority to dismiss them without compensation, have often sought to blunt the impact of this provision by (i) requiring the bank's directors to guarantee the employment agreement, (ii) entering into a personal services agreement directly with the bank's directors or (iii) entering into an employment agreement with the bank's holding company.

Article 342-409 of the Banking Code also contains a provision entitling the board of a state bank, in its discretion, to dismiss the bank's officers.¹⁸² This article, however, provides that "any contract for a fixed term of employment shall be void."¹⁸³ Thus, the Banking Code provisions concerning agreements with bank officers limits a state bank's ability to elect the alternatives discussed above. This distinction was demonstrated by the decision in *Smith v. Joplin*.¹⁸⁴

The *Smith* case concerned an employment agreement between Texas Bank

176. *Id.* (citing 12 U.S.C. § 214b (1988)).

177. 880 F.2d at 829.

178. 12 U.S.C. § 24 (1988).

179. *Id.*

180. 12 C.F.R. § 7.5220 (1988).

181. *See, e.g., Kemper v. First Nat'l Bank in Newton*, 94 Ill. App. 3d 169, 418 N.E.2d 819 (1981) (National Bank Act empowered board of directors to dismiss bank president before conclusion of his tenure without subjecting bank to liability for wrongful discharge). *Cf. Citizens State Bank v. Libertelli*, 215 N.J. Super. 190, 521 A.2d 867 (App. Div. 1987) (five-year employment agreement between New Jersey-chartered bank and its president was unenforceable, because state banking laws entitled board to remove bank's officers at pleasure). *But see Potter v. Village Bank of N.J.*, 225 N.J. Super. 547, 543 A.2d 80 (App. Div. 1988) (public policy prevented directors from discharging bank president who reported alleged money laundering activities of bank's directors).

182. TEX. REV. CIV. STAT. ANN. art. 342-409 (Vernon 1981).

183. *Id.*

184. 879 F.2d 159 (5th Cir. 1989).

& Trust Co. (TB&T), a state-chartered bank, and Charles Joplin. In the fall of 1986, TB&T was failing, and the Commissioner had placed TB&T under supervision. The directors of TB&T asked Joplin to serve as president. Before Joplin would accept the job, he required that six months' compensation be paid either in advance or into an escrow account. Instead, the directors guaranteed Joplin's six-month employment agreement. The escrow account was never created, and TB&T failed two months later.

Subsequently, the directors sought a declaratory judgment that Joplin's employment agreement was unenforceable. Joplin counterclaimed for compensation covering the remaining four months of his employment contract. Joplin claimed that his employment agreement was with the directors directly. Alternatively, he claimed that it was permissible for the directors to guarantee his employment agreement.

The Court of Appeals for the Fifth Circuit held that the directors were not responsible for the balance of Joplin's employment agreement.¹⁸⁵ First, the court held that the employment agreement was between Joplin and TB&T.¹⁸⁶ The *Joplin* court noted that directors, acting in their individual capacities, cannot hire a bank president. Second, the court held that guarantors are not liable when the underlying obligation is unenforceable.¹⁸⁷ Thus, the *Joplin* decision eliminates one technique, and casts doubts on other alternatives, for hiring an officer of a Texas-chartered bank for a definite duration.

D. Lender Liability

1. Bank Tying

One of the cases that arose during the survey period extended the applicability of the antitying provisions of the Bank Holding Company Act.¹⁸⁸ In *Amerifirst Properties, Inc. v. FDIC*,¹⁸⁹ the Court of Appeals for the Fifth Circuit held that a bank could not "tie" a loan commitment to a borrower's agreeing to purchase real estate.¹⁹⁰

Amerifirst Properties, Inc. (Amerifirst) negotiated with Western Bank-Westheimer (Western Bank)¹⁹¹ for a loan. Western Bank committed to fund the loan on the condition that Amerifirst purchase a parcel of real estate then being held as other real estate owned ("OREO") by Western Bank.¹⁹²

185. *Id.* at 160.

186. *Id.*

187. *Id.*

188. 12 U.S.C. § 1972(1)(A) (1982). This section states that "[a] bank shall not in any manner extend credit . . . on the condition or requirement—(A) that the customer shall obtain some additional credit, property, or service from such bank other than a loan, discount, deposit, or trust service."

189. 880 F.2d 821 (5th Cir. 1989).

190. *Id.* at 823-24.

191. The FDIC, as the receiver for Western Bank, substituted itself as the real party in interest.

192. This practice was not uncommon during the past few years as financial institutions struggled to survive. See *JST Properties v. First Nat'l Bank*, 701 F. Supp. 1443 (D. Minn. 1988) (borrowers who were required to accept other real estate owned as part of real estate

Subsequently, Western Bank reneged on its loan commitment because it had entered into an agreement to sell the real estate to a third party.

The district court dismissed Amerifirst's antitying complaint because Western Bank never funded the loan. The Court of Appeals for the Fifth Circuit, however, held that actual funding of a loan is not required.¹⁹³ The court of appeals noted that Western Bank's use of economic leverage was precisely what the antitying provisions were intended to prevent.¹⁹⁴ Thus, the mere "offer of a tied loan," not the consummation of the loan, is sufficient for a violation to occur.¹⁹⁵

2. *Promissory Estoppel and Breach of Contract*

In *MBank Abilene, N.A. v. LeMaire*,¹⁹⁶ MBank Abilene N.A. (MBank Abilene) appealed a \$69 million judgment that it had breached an oral commitment to lend. In 1976, Abilene National Bank (ANB), MBank Abilene's predecessor, began funding the oil and gas exploration efforts of Richard Patton (Patton) and Harry LeMaire (LeMaire). When Patton and LeMaire had an opportunity to acquire certain oil and gas properties, ANB's President, Don Earney (Earney), encouraged Patton and LeMaire to form a holding company for such purpose. Earney joined the Board of Directors of the new venture. Afterwards, ANB loaned \$3 million and Continental Illinois National Bank and Trust (Continental) loaned \$5 million to LeMaire and Patton's holding company. Subsequently, LeMaire and Patton, at Earney's request, moved their entire banking relationship from Continental to ANB.

In 1982, Earney made the oral commitment to extend credit, of up to \$3 million, that became the subject of litigation. The loan commitment was made in violation of ANB's legal lending limit. Consequently, the Comptroller issued a cease and desist order prohibiting ANB from funding the commitment. When LeMaire and Patton were unable to obtain financing elsewhere, their company failed. A jury returned a verdict in favor of LeMaire and Patton for \$100 million, which was reduced to \$18.5 million after this appeal.

On appeal, MBank Abilene raised over 150 points of error, asserting, most importantly, that the terms of the contract were not definite. The court of appeals determined that the jury could have inferred the terms of the oral contract from the parties' extensive course of dealings.¹⁹⁷ MBank Abilene contended, however, that the Statute of Frauds¹⁹⁸ required the oral commitment to lend, even if a valid contract, to be in writing to be enforceable. The

loan package sued bank alleging impermissible tie). Typically, such transactions were an attempt to convert a non-income-producing property into an earning asset. Moreover, the sale of other real estate owned at a price in excess of book value would increase the institution's capital.

193. 880 F.2d at 824.

194. *Id.*

195. *Id.* at 825 (court's emphasis).

196. No. C14-86-00834-CV (Tex. App.—Houston [14th Dist.], Apr. 6, 1989, n.w.h.) (not yet reported).

197. *Id.*, slip. op. at 7 (Westlaw, CS-TX).

198. TEX. BUS. & COMM. CODE ANN. § 26.01 (Vernon 1988).

court of appeals agreed, because the loan commitment, when eventually funded, would have been secured by oil and gas properties.¹⁹⁹ If the contract were unenforceable, then ANB could not have breached it.²⁰⁰ Nonetheless, the court upheld the jury verdict under the doctrine of promissory estoppel.²⁰¹

MBank Abilene also raised other contentions, the most notable of which was that the oral commitment was unenforceable because it violated ANB's then existing legal lending limit. The court of appeals stated that there was an apparent conflict of authority on this issue.²⁰² The court held that the plaintiffs could obtain damages because the legal lending limit provisions did not preempt actions based on state common law principles.²⁰³ The court of appeals dismissed MBank Abilene's other points of error and affirmed the award of damages to LeMaire and Patton.²⁰⁴

Primarily as a result of the *LeMaire* decision, the FDIC, as receiver for MBank Abilene, paid off all insured deposits.²⁰⁵ Such an approach differs dramatically from the manner in which the FDIC Receiver resolved the other MBanks for which it was appointed receiver.²⁰⁶ In contrast, the Bridge Bank engaged in P&A transactions with the other failed MBanks.

II. STATUTORY LAW

The 1989 legislative session passed a flurry of bills that affect financial institutions. The statutes with the closest nexus to banking are discussed below.

A. Lender Liability

1. Supersedeas Bonds

The Texas Legislature adopted a statute intended to provide state banks with protection, equal to that afforded national banks, from actions to collect on a judgment before it becomes final. The National Bank Act includes a provision²⁰⁷ interpreted to bar enforcement actions against a national bank until all appeals have been exhausted.²⁰⁸ This provision also enables national banks to appeal adverse judgments without first posting a supersedeas bond.²⁰⁹

This is not the first time that government officials have attempted to pro-

199. No. C14-86-00834-CV, slip op. at 9 (Westlaw, CS-TX).

200. *Id.*

201. *Id.*

202. *Id.*, slip op. at 7 (Westlaw, CS-TX).

203. *Id.*, slip op. at 8 (Westlaw, CS-TX).

204. *Id.*, slip op. at 29-30 (Westlaw, CS-TX).

205. *Lender Liability Case Explores New Ground*, 5 Texas Lawyer, April 17, 1989, at 18, col. 2.

206. *Id.*

207. 12 U.S.C. § 91 (1988).

208. *See, e.g., U.S. v. Taylor*, 881 F.2d 207, 210 (5th Cir. 1989) (12 U.S.C. § 91 (1988) (bars abstracts of judgment against a national bank's assets until all appeals have been exhausted)).

209. 12 U.S.C. § 91 (1988).

vide such protections to state financial institutions. In 1988, the Texas Department of Banking (the Banking Department) adopted a regulation that provided that:

[n]o attachment, injunction, or execution against any State Bank or its property shall be effective if issued before final judgment in any suit, action or proceeding in any court. As used in this section, the term 'final judgment' means a judgment on the merits which is no longer subject to examination on appeal and either because of disposition on appeal and conclusion of the appellate process, or because of the passage, without action, of the time for seeking appellate review.²¹⁰

The court of appeals in *Bank of East Texas v. Jones*,²¹¹ however, held that the Banking Department lacked the statutory authority to promulgate such a regulation. Accordingly, the Legislature effectively overruled this holding last session when it enacted a statute that closely paralleled the contents of the Banking Department's regulation.²¹² Moreover, the Legislature expanded the statute's scope to include savings and loan associations.²¹³ The statute does not restrict writs of garnishment served on accounts maintained at a financial institution on behalf of the institution's customers.²¹⁴ In addition, the statute only affects orders entered after September 1, 1989.²¹⁵

A notable omission in the statute is that it does not explicitly cover a financial institution's directors, officers and agents when they act within the scope of their employment. Presumably, the protections afforded by the statute were intended to be extended to people acting in their official capacity because a financial institution can act only through its directors, officers and agents. Nonetheless, the statute is silent on this issue.

2. Customer Records

One statute enacted during the last legislative session is intended to reduce the burdens on financial institutions resulting from the production of bank records.²¹⁶ Previously, financial institutions were subject to the conflicting desires of litigants requesting customer records and bank customers attempting to keep their affairs private. Consequently, financial institutions that sought to protect their customers' privacy, by contesting the validity and breadth of a subpoena, often became entangled in other people's litigation. Conversely, financial institutions that agreed to provide the requested infor-

210. 7 TEX. ADMIN. CODE § 3.27 (Jan. 12, 1988).

211. 758 S.W.2d 293, 295 (Tex. App.—Tyler 1988, no writ).

212. 7 TEX. REV. CIV. STAT. ANN. arts. 342-609 (Vernon 1989).

213. *Id.* These protections were not conferred upon credit unions.

214. *Id.*

215. *Id.*

216. TEX. REV. CIV. STAT. ANN. art. 342-705 (Vernon 1989).

The Office of Thrift Supervision (OTS) promulgated a regulation that would have governed disclosure of customer information by Federal Savings and Loan Associations (Federal S&Ls). 54 Fed. Reg. 5629 (1989). This regulation, which became effective December 15, 1989, would have preempted state law provisions from covering Federal S&Ls. The OTS, however, has indicated its intent to withdraw this regulation. See *OTS Plans to Withdraw Rule that Limits Release of Customer Information*, [Jan.-June] Banking Rep. (BNA) No. 54, at 628 (April 9, 1990).

mation became subject to causes of action based on common law rights of privacy.

Parties in disputes with financial institutions were also using demands for customer records as a weapon. The previous statute did not require the party requesting the records to cover all the costs entailed in record production.²¹⁷ Consequently, there was a tremendous shortfall between the time and expense associated with production of records and the amount that could be recouped from the party requesting such document production. Moreover, financial institutions were hesitant to expose their customers' affairs to adverse parties in litigation. Thus, financial institutions often settled lawsuits when they otherwise would not have been inclined to do so.

The Legislature responded to this problem by adopting procedures to obtain bank records.²¹⁸ These procedures differ depending upon whether the financial institution or the customer is a proper or necessary party to the proceeding.²¹⁹

a. Privacy

A financial institution need not disclose records of an individual who is not a party to a lawsuit unless both (i) a court orders production, and (ii) the financial institution obtains the customer's written consent.²²⁰ Unless a court orders otherwise, a party seeking the records of a customer, who is also a proper or necessary party to the litigation, must provide the customer with notice of the order, subpoena or request, in the manner provided by Rule 21a of the Texas Rules of Civil Procedure.²²¹ Such notice must be given at least ten days prior to the date upon which the financial institution must comply with the order, subpoena or request;²²² and the party must certify to the financial institution, at the time the order, subpoena or request is provided, that the customer has been served with or mailed a copy of the order, subpoena or request.²²³ Even with customer consent, the litigant must pay the costs of document production.²²⁴

In response to a notice of an order, subpoena, or request for disclosure, examination or production of customer records; customers can file a motion to quash or for protection from such production requests.²²⁵ A motion to quash or for protection must be verified.²²⁶ In addition, the motion to quash or for protection must be filed before the date set for disclosure and must be served on both the party requesting such records and the financial institution.²²⁷ Failure to file a motion to quash is deemed to be consent to the

217. The former article 342-705 only covered the reasonable costs of copying records.

218. TEX. REV. CIV. STAT. ANN. art. 342-705 (Vernon 1989).

219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.*

223. *Id.*

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

production request.²²⁸

The statute does not restrict the ability of a bank to use or disclose customer records, if such disclosure is: (i) in good faith and in the usual course of the institution's financial business, (ii) in the usual course of litigation affecting the institution's interests, or (iii) with the express or implied consent of the customer.²²⁹

Curiously, this provision of the statute refers to a bank rather than a financial institution. Accordingly, courts probably will be called upon to determine whether use of customer records by financial institutions other than banks was implicitly limited by the statute. Further, the statute does not restrict disclosures that might be required under federal law. The statute also does not apply to the investigation or prosecution of criminal offenses, requests for records by investigative committees of the Texas Legislature, or requests for records by the Texas Attorney General.

b. Costs

A litigant requesting the records of a customer must either pay the estimated costs of production in full in advance or post a cost bond in an amount sufficient to cover such expenses.²³⁰ Such expenses include costs of reproduction, postage, delivery and other expenses associated with requesting disclosure, obtaining consents for disclosure, or examining or producing records.²³¹ Accordingly, such costs now include lost employee time.

3. Statute of Frauds

The Legislature's amendments to the Statute of Frauds²³² were perhaps the highlight of its efforts to reduce the vulnerability of financial institutions to lender liability suits. Increasingly, banks have been required to defend suits for breach of oral commitments to lend funds. The *LeMaire* case,²³³ discussed earlier, originally resulted in a jury verdict against MBank Abilene, in the amount of \$100 million,²³⁴ because ANB's breach of an oral commitment to lend allegedly led to the demise of the plaintiffs' oil and gas company.

The amendments to the Statute of Frauds require a loan agreement,²³⁵ involving an amount in excess of \$50,000 to be both in writing and signed by either the party to be bound or such party's representative in order to be

228. *Id.*

229. *Id.*

230. *Id.*

231. *Id.*

232. Tex. S.B. 413, 71st Leg. (1989). The legislative history of the amendments noted the need to reduce the number of lender liability suits by providing certainty regarding when an agreement to lend must be in writing to be enforceable.

233. No. C14-86-00834-CV (Tex. App.—Houston [14th Dist], Apr. 6, 1989) (not yet reported).

234. The judgment was reduced to \$18 million on appeal.

235. The definition of the term "loan agreement" excludes credit card and open-ended consumer accounts. Tex. Bus. & Comm. Code Ann. § 26.02 (Vernon 1989).

enforceable.²³⁶ The amendments provide that *prior* and *contemporaneous* oral agreements may not be used to vary the terms of a written agreement that complies with the Statute of Frauds.²³⁷ In order to take advantage of the protections afforded by the amendments, a financial institution must both (i) cause the customer to execute a statement that details the requirements of the statute (this statement may be part of other transaction documents, such as the loan agreement) and (ii) conspicuously post notice in the lobby disclosing the applicability of the Statute of Frauds to oral agreements.²³⁸

The content of the statutory notice has created some confusion because it apparently contains a typographical error. According to the Statute of Frauds amendments, the notice is required to state that a written agreement "may not be contradicted by evidence of prior, contemporaneous or *subsequent* oral agreements of the parties."²³⁹ The operative provisions of the statute, however, are silent regarding the effect of subsequent oral agreements. According to State Senator Ike Harris, in a letter sent to the Commissioner for the Banking Department (the Commissioner), the discrepancy resulted because the bill was amended to delete the word "subsequent" in both the text of the statute and the notice provision but, mistakenly, the term was not deleted in the notice.²⁴⁰ According to the Senator, the Legislature will attempt to correct the error during the 1991 Legislative Session.²⁴¹ In the meantime, however, financial institutions must continue to use the statutory notice.

Two other aspects of the amendments are worth noting. First, the amendments to the Statute of Frauds take effect on September 1, 1989, but do not apply to loan agreements executed before but renewed or extended after that date.²⁴² Second, the original Senate version of the bill²⁴³ explicitly noted that the amendments to the Statute of Frauds did not apply to causes of action brought under the DTPA.²⁴⁴ The final version, however, makes no reference to DTPA actions.²⁴⁵ Consequently, the legislative history appears

236. *Id.*

237. *Id.*

238. *Id.* The notice must be prominently displayed in a manner that will "fully inform borrowers" of the statute's requirements. *Id.* The Statute of Frauds states that if the customer does not execute a statement regarding the statute's contents, then the statute's provisions do not apply. *Id.* The statute also requires a posted notice, but does not state that failure to post a notice will make the protections inapplicable. *Id.* Consequently, a penalty for failing to post the required notice may not be imposed.

The Finance Commission of Texas requires a notice, "which must be signed by both the borrower and the financial institution," to be enforceable against both parties. TEX. ADMIN. CODE § 3.34. It "can be in a separate document or incorporated in one or more of the documents constituting the loan agreement." *Id.* "The notice must be in type that is bold faced, capitalized, underlined or otherwise set out from surrounding written material so as to be conspicuous." *Id.*

239. TEX. BUS. & COMM. CODE ANN. § 26.02 (Vernon 1989).

240. Letter from O.H. "Ike" Harris to Commissioner Kenneth Littlefield (Aug. 9, 1989).

241. *Id.*

242. Tex. S.B. 413, 71st Leg. (1989).

243. *Id.*

244. TEX. BUS. & COM. CODE ANN. § 17.45 (Vernon 1983).

245. *Id.* § 26.02.

to support a Statute of Frauds defense to a DTPA action.

The Legislature's extensive efforts to amend the Statute of Frauds might well have been wasted. The amendments were intended to avoid judgments, such as the *LeMaire* decision, against financial institutions for breach of oral agreements. What if the amendments were in effect before the litigation in *LeMaire*? The *LeMaire* court held that the loan commitment at issue involved realty, and therefore, must have been in writing to be enforceable.²⁴⁶ Nonetheless, MBank Abilene was held liable because *LeMaire* had relied on ANB's oral representations.²⁴⁷ Thus, although the contract was required to be in writing, the court enforced the agreement on a promissory estoppel theory.²⁴⁸

The rationale for the *LeMaire* holding casts doubt upon the protections provided by the amendments to the Statute of Frauds. It is unusual for a financial institution to make oral loan commitments to new customers. Accordingly, breach of loan commitment cases invariably will arise with a prolonged relationship as a backdrop. Presumably, customers will be less justified in depending on oral commitments when financial institutions provide the new notices required under the Statute of Frauds. Nonetheless, if courts ignore the unenforceability of the underlying contract in order to impose liability based on promissory estoppel, then the protections intended to be provided by the amendments to the Statute of Frauds could prove illusory.

4. *Deceptive Trade Practices Act*

The Legislature also amended the DTPA to provide that any consumer, not merely a business consumer, may waive the protections afforded by the DTPA if the consumer:

- (a) is not in a significantly disparate bargaining position,
- (b) is represented by an attorney in obtaining goods (other than the consumer's principal residence) or services in exchange for consideration, paid or to be paid, that exceeds \$500,000, and
- (c) expressly waives application of the DTPA, in a written contract, executed by both the consumer and his attorney.²⁴⁹

B. *Supervision and Regulation*

1. *Enforcement*

a. *Director Qualification*

Section three of Senate Bill 962 amends the Texas Banking Code to prohibit an individual from serving as a director of a state bank if the bank has

246. No. C14-86-00834-CV (Tex. App.—Houston [14th Dist.] Apr. 6, 1989) (not yet reported).

247. *Id.* During the course of dealing between the parties, ANB had made and honored various oral loan commitments.

248. *Id.*

249. Tex. S.B. 437, 71st Leg. (1989).

charged off any of his *obligations* to the bank.²⁵⁰ Previously, the statute only disqualified directors when the bank held a charged off *note*.²⁵¹ A director now becomes disqualified when the obligation is charged off even if the director has fully complied with the terms of his agreement.²⁵²

b. Removal

The Commissioner's authority to remove individuals from their positions with a state bank has been significantly expanded. The Commissioner may serve notice of his intention to remove any individual who has violated a cease and desist order, committed certain unsafe or unsound banking practices at the bank, caused a "substantial financial loss or other damage" to another bank or "business institution,"²⁵³ demonstrated "personal dishonesty or a wilful or continuing disregard" for the other institution's safety or has demonstrated that he is unfit to continue serving the bank.²⁵⁴ The person then has ten days to respond to the notice or the removal action becomes final.²⁵⁵ Previously, the statute appeared to prevent a person from being removed unless the Commissioner first gave him written notice detailing the offensive conduct, presented his conclusions at a meeting of the bank's board of directors, and determined that such person was continuing to engage in the impermissible activities.²⁵⁶ Now, however, the Commissioner is empowered to issue an order immediately suspending a person from service.²⁵⁷

c. Conservatorship

The Legislature amended the Texas Banking Code to provide that the prior appointment of a supervisor for the bank is not a prerequisite for the appointment of a conservator. The statute had stated that the Commissioner could appoint a conservator if, "[a]fter the period of supervision," the Commissioner made certain determinations.²⁵⁸ Now, the Commissioner may appoint a conservator, at any time, if he determines the bank to be in an unsafe condition *and* "immediate and irreparable harm is threatened to the bank, its depositors or stockholders, or the public . . ."²⁵⁹

250. Tex. S.B. 962, 71st Leg. (1989).

251. TEX. REV. CIV. STAT. ANN. art. 342-405 (Vernon 1988).

252. Tex. S.B. 962, 71st Leg. (1989).

253. Presumably, the Commissioner could seek to remove an individual if the conduct that gave rise to grounds for removal occurred at a savings and loan association because the term "business institution," would include savings and loan associations.

254. Tex. S.B. 962, 71st Leg. (1989).

255. *Id.*

256. TEX. CIV. STAT. ANN. art. 342-412 (Vernon Supp. 1990); *see also* Tex. S.B. 962, 71st Leg. (1989) (Report of Financial Institution Committee). "The Banking Code appeared to require that an offending officer or director has violated a valid Cease and Desist Order before a removal action can be initiated." *Id.*

257. Tex. S.B. 962, 71st Leg. (1989).

258. TEX. REV. CIV. STAT. ANN. art. 342-801a, § 4 (Vernon Supp. 1990).

259. Tex. S.B. 962, 71st Leg. (1989) (emphasis added).

2. *Corporate Structure*

a. *Change of Domicile*

The Legislature also authorized state banks to change their domicile, upon consent of the Commissioner, to any location where that bank operates a branch.²⁶⁰ Previously, the change of domicile provisions for state banks mirrored the National Bank Act,²⁶¹ and thus, prohibited state banks from moving their domicile more than thirty miles.²⁶² The amendment provides state banks with flexibility in light of the advent of statewide branching in Texas. Conversely, national banks domiciled in Texas are still subject to the thirty mile restriction.

b. *Identification of Branch Facilities*

In order to avoid public confusion, state and national banks must identify their branch facilities.²⁶³ Signs and bank documents in use on or before September 1, 1989, must comply with this new article of the Texas Banking Code before June 1, 1990.²⁶⁴ A six-month extension may be granted in case of hardship.²⁶⁵

3. *Resolution of Failing and Failed Savings and Loan Associations*

The Legislature has enhanced the flexibility of state regulators to respond to potential or actual failures of savings and loan associations. The Texas Savings and Loan Commissioner (the S&L Commissioner) may approve a merger for an association in an unsafe condition if he believes approval is in the best interest of all concerned parties.²⁶⁶ Similarly, the legislature adopted a new provision that authorizes the S&L Commissioner to approve an application if he determines that the transaction's benefit to the public outweighs any anticompetitive effects.²⁶⁷ Previously, the S&L Commissioner could not approve a merger or reorganization if the transaction failed to meet any one of seven statutory considerations.²⁶⁸

4. *Reorganization of the Finance Commission*

The Finance Commission oversees the state authorities that regulate fi-

260. *Id.*

261. 12 U.S.C. § 30(b) (1988).

262. TEX. REV. CIV. STAT. ANN. art. 342-314 (Vernon Supp. 1990).

263. Tex. S.B. 1001, 71st Leg. (1989). State banks and national banks are prohibited from using any:

form of advertising, including a sign or printed or broadcast material, that implies or tends to imply that a branch facility is a separately chartered or organized bank. A sign at a branch facility and all official bank documents, including checks, cashier's checks, loan applications, and certificates of deposit, must bear the name of the principal bank and if a separate branch name is used must identify the facility as a branch.

264. *Id.*

265. *Id.*

266. Tex. S.B. 607, 71st Leg. (1989).

267. *Cf.* TEX. REV. CIV. STAT. ANN. art. 852a-10.03 (Vernon 1964 & Supp. 1990).

268. *Id.*

nancial institutions. Traditionally, the Finance Commission consisted of three separate divisions, one for banks, savings and loan associations, and consumer credit firms.²⁶⁹ Basically, the Finance Commission served as an advisory board.²⁷⁰ In 1989, the Legislature eliminated this division structure within the Finance Commission.²⁷¹

The Finance Commission now consists of nine individuals: two bank executives, two savings and loan association executives, and five individuals, including one certified public accountant not employed in the banking industry.²⁷² The Finance Commission is authorized to hire an executive director and staff personnel to aid in the conduct of the Commission's affairs.²⁷³ Another change is that the Finance Commission now must hold at least six regular public meetings, instead of the prior minimum of two, each year.²⁷⁴ The duties of the Finance Commission have not been materially changed. Instead, the Legislature is apparently attempting to provide the Finance Commission with the tools to perform its duties. Interestingly, the Legislature required the Finance Commission to study merging the Banking Department, the Savings and Loan Department, and the Office of the Consumer Credit Commissioner.²⁷⁵

III. CONCLUSION

In 1989, the banking industry in Texas continued to experience the dramatic and wrenching changes that have been the hallmark of the last few years. This survey reflects these developments. We can expect more of the same next year. Already, two new questions have been raised that will significantly affect the future course of banking law: (i) how will the Resolution Trust Company resolve the dozens of failed Texas thrift institutions and dispose of the billions of dollars in real estate and other assets under its control, and (ii) how will the Federal bank regulatory agencies administer the powers and the dictates contained in FIRREA? Undoubtedly, the answers to these questions and others will transform the business of banking and banking law during the 1990s.

269. TEX. REV. CIV. STAT. ANN art. 342-103 (Vernon Supp. 1990).

270. Tex. S.B. 607, 71st Leg. (1989).

271. *Id.*

272. *Id.*

273. *Id.*

274. *Id.*

275. *Id.*



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