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AFTER the tumultuous Texas bank failures and the decimation of the Texas real estate market, lenders, regulators, and borrowers litigated to collect, or avoid collection of, outstanding loans. During the past two years, opinions emanating from these disputes yielded significant new guidance for practitioners in the banking litigation arena. For example, the Texas supreme court issued no less than three opinions on usury. Further, the Fifth Circuit, federal district courts, and many of the Texas courts of appeal issued important opinions on the application of the Superpower Defenses, successor institution interest rates, the duty of good faith and fair dealing, commercial reasonableness, summary judgment practice and procedure, and assignments of rents. This Article summarizes and comments upon these and other developments in banking litigation law during the survey period.

I. FEDERAL DOCTRINES AND STATUTES

A. The D'Oench, Duhme Doctrine and 12 U.S.C. § 1823(e)

Texas state courts, as well as federal courts interpreting Texas law, have continued their broad application and interpretation of the Superpower Defenses available to federal receivers, including the D'Oench, Duhme doctrine1 and 12 U.S.C. § 1823(e),2 to extend protection to transferees of the FDIC, FSLIC and RTC. Use of these Superpower Defenses precludes borrowers' defenses to liability and claims on instruments based on pre-receivership acts. Several notable decisions during the survey period, however, limit the application of these Superpower Defenses.

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1. Overview of the D'Oench, Duhme Doctrine and Section 1823(e)

In D'Oench, Duhme & Co. v. FDIC, the United States Supreme Court fashioned a rule of estoppel prohibiting borrowers from asserting defenses or claims against the receiver of a failed institution based on oral or unrecorded agreements that attempt to vary the terms of written obligations. The D'Oench, Duhme doctrine "applies where the borrower is party to a scheme or agreement which would tend to either deceive or mislead the creditors of the bank or the bank examiners." The fact that the borrower may have been "innocent" or without intent "to deceive banking authorities or that the underlying transaction was not fraudulent" is simply not relevant to the application of the doctrine.

Section 1823(e), which supplements the D'Oench, Duhme doctrine, affords the FDIC comprehensive protection against any agreement which tends to diminish or defeat the FDIC's interest in any asset acquired by it unless such agreement: (1) is in writing, (2) was executed by the depository institution and the obligor contemporaneously with the acquisition of the asset, (3) was approved by the board of directors of the depository institution, and (4) has been continuously an official record of a depository institution.

Together, the "dungeon of Duhme" and section 1823(e) have created an almost impenetrable barrier shielding federal receivers from claims and defenses of borrowers in suits based on promissory notes and guaranties.

2. The Reach of the Superpower Defenses

Cases within the survey period confirm that the D'Oench, Duhme doctrine and section 1823(e) bar claims and defenses based on either (1) fraud, (2)
breach of an oral agreement, breach of the duty of good faith and fair dealing, breach of fiduciary duty, promissory estoppel, violations of the Texas Deceptive Trade Practices—Consumer Protection Act, (7) failure of consideration, (8) usury, negligent misrepresentation, (10) negligence, (11) alteration, (12) unjust enrichment, or (13) inadequate bid price or wrongful foreclosure.

3. Post-Judgment Application

In recent years, Texas state courts and federal courts have been divided on whether a federal receiver may assert the D'Oench, Duhme doctrine and section 1823(e) when the receiver is appointed after a judgment has been rendered against the failed institution. For example, in Olney Savings & Loan Ass’n v. Trinity Banc Savings Ass’n the Fifth Circuit held that a post-judgment federal receiver is not entitled to the protections of D'Oench, Duhme and section 1823(e). By contrast, the Dallas court of appeals has held that such a receiver may assert these federal protections. Both federal district courts and the First District court of appeals in Houston have aligned themselves with the Fifth Circuit’s position on this issue, as discussed below.

In First Republic Bank Fort Worth v. Norglass, Inc. the FDIC removed the action to federal court almost three months after judgment had been rendered against the failed institution. After intervention and removal, the FDIC filed motions for relief from the judgment and for summary judgment, which the federal district court denied. In urging its motions, the FDIC argued that section 212 of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) empowered the FDIC with the right to raise the Superpower Defenses for the first time after the entry of a final

11. See FDIC v. Hamilton, 939 F.2d 1225, 1229-31 (5th Cir. 1991); Bowen, 915 F.2d at 1017.
13. See Clay, 934 F.2d at 73; Bowen, 915 F.2d at 1017; Texas Country Living, 756 F. Supp. at 991.
14. See Bowen, 915 F.2d at 1017; Goldencrest Joint Venture, 761 F. Supp. at 34.
19. See Clay, 934 F.2d at 72; Texas Country Living, 756 F. Supp. at 988.
21. Id.
22. Id.
23. 885 F.2d 266 (5th Cir. 1989).
26. Id. at 1225.
judgment.\textsuperscript{27}

The federal district court, relying on \textit{Thurman v. FDIC}\textsuperscript{28} and \textit{Olney},\textsuperscript{29} held that the section of FIRREA upon which the FDIC relied did not endow the FDIC with new substantive rights entitling it to raise the Superpower Defenses for the first time on appeal. Moreover, relying on 12 U.S.C. § 1821(d)(13)(A) and (D), the court held that the “FDIC became statutorily obligated to abide by the [state court] judgment” once the state court judgment became a final unappealable judgment.\textsuperscript{30} Notably, the federal district court declined to address the Dallas court of appeals opinions in \textit{FDIC/Manager Fund v. Larsen}\textsuperscript{31} and \textit{FSLIC v. T.F. Stone—Liberty Land Associates},\textsuperscript{32} stating that “[f]or the most part, the opinions in those cases are devoid of sound reasoning.”\textsuperscript{33}

In \textit{Union Federal Bank v. Minyard}\textsuperscript{34} the Fifth Circuit allowed the FDIC to assert the \textit{D'Oench, Duhme} doctrine on appeal after the FDIC was appointed receiver subsequent to the entry of judgment in favor of the failed bank. Unfortunately, the Fifth Circuit merely cited the case of \textit{FDIC v. Castle},\textsuperscript{35} without discussion, and failed to address any of the relevant case law in

\textsuperscript{27} Id. at 1231. The pertinent portion of section 212 is found in 12 U.S.C. § 1821(d)(13), which provides:

\begin{enumerate}
\item[(13)] Additional rights and duties
\item[(A)] Prior final adjudication
\begin{itemize}
\item The Corporation [FDIC] shall abide by any final unappealable judgment of any court of competent jurisdiction which was rendered before the appointment of the Corporation as conservator or receiver.
\end{itemize}
\item[(B)] Rights and remedies of conservator or receiver
\begin{itemize}
\item In the event of any appealable judgment, the Corporation as conservator or receiver shall:
\begin{enumerate}
\item 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; and
\item not be required to post any bond in order to pursue such remedies.
\end{enumerate}
\end{itemize}
\item[(C)] No attachment or execution
\begin{itemize}
\item No attachment or execution may issue by any court upon assets in the possession of the receiver.
\end{itemize}
\item[(D)] Limitation on judicial review
\begin{itemize}
\item Except as otherwise provided in this subsection, no court shall have jurisdiction over:
\begin{enumerate}
\item any claim or action for payment from, or any action seeking a determination of rights with respect to, the assets of any depository institution for which the Corporation has been appointed receiver, including assets which the Corporation may acquire from itself as such receiver; or
\item any claim relating to any act or omission of such institution or the Corporation as receiver.
\end{enumerate}
\end{itemize}
\end{enumerate}


28. 889 F.2d 1441 (5th Cir. 1989).
29. 885 F.2d at 266.
32. 787 S.W.2d 475 (Tex. App.—Dallas 1990, writ dism’d).
33. 751 F. Supp. at 1232 n.5.
34. 919 F.2d 335 (5th Cir. 1990).
35. 781 F.2d 1101 (5th Cir. 1986).
The Dallas court of appeals has continued to follow its decisions in *Stone* and *Larsen*. In *FDIC v. F & A Equipment Leasing* the Dallas court of appeals, citing *Stone* and *Larsen*, held that the FDIC was entitled to raise the Superpower Defenses for the first time in an attempt "to eviscerate a Texas state court appealable judgment rendered before the receivership." In so holding, the court recognized that section 1821(d)(13)(B) of FIRREA "authorized the exercise of all rights and remedies available to the FDIC in the instance of appealable judgments." Because the subject judgment was an appealable judgment, the court found that the FDIC could assert the Superpower Defenses on appeal even though the defenses had not been raised at trial or preserved for review on appeal.

Conversely, the Houston First District court of appeals has held in two separate opinions that a federal receiver may not assert the Superpower Defenses for the first time on appeal. In both *Beach v. RTC* and *FDIC v. Golden Imports* the court rejected the opinions in *F & A Equipment Leasing, Stone*, and *Larsen*, recognizing that the rule set forth in those cases "is under scrutiny by the Texas supreme court." Accordingly, the Houston First District court of appeals chose to follow the opinions rendered by the federal courts "both because of their expertise in the application of federal law and because they have reached a fairer result."

4. Miscellaneous Cases of Import

Several other cases worthy of note impose various limitations on the *D'Oench, Duhme* doctrine. In *Cockrell v. Republic Mortgage Insurance Co.* the Dallas court of appeals held that a federally insured institution, which had acquired a potential liability through a FSLIC assisted merger with another institution, may not assert the *D'Oench, Duhme* doctrine. In *Cockrell*, Secor Bank, F.S.B. (Secor) merged with Coosa Federal Savings &

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36. Although outside these surveyed courts, a recent Fourth Circuit opinion warrants mentioning. In *FDIC v. Hadid*, Nos. 90-1825, 90-1844, 1991 WL 212997 (4th Cir. Oct. 23, 1991), the Fourth Circuit ruled that the FDIC could raise the Superpower Defenses "for the first time on appeal in circumstances where the FDIC succeeds to the bank's interest in a judgment in the bank's favor which the promisor seeks to avoid based on an oral understanding." *Hadid*, 1991 WL 212997, at *4 (emphasis added). The court thus distinguished cases in which the FDIC inherited a judgment in favor of the failed institution from those in which the FDIC inherited a judgment against the failed institution.

37. 787 S.W.2d at 475.

38. 793 S.W.2d at 37.

39. 800 S.W.2d 231 (Tex. App.—Dallas 1990, no writ).

40. *Id.* at 236 (citing *Stone*, 787 S.W.2d at 484-85).

41. *Id.*

42. *Id.*


46. *Id.*

47. 817 S.W.2d 106 (Tex. App.—Dallas 1991, n.w.h.).
Loan Association (Coosa) in a merger that the FSLIC financially assisted. Through the merger, Secor acquired eleven promissory notes that Cockrell executed. In a deficiency judgment action on the notes, Cockrell asserted the defense of fraud based on an alleged oral agreement with Coosa, whereby Coosa agreed that it would bid the note values of the properties securing the loans at foreclosure so that no deficiency would result in exchange for Cockrell's agreement that he would not file bankruptcy. Secor asserted that the D'Oench, Duhme doctrine barred this defense of fraud based on the oral agreement. Although the Dallas court of appeals recognized that the D'Oench, Duhme doctrine has been extended to purchasers and bridge banks of the FDIC, it nonetheless found that there were "no cases . . . where the D'Oench, Duhme doctrine has been used to protect a federally-insured institution where the institution, not the FDIC or FSLIC in a receivership capacity, acquired a potential liability, instead of an asset." 48 Moreover, the court held that "[t]he D'Oench, Duhme doctrine was crafted to aid the FDIC's ability to protect the assets of failed banks in purchase and assumption transactions" and "was not designed to let every lending institution escape liability for possible fraudulent acts of its officers." 49 Accordingly, the court declined to extend the existing parameters of the D'Oench, Duhme doctrine. 50

In Agri Export Cooperative v. Universal Savings Ass'n 51 the beneficiary of a letter of credit brought suit for wrongful dishonor of the letter of credit against Universal Savings Association which was under RTC receivership. In defense of the wrongful dishonor suit, the RTC urged that the D'Oench, Duhme doctrine and section 1823(e) barred recovery "since the letter of credit was neither approved by Universal Savings Board of Directors nor properly recorded in Universal's records." 52 The federal district court, however, finding that no secret or side agreements of any kind were involved, refused to apply either the D'Oench, Duhme doctrine or section 1823(e) to allow the RTC to avoid liability on the letter of credit. 53 In so holding, the court stated that "it is unlikely that D'Oench applies when the agreement that the insuring institution is trying to nullify is what might be characterized as a pure obligation of the failed bank or savings and loan association." 54 Moreover, the court recognized and applied the "completely innocent" exception to the D'Oench, Duhme doctrine. 55 Therefore, finding that the plaintiff was a completely innocent party with regard to the letter of

48. Id. at 114.
49. Id. at 115.
50. Id.
52. Id. at 827.
53. Id. at 832.
54. Id.
55. Id. (citing FDIC v. Meo, 505 F.2d 790, 793 (9th Cir. 1974)). The district court's application of the "completely innocent" exception is highly suspect in light of recent Fifth Circuit authority disavowing any requirement of the borrower's malfeasance, recklessness, or negligence under the D'Oench, Duhme doctrine. See Bower v. FDIC, 915 F.2d 1013, 1016-17 (5th Cir. 1990); Bell & Murphy & Assocs. v. InterFirst Bank Gateway, N.A., 894 F.2d 750, 753-54 (5th Cir.), cert. denied, 111 S. Ct. 244 (1990).
credit and that the letter of credit was not an asset of the failed institution, the court held that the D'Oench, Duhme doctrine did not apply to bar recovery on the letter of credit.\(^{56}\)

Two cases have refused to extend the application of the D'Oench, Duhme doctrine to bar defenses based on written agreements not found within the promissory note. In the first, \textit{FDIC v. Laguarta},\(^{57}\) the Fifth Circuit held that an obligation to fund found in a loan agreement, which was a separate document from the promissory note sued on, was not barred by the D'Oench, Duhme doctrine. In reaching its holding, the Fifth Circuit found that the loan agreement was "integral to the loan transaction."\(^{58}\) In that case, the FDIC did not contend that the loan agreement was "absent from the loan file or otherwise concealed."\(^{59}\)

In \textit{RTC v. Oaks Apartments Joint Venture}\(^{60}\) a federal district court similarly found that the limitations of the guarantors' liability on the promissory note, which were found within the written guaranty agreements themselves, were not barred by the D'Oench, Duhme doctrine. In that case, the guarantors executed guaranties contemporaneously with the promissory note, which limited their liability on the promissory note to a percentage of the amount owed. The RTC argued that the guarantors were estopped by the D'Oench, Duhme doctrine from asserting a limitation of their individual liability pursuant to the guaranties. The district court disagreed, holding that the guaranties did not constitute "a side agreement to reduce the value of an asset of a failed thrift."\(^{61}\) Therefore, the D'Oench, Duhme doctrine did not bar the guarantors from asserting their limited liability on the underlying promissory note.\(^{62}\)

\textbf{B. Federal Holder in Due Course Doctrine}

\textit{1. Holder in Due Course Doctrine and Variable Interest Rate Notes}

A crossroad is finally being reached as state and federal courts struggle with the inclusion of variable interest rate promissory notes within the protection of the federal holder in due course doctrine. The federal holder in due course doctrine has been frequently used to reject categorically a wide variety of personal defenses asserted by both borrowers and guarantors.\(^{63}\) Within the last several years, both the Fifth Circuit and Texas state courts have recognized federal holder in due course protection even when tradi-

\(^{56}\) 767 F. Supp. at 834.
\(^{57}\) 939 F.2d 1231 (5th Cir. 1991).
\(^{58}\) \textit{Id.} at 1239.
\(^{59}\) \textit{Id.}
\(^{61}\) \textit{Id.} at 1336.
\(^{62}\) \textit{Id.}
\(^{63}\) In Gunter v. Hutcheson, 674 F.2d 862 (11th Cir.), \textit{cert. denied}, 459 U.S. 826 (1982), the bench first recognized the federal holder in due course doctrine. The court relied upon principles of federal common law to protect the FDIC from ordinary fraud claims of which it lacks knowledge. \textit{Id.} at 869. Consequently, the court held that when the FDIC acquires a note in a purchase and assumption transaction for value, in good faith, and without actual knowledge of the fraud claim, it takes the note free of this claim. \textit{Id.} at 873.
tional holder in due course requirements under Texas state law have not been met. During the survey period, however, the Fifth Circuit first held that the owner of a non-negotiable promissory note, acquired in a bank failure transaction, did not enjoy federal holder in due course status.

In Sunbelt Savings, FSB v. Montross the borrower had executed and later defaulted upon what was described as a $1.1 million variable interest rate promissory note. Sunbelt Savings, the lender, foreclosed on the note's underlying security and brought suit against the borrower to recover the deficiency. The borrower offered the following personal defenses to the deficiency suit: "(1) Old Sunbelt prevented him from transferring the note to a new debtor as allowed by the deed of trust, thus, excusing his performance; and (2) as an affirmative defense, he satisfied the conditions in the deed of trust, thus, absolving him of personal liability for the note." Sunbelt Savings failed after it filed suit, and the FSLIC assumed control and established Sunbelt Savings, FSB. Sunbelt Savings, FSB then intervened as plaintiff and moved for summary judgment on the borrower's personal defenses. In response to the motion for summary judgment, the borrower asserted that "the federal holder in due course doctrine should not apply to the non-negotiable instrument at issue in this case and that he had either presented sufficient evidence to avoid summary judgment or had been denied the opportunity for effective discovery so as to do so." The federal trial court, however, held that the federal holder in due course doctrine applied to non-negotiable instruments, thereby barring the borrower's personal defenses as a matter of law, and granted Sunbelt Savings, FSB's motion for summary judgment.

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64. See Campbell Leasing v. FDIC, 901 F.2d 1244, 1249 (5th Cir. 1990); Smith v. FDIC, 800 S.W.2d 648, 651 (Tex. App.—Houston [14th Dist.] 1990, writ dism'd by agr.); NCNB Tex. Nat'l Bank v. Campise, 788 S.W.2d 115 (Tex. App.—Houston [14th Dist.] 1990, writ denied). Texas state law requires a "holder in due course" to be "a holder who takes the instrument (1) for value; and (2) in good faith; and (3) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person." TEX. BUS. & COM. CODE ANN. § 3.302(a) (Tex. UCC) (Vernon 1968). Texas state law, however, does not permit bulk transferees to enjoy holder in due course status. Id. § 3.302(c)(3).

65. Sunbelt Sav., FSB Dallas, Tex. v. Montross, 923 F.2d 353 (5th Cir.), reh'g granted en banc, 932 F.2d 363 (5th Cir.), and opinion reinstated in part per curiam sub nom. RTC v. Montross, 944 F.2d 227 (5th Cir. 1991).

66. Id. at 354.

67. Id.
On the borrower's appeal, a panel of the Fifth Circuit held that the federal holder in due course doctrine should not be extended to protect either the FDIC or its successor in cases in which it acquires non-negotiable instruments through purchase and assumption transactions. The panel reasoned that the court had never previously extended federal holder in due course status to non-negotiable instruments and that such extension was both unwarranted and undesirable. Although the Fifth Circuit recognized that existing federal law and policy considerations have afforded the FDIC protections "from being disadvantaged when it is forced to assume control of a troubled financial institution," the appellate court further recognized that "the nature of the assets the FDIC receives from the institutions remains unchanged." Because the court found that negotiability is not merely a technical requirement, but the foundation of Article Three and the holder in due course doctrine, and further found that non-negotiable instruments are only contractual agreements that do not enjoy holder in due course protections, the Fifth Circuit determined that extending the federal holder in due course doctrine to non-negotiable instruments would "bestow a benefit on the FDIC by changing the assets' nature—actually enhancing their value." Accordingly, the Fifth Circuit refused to engraft a significant and unintended benefit onto the federal holder in due course doctrine, stating:

Extending holder in due course status to the FDIC and its successors respecting non-negotiable instruments is both unnecessary and undesirable. When the FDIC assumes control of an institution, the assets are what they are — negotiable instruments, contracts, real property, and so on. We agree that the FDIC should not be disadvantaged by the circumstances of its assumption of control, but this policy does not require giving the FDIC the ability to transmute lead into gold. Allowing the FDIC to transform contracts into negotiable instruments would defeat the reasonable commercial expectations of the variable interest note makers. Carried only a little further, this transformation would affect all contracts and even the title to real property. Alchemy is the province of Congress; therefore, we decline to extend [the federal holder in due course doctrine] to non-negotiable instruments.

68. Id.
69. Id. at 356-57, 358.
70. See 923 F.2d at 356.
71. Id. The court specifically reiterated the protection of, inter alia, D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942) and 12 U.S.C. § 1823(e). Id.
72. Id.
73. Id. The Fifth Circuit further noted that makers of non-negotiable notes would have no expectation that the holder in due course doctrine "would strip them of their defenses," because such makers sign only a contractual obligation to repay the debt. 923 F.2d at 356.
74. Id. Since Montross, a federal district court held that the FDIC was a federal holder in due course of a variable interest rate promissory note. See FDIC v. Hershiser Signature Properties, 777 F. Supp. 539 (E.D. Mich. 1991). The court noted that it is "not clear that application of holder in due course principles to this case depends on a finding that the Note is negotiable." Id. at 542. The district court distinguished Montross because the parties in Montross had accepted that the note involved was not negotiable. The analysis in Hershiser Signature Properties appears to be more consistent with existing federal holder in due course authority and rationale than the initial panel decision in Montross.
Shortly after the panel announced its opinion, the Fifth Circuit granted a
rehearing of the panel decision en banc.\textsuperscript{75} After additional briefing and reargument of the case, the Fifth Circuit issued a two paragraph opinion reinstating the main holding of the panel.\textsuperscript{76} The court, however, expressed no position on the effect that a variable interest rate note would have on the issue of negotiability.\textsuperscript{77} In fact, the Fifth Circuit found that no issue regarding the negotiability of the note had been raised either at the trial court or on appeal, and thus held that Sunbelt Savings' subsequent contention that the note was negotiable "comes too late."\textsuperscript{78} Finally, the Fifth Circuit stressed the necessity that any defenses that the maker asserts be based on documents on file at the institution at the time of its insolvency.\textsuperscript{79}

Significantly, two other cases decided during the survey period directly addressed the inability of certain promissory notes to meet the sum certain requirement for negotiability. In \textit{RTC v. Oaks Apartments Joint Venture}\textsuperscript{80} the federal district court determined that a note for "the sum of TWO MILLION AND NO/100 DOLLARS ($2,000,000.00) or so much thereof as may be advanced . . . ." was not an obligation to pay a sum certain. The court refused to extend federal holder in due course protection to such a note. The court also stated that the stipulated facts submitted to the court did not clarify whether the note had been acquired in a purchase and assumption transaction.\textsuperscript{82} Further, in \textit{Dillard v. NCNB Texas National Bank}\textsuperscript{83} the Austin court of appeals held that a variable interest rate note was not a negotiable instrument and could not be transferred by indorsement. The courts thus seem to be scrutinizing the precise nature of the obligation sued upon in view of the expansive defenses available to a holder if the obligation is considered negotiable.

\textsuperscript{75} See Sunbelt Sav., FSB Dallas, Tex. v. Montross, 932 F.2d 363 (5th Cir. 1991) (en banc). Many practitioners believed that the court would take the opportunity to address the issue of whether a variable interest rate would render a promissory note non-negotiable. The argument sometimes made is that the variable interest rate prevents the note from being a negotiable instrument because it is not for a "sum certain." See \textit{TEX. BUS. \\& COM. CODE ANN. }§ 3.106 \\& cmt. 1 (Tex. UCC) (Vernon 1968) ("The computation must be one which can be made from the instrument itself without reference to any outside source, and this section does not make negotiable a note payable with interest 'at the current rate.' ").

\textsuperscript{76} See RTC v. Montross, 944 F.2d 227 (5th Cir. 1991) (per curiam).

\textsuperscript{77} \textit{Id.}

\textsuperscript{78} \textit{Id.} The court stated that "[t]he maker of the note gave other reasons for the note being non-negotiable, and the case was presented on the appeal with both parties accepting the non-negotiability of the note." \textit{Id.}

\textsuperscript{79} \textit{Id.}

\textsuperscript{80} 753 F. Supp. 1332 (N.D. Tex. 1990).

\textsuperscript{81} \textit{Id.} at 1337 n.2.

\textsuperscript{82} "Moreover, there is no evidence that the takedown was a purchase and assumption transaction rather than a liquidation or that knowledge of the limited liability of the individual partners would have made any difference in FDIC's consideration of the assets and liabilities of Meridian Savings Association [the failed institution]." \textit{Id.} at 1337.

\textsuperscript{83} 815 S.W.2d 356 (Tex. App.—Austin 1991, n.w.h.).

\textsuperscript{84} \textit{Id.} at 360.
2. The Effect of the Holder in Due Course Doctrine and the Courts' Limitation on its Application

Four other cases in the survey period illustrate the devastating effect of the application of the federal holder in due course doctrine upon a borrower, and further demonstrate the courts' attendant reluctance to apply this doctrine under certain circumstances. In Smith v. FDIC\(^8\) the Houston Fourteenth District court of appeals applied the federal holder in due course doctrine in affirming the grant of a summary judgment in favor of the FDIC as the holder of a note. In this case, the court used the federal holder in due course doctrine to dispose of the borrower's defense that a collateral sale of stock certificates was not conducted in a commercially reasonable manner.\(^6\)

Similarly, in FSLIC v. Cribbs\(^7\) the Fifth Circuit affirmed a summary judgment in favor of the assignee of the assets of two banks. In Cribbs the borrower alleged a typical shotgun of defenses,\(^8\) which the court summarily rejected by virtue of the federal holder in due course doctrine. The Fifth Circuit also approved the district court's entry of a protective order denying discovery until disposition of the summary judgment.\(^9\) In both cases, the courts rejected the borrower's defenses based solely on the federal holder in due course doctrine.

In Patterson v. FDIC,\(^9\) however, the Fifth Circuit discussed the limits of the federal holder in due course doctrine. The court did not apply the doctrine to the borrower's "real" defense that the real estate collateral for a loan was her homestead.\(^10\) More recently, in Beach v. RTC,\(^11\) the Houston First District court of appeals held that the RTC could not assert holder in due course status with respect to a judgment because a judgment is not a negotiable instrument.\(^12\) Moreover, this Texas appellate court declined to allow the RTC to raise the holder in due course defense for the first time on appeal despite other Texas appellate decisions to the contrary.\(^13\) These cases

\(^8\) 800 S.W.2d 648 (Tex. App.—Houston [14th Dist.] 1990, writ dism'd by agr.). No mention was made in the opinion whether the note was for a fixed or variable rate of interest.
\(^9\) Id. at 651-52.
\(^10\) 918 F.2d 557 (5th Cir. 1990).
\(^11\) The defenses and counterclaims included fraud in the inducement, usury, indemnity and contribution, fraud, and breach of fiduciary duty. Id. at 559.
\(^12\) Id. at 560.
\(^13\) Id. at 560.
\(^14\) 918 F.2d 480 (5th Cir. 1990).
\(^15\) Id. at 544. "Real" defenses recognized under the Uniform Commercial Code include infancy, incapacity, duress, illegality of the transaction, fraud in the factum, discharge in insolvency, and certain other types of discharge. See Tex. Bus. & Com. Code Ann. § 3.305 (Tex. UCC) (Vernon 1968).
\(^17\) Id. at *2.
\(^18\) Id. The court refused to follow four Dallas court of appeals decisions: FDIC v. F & A Equip. Leasing, 800 S.W.2d 321 (Tex. App.—Dallas 1990, writ granted); FDIC/Manager Fund v. Larsen, 793 S.W.2d 37 (Tex. App.—Dallas 1990, writ granted); FDIC v. Zoubi, 792 S.W.2d 825 (Tex. App.—Dallas 1990, no writ); FSLIC v. T.F. Stone—Liberty Land Assocs., 787 S.W.2d 475 (Tex. App.—Dallas 1990, writ dism'd). The court instead followed three federal cases: Thurman v. FDIC, 889 F.2d 1441 (5th Cir. 1989); Olney Savings & Loan Ass'n v. Trinity Bank Savings Ass'n, 885 F.2d 266 (5th Cir. 1989); First RepublicBank Fort Worth v. Norglass, Inc., 751 F. Supp. 1224 (N.D. Tex. 1990). Inasmuch as the Dallas court of ap-
demonstrate the courts' willingness to impose restraint on a federal judicial doctrine otherwise unfettered.

C. Removal Jurisdiction and Receiver Intervention

In Hickey v. NCNB Texas National Bank95 the federal district court addressed the effect of its order striking the FDIC-Receiver's intervention on the court's jurisdiction over the remaining claims among the parties. The plaintiff filed a lender liability lawsuit in state court based on pre-receivership acts against NCNB Texas National Bank (NCNB).96 The FDIC, as receiver for First Republic Bank of Fort Worth, N.A. (FDIC-Receiver), intervened in the state court action under Rule 60 of the Texas Rules of Civil Procedure, and removed the case to federal court pursuant to 12 U.S.C. § 1819(b)(2)(B). Subsequent to the removal, NCNB filed a motion for partial summary judgment on both its counterclaim and third-party complaint seeking recovery on a promissory note, and further filed a motion to dismiss the claims that the plaintiff had asserted against NCNB. The FDIC-Receiver also filed its motion for summary judgment with regard to the plaintiff’s pre-receivership based claims. The court granted NCNB's motion for partial summary judgment on the promissory note and dismissed all the plaintiff's claims against NCNB.97 The granting of NCNB's motion for partial summary judgment and motion to dismiss resolved all the claims among the parties to the litigation except for the FDIC-Receiver's motion for summary judgment.98 To finally resolve the litigation, the court signed an order striking the FDIC-Receiver's intervention.99

The FDIC-Receiver subsequently moved for reconsideration of the order striking its intervention, arguing that this order might render the court's previous orders granting NCNB partial summary judgment and dismissing the plaintiff's claims against NCNB void for lack of jurisdiction. The court summarily dismissed this argument. Because the state court did not strike the FDIC-Receiver's intervention, the federal district court determined that the FDIC-Receiver had the right to remove the case to federal court, and the action was therefore "deemed to have arisen under the laws of the United States."100 The court, therefore, rejected the FDIC-Receiver's argument regarding the potential retroactive loss of jurisdiction, holding that:

[As] long as FDIC-Receiver was an intervenor in this action, whether or not it should have been, this court had subject matter jurisdiction, with the consequence that there [could not] be a legitimate argument that the court did not have jurisdiction to make the adjudications that

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96. The plaintiff based his lender liability claims on the alleged acts and omissions of First Republic Bank Fort Worth, N.A., the failed bank. Id. at 899.
97. Id. at 897-98.
98. Id. at 898.
99. Id.
were made by the orders signed by the court . . . .\(^{101}\)

The *Hickey* opinion further criticized the FDIC-Receiver for its intervention in the state court action for the apparently sole purpose of exercising the “FDIC-Receiver’s federal jurisdiction status and removal power.”\(^{102}\) Although the court recognized the FDIC-Receiver’s procedural right under state law to intervene,\(^{103}\) it held that the FDIC-Receiver was not an intervenor of right under Rule 24(a)(2) of the Federal Rules of Civil Procedure:

Even if the court were to assume that FDIC-Receiver claims an interest relating to the transactions, by virtue of the fact that it could become liable if the plaintiff were to chose to sue it with respect to the transactions upon which plaintiff sued NCNB, nevertheless FDIC-Receiver did not satisfy the second Rule 24(a)(2) test because nothing in the record of this case would suggest that FDIC-Receiver was so situated when it intervened that the disposition of the claims asserted by plaintiff against NCNB . . . “may as a practical matter impair or impede [FDIC-Receiver’s] ability to protect its interest.”\(^{104}\)

The court instead found that this action could have affected the FDIC-Receiver adversely only because the FDIC-Receiver had intervened, thereby inviting the plaintiff to assert claims against it.\(^{105}\) Significantly, the premise of the court’s holding was that the plaintiff had not brought suit against either the FDIC-Receiver or the failed bank.\(^{106}\)

This same federal district court once again addressed the issue of the FDIC-Receiver’s removal power and intervention in *Bank One, Texas, N.A. v. Elms*.\(^ {107}\) In *Elms* Bank One, Texas, N.A. (Bank One) sought recovery of the balance owed on a promissory note from the defendant and the defendant filed various lender liability counterclaims, based on pre-receivership acts, against Bank One.\(^ {108}\) The FDIC, as receiver for MBank Fort Worth, N.A., intervened in and removed the state court action. Like *Hickey*, the defendant in *Elms* asserted no cause of action against either the failed bank or the FDIC-Receiver.\(^ {109}\) The *Elms* opinion results from the defendant’s motion to remand and the court’s *sua sponte* consideration of the propriety of the FDIC-Receiver’s intervention in the state court litigation.\(^ {110}\)

As in *Hickey*, the *Elms* opinion criticized the FDIC-Receiver for intervening for the mere purpose of removing the action to federal court.\(^ {111}\) How-

\(^{101}\) Id.

\(^{102}\) Id. at 899-900.

\(^{103}\) See id. at 898.

\(^{104}\) Id. at 899 (quoting Fed. R. Civ. P. 24(a)(2)).

\(^{105}\) 763 F. Supp. at 899.

\(^{106}\) Id. at 897-99. Notably, the court found unpersuasive Pernie Bailey Drilling Co. v. FDIC, 905 F.2d 78 (5th Cir. 1990), “because there the suit had been brought against the failed bank, not the bank that had entered into a purchase and assumption agreement with the failed bank, as had NCNB.” Id. at 899.


\(^{108}\) The defendant sought monetary damages from Bank One based on the alleged conduct of MBank Fort Worth, N.A., the failed bank, and its predecessor. Id. at 87.

\(^{109}\) Id.

\(^{110}\) Id. at 86.

\(^{111}\) Id. at 88.
ever, the court once again held that, because the FDIC-Receiver’s “procedurally correct” intervention had “not been stricken or dismissed [by the state court], FDIC [was] a party to the action, with the consequence that the litigation ‘shall be deemed to arise under the laws of the United States.’”112 Hence, the court’s subject matter jurisdiction depended on neither the presence of a federal defense nor diversity of citizenship.113 The court further found that the FDIC-Receiver timely removed the action, holding that the thirty-day time period for filing notice of removal begins to run from the date of intervention,114 following Addison Airport v. Eagle Investment Co.115

The court, sua sponte, further examined the propriety of the FDIC-Receiver’s intervention pursuant to Rule 24(a) of the Federal Rules of Civil Procedure,116 and concluded “that there is no valid reason why FDIC should enjoy the status of intervenor in this action.”117 In examining the propriety of the FDIC-Receiver’s intervention in Elms, the court addressed the FDIC-Receiver’s potential indemnification obligations.118 Although recognizing the FDIC-Receiver’s potential liability to Bank One if Bank One were held liable for a claim made against it based on the failed bank’s conduct, the court stated that “this indemnification obligation can never be a reality in this action because, as a matter of law, Elms has no right of recovery from Bank One on the counterclaim he has asserted against Bank One.”119 The court thus characterized the FDIC-Receiver’s interest in the litigation as “insubstantial.”120 The court also found that the FDIC-Receiver’s interest was contingent at best, rather than direct as required by Rule 24(a)(2).121 Specifically, the court stated that the FDIC-Receiver could have potential direct liability in the lawsuit, and thus satisfy the re-

112. 764 F. Supp. at 87-88 (quoting 12 U.S.C. § 1819(b)(2)(A)). “[T]here is no question that under state law [the FDIC] had the procedural right to intervene and did so in a procedurally correct manner.” Id. at 87 & n.3 (citing Tex. R. Civ. P. 60)).
113. Id. at 88.
114. Id.
116. See 764 F. Supp. at 88-89. The court stated:

There is no statute of the United States that confers an unconditional right on FDIC to intervene in this action. Thus, for FDIC to be entitled to the status of intervener of right, the following requirements must be met: (1) the step taken by FDIC to intervene must have been timely, (2) FDIC must have an interest relating to the property or transaction which is the subject of the action, (3) FDIC must be so situated that the disposition of the action may, as a practical matter, impair or impede its ability to protect that interest, and (4) FDIC’s interest must be inadequately represented by the existing parties to the suit. If any of those requirements is not met, the intervention of FDIC is not “of right”, and is subject to being dismissed.

Id. at 89 (citation omitted).
117. Id. at 90.
118. Id. at 89.
119. Id. Notably, the court’s statement regarding Bank One’s non-liability to the defendant on his counterclaims is merely dicta; the Elms opinion is devoid of any reference to a dispositive motion on the defendant’s counterclaims before the federal district court.
120. 764 F. Supp. at 89.
121. Id. (citing Travelers Indem. Co. v. Dingwell, 884 F.2d 629, 638 (1st Cir. 1989); Restor-A-Dent Dental Lab. v. Certified Alloy Prods., 725 F.2d 871, 874 (2d Cir. 1984)).
requirements of Rule 24(a)(2), only if another party to the action asserted a cause of action against the FDIC-Receiver or if the "FDIC itself creates claim or issue preclusion as to it by virtue of its intermeddling in the action." Accordingly, the court held that the FDIC-Receiver did not have an interest relating to the property or transaction which is the subject of the action, under Rule 24(a)(2). For these same reasons, the court also held that the "FDIC [was] not so situated that the disposition of the action [might], as a practical matter, impair or impede its ability to protect any interest it [had]," as required by Rule 24(a)(2). Finally, the court held that the FDIC-Receiver failed to satisfy the requirement of Rule 24(a)(2) relating to inadequate representation of its interest by existing parties to the lawsuit. The court dismissed the FDIC-Receiver's intervention, thereby destroying the court's subject matter jurisdiction, and remanded the case to the state court from which it was removed.

In both *Hickey* and *Elms* the borrower asserted claims based on the alleged conduct of the failed banks against the successor banks, rather than against the failed banks themselves or the FDIC in its receivership capacity. As a direct result, the court in *Elms* and *Hickey* held that the FDIC-Receiver's intervention in these actions lacked substantive propriety under Rule 24(a)(2) of the Federal Rules of Civil Procedure. Specifically, the court found that the FDIC-Receiver would not be adversely affected or directly liable for the pre-receivership based claims unless either the FDIC-Receiver or the failed bank was a party to the suit; and thus the FDIC-Receiver's interest in the litigation's subject matter was too remote. In so doing, the

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122. 764 F. Supp. at 89. The court cited no authority for its absolute construction of what constitutes "direct interest" as applied to the FDIC-Receiver. In fact, both *Travelers Indemnity Co.* and *Certified Alloy Products* acknowledged that this requirement of Rule 24(a)(2) defies a simple, precise, and authoritative definition. See *Travelers Indem. Co.*, 884 F.2d at 638; *Certified Alloy Prods.*, 725 F.2d at 874.

123. See 764 F. Supp. at 89.

124. Id.

125. Id. at 89-90.

126. Id. at 90.

127. *Contra* NCNB Tex. Nat'l Bank v. Hopkins, No. CA3-90-2843-D, slip op. at 4-5 (N.D. Tex. Jan. 17, 1991) (Fitzwater, J.). In *Hopkins* NCNB brought suit in state court to recover on notes and guaranties that the defendants executed originally in favor of First RepublicBank Dallas, N.A. (FRB). *Id.* at 1. FRB was declared insolvent and the FDIC was appointed as receiver. *Id.* at 1-2. NCNB obtained the notes and guaranties subject to the terms of a purchase and assumption agreement with the FDIC, which did not require NCNB to assume liability for claims based on FRB's conduct. *Id.* Further, the indemnity agreement between the FDIC and NCNB required the FDIC to indemnify NCNB for all pre-receivership claims. *Id.* at 2. Notably, the agreements between the FDIC and NCNB were identical to the agreements between these same entities in *Hickey*.

When the defendant counterclaimed against NCNB based on the alleged conduct of FRB, the FDIC-Receiver intervened in and removed the state court action. No. CA3-90-2843-D, slip op. at 2. Like both *Hickey* and *Elms*, the defendants asserted no claims against either the FDIC-Receiver or FRB. *Id.* In federal court, the defendants filed, *inter alia*, a motion to remand and a plea in intervention. *Id.* at 1. Because the defendants counterclaims were based on FRB's conduct, the defendants' sought declaratory interpretation of the purchase and assumption agreement, and the FDIC was required to indemnify NCNB under the purchase and assumption agreement's terms, Judge Fitzwater held that the FDIC was both a proper counter-defendant and a real party in interest. *Id.* at 3-4. The court, therefore, denied the
court apparently accorded little weight to or failed to fully appreciate the FDIC-Receiver's liability to the successor banks for successful pre-receivership based claims under the indemnity agreements between FDIC-Receiver and the successor banks. Regardless of whether the borrower asserts such claims against the successor bank, the FDIC-Receiver is the only entity liable for the claims based on the failed bank's conduct, and thus possesses a real and substantial interest in the disposition of these claims.128

Although the federal district court stated that the FDIC-Receiver had no justification to intervene other than to remove the state court action, perhaps the federal district court's strongest motivation for its striking the FDIC's intervention rests in its finding that the successor banks were not liable as a matter of law for the borrowers' pre-receivership based claims. Regardless, form over substance seems to have prevailed in both the Hickey and Elms opinions.

A final noteworthy case in the removal arena is Prince George Joint Venture v. Sunbelt Savings F.S.B.129 In that case, the court held that 12 U.S.C. § 1821(d)(12) conveyed upon the FDIC and the RTC an absolute right to a 90-day stay of litigation when requested by the receiver.130 Moreover, the court found that the receiver may request and receive the stay at any time after appointment.131

D. Bank Tying

Only one case during the survey period involved claims arising under the federal bank tying statutes.132 The Houston Fourteenth District court of defendants' motion to remand. Id. at 4. Judge Fitzwater further upheld the FDIC-Receiver's intervention under Rule 24(a)(2), stating in relevant part:

The FDIC is the only party liable for claims based on FRB's conduct and is therefore the only party able to defend against the above claims. NCNB is concerned with recovery on the notes and guaranties. The FDIC is concerned with interpretation of the [purchase and assumption agreement] and the alleged actions of FRB.

No. CA3-90-2843-D, slip op. at 5.

128. Cf. Pernie Bailey Drilling Co. v. FDIC, 905 F.2d 78, 80 (5th Cir. 1990). In Pernie Bailey Drilling Co. the Fifth Circuit stated:

We are not convinced by Pernie Bailey's assertion that FDIC is not a party to the case. The designation of FDIC as a proper party stems in part from its obligation to indemnify NCNB under the terms of the P & A Agreement. After assignment, NCNB became the proper party to sue on the notes, but even so, FDIC is entitled to defend a claim for rescission. Although the notes were assigned before removal, the FDIC remained the proper party to defend all claims for damages against the closed bank.

Id.


130. Id. at 134.

131. Id. at 135.


The borrower-plaintiff, a hardware store, alleged that the bank-defendant failed to fund a $100,000 loan needed to finance seasonal inventory. When the loan did not fund, the hardware store closed and filed suit. The trial court granted a directed verdict on the claims arising under the bank tying statutes, the Texas Deceptive Trade Practices—Consumer Protection
appeals affirmed a grant of directed verdict in favor of a bank on the tying claims. The essence of the borrower's claim was that the bank required the borrower to maintain an exclusive banking arrangement with the bank defendant. The court of appeals analyzed the three elements required to establish a bank tying claim, and found that the borrower's evidence was insufficient and that the directed verdict in favor of the bank on the tying issue was proper. In finding in favor of the bank, the court held that "it is normal and traditional practice for a prospective borrower to keep with the lending bank its business deposits and for the bank to protect its investment by imposing restrictions on borrowing by the debtor from other concerns."

E. Prudential Mootness and Exhaustion of Remedies

1. Prudential Mootness

The federal bench continues to recognize and apply the prudential mootness doctrine to dismiss actions, including counterclaims, filed against failed institutions without assets to satisfy a monetary judgment. A Federal Home Loan Bank Board determination that the failed institution is insolvent and that liquidation of the institution's assets would leave none available for unsecured creditors virtually assures dismissal on mootness grounds. Further, one federal district court found that the failed institution was precluded under the applicable purchase and assumption agreement from ever obtaining assets in the future from which the claimant could collect. The statutory cap on the maximum liability a claimant could recover also may

133. Id. at 238.
134. Id.
135. The court identified these elements as: (1) the practice in question must benefit the bank; (2) the practice must be unusual in the banking industry; and, (3) the practice must involve an anti-competitive tying arrangement. Id. (citing Rae v. Union Bank, 725 F.2d 478, 480 (9th Cir. 1984); FDIC v. Eagle Properties, 664 F. Supp. 1027, 1054 (W.D. Tex. 1985)).
136. 810 S.W.2d at 238.
138. See FDIC v. Browning, 757 F. Supp. 772 (N.D. Tex. 1989). In Triland Holdings & Co. v. Sunbelt Service Corp., 884 F.2d 205 (5th Cir. 1989), the Fifth Circuit recognized the viability of the prudential mootness doctrine. In Browning the failed institution filed a collection action on notes and guaranties. The defendant counterclaimed for fraud, breach of fiduciary duty, declaratory judgment, and usury. See 757 F. Supp. at 772 n.1. The federal district court found that no assets of the failed institution would ever be available to the defendant even if he prevailed on his counterclaims, because the failed institution was insolvent and the liquidation of that institution's assets would leave none available for the unsecured creditors. Id. at 773. Accordingly, the court dismissed the defendant's counterclaims on the basis of prudential mootness in light of the Fifth Circuit's opinion in Triland Holdings & Co. See id.
139. See Browning, 757 F. Supp. at 773. In Browning the court noted that this determination with regard to Old Sunbelt, the failed institution, was "undisputed." Id. How a litigant could challenge such a determination is not readily apparent from a reading of the Browning opinion, or otherwise.
140. Id.
eliminate the ability of the court to render any monetary judgment against the receiver of the failed institution. Consequently, a failed institution's inability to satisfy a judgment resulting from claims asserted against it offers a clear basis for the dismissal of these claims.

2. Exhaustion

A claimant must follow the administrative claims procedure to pursue litigation against the FDIC acting as receiver of a failed financial institution. Otherwise, a litigant faces a significant risk that a court will dismiss the claim for failure to exhaust administrative remedies. For example, in United Bank of Waco, N.A. v. First Republic Bank Waco, N.A. the federal district court dismissed counterclaims asserted against the failed institution because the claimant failed to file an administrative claim. When litigating with institutions in receivership, a claimant, therefore, must take special care to comply with the unique statutory framework and common law doctrines that operate to protect the government and the failed institutions.

II. LENDER LIABILITY

A. Usury

I. What Constitutes “Interest”

The Texas supreme court clarified the definition of “interest” under the Texas usury statutes twice during the survey period. In Briones v. Solomon, the court relied upon the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 212, 103 Stat. 242, codified at 12 U.S.C. § 1821(i)(2) (1988 & Supp. II 1990), which limits the claimant's recovery to the amount received in a liquidation. Because the court found nothing would be obtained in a liquidation, the court concluded that it could not enter a judgment against the receiver of the failed institution. Id. at 773.

This procedure does not prevent a litigant from filing suit if both the administrative claim is filed and the statutory framework is followed. The claims procedure was revamped in light of the United States Supreme Court's opinion in Coit Independence Joint Venture v. FSLIC, 489 U.S. 561 (1989).

141. In Browning the court relied upon the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 212, 103 Stat. 242, codified at 12 U.S.C. § 1821(i)(2) (1988 & Supp. II 1990), which limits the claimant's recovery to the amount received in a liquidation. Because the court found nothing would be obtained in a liquidation, the court concluded that it could not enter a judgment against the receiver of the failed institution. Id. at 773.

142. The claims procedure is set out in 12 U.S.C. § 1821(d)(5)-(14) (1988 & Supp. II 1990). This procedure does not prevent a litigant from filing suit if both the administrative claim is filed and the statutory framework is followed. The claims procedure was revamped in light of the United States Supreme Court's opinion in Coit Independence Joint Venture v. FSLIC, 489 U.S. 561 (1989).

143. See, e.g., United Bank of Waco, N.A. v. First Republic Bank Waco, N.A., 758 F. Supp. 1166, 1168 (W.D. Tex. 1991) (granting FDIC's motion to dismiss because the bank had not first filed a claim with the FDIC as required by FIRREA); Circle Indus. v. City Fed. Sav. Bank, 749 F. Supp. 447, 455 (E.D.N.Y. 1990) (holding that the district court had no jurisdiction because Circle Industries had not first filed claims before the RTC), aff'd, 931 F.2d 7 (2d Cir. 1991); Patrick T. Frawley & Assocs. v. City Fed. Sav. Bank, No. 90-2060, 1990 WL 63546, at *3 (E.D. Pa. May 9, 1990) (holding that the court had no jurisdiction over plaintiffs' claims due to plaintiffs' failure to exhaust administrative remedies).


145. Id. at 1168. The failed bank interpled funds into the court's registry to determine ownership of a savings account between two claimants. Id. at 1166. One of the claimants asserted interpleader claims against the failed institution for violations of the Texas Deceptive Trade Practices—Consumer Protection Act and negligence. Id. Several notices of the bank's closing and the claim bar date were served on the failed bank's creditors, and the claimant was personally served with notice. Id.


Article 5069-1.01(a) of the Texas Revised Civil Statutes defines "interest" as "the compensation allowed by law for the use or forbearance or detention of money; provided however, this
A judgment debtor asserted a claim for usury against a judgment creditor who had demanded an excessive amount of post-judgment interest from the judgment debtor. The trial court found in favor of the judgment debtor and assessed statutory usury penalties against the judgment creditor. The San Antonio court of appeals, however, held that no evidence existed of the use, forbearance, or detention of money loaned necessary to a finding of both statutory interest and usury, and reversed the trial court’s ruling.

On further appeal, the Texas supreme court held that the Texas statutory definition of interest contemplates post-judgment interest, and thus the Texas usury statutes apply to a demand for post-judgment interest. Significantly, the supreme court further dismissed the appellate court’s conclusion that "an actual loan of money" was necessary "to trigger the usury laws' and therefore the definition of 'interest' had to include it." The supreme court noted that the current statutory definition of interest does not require a contract to loan money, and that such a restrictive requirement "would conflict with decisions by this court applying the usury penalties in other cases involving other types of debt.

In *Victoria Bank & Trust Co. v. Brady* the debtors asserted a counterclaim for usury against the lender on the basis that the lender required the debtors to assume a third-party’s debt to a different lender as a condition of the lender’s extension of credit to the debtors. Relying on *Alamo Lumber Co. v. Gold*, the appellate court held that the lender charged usurious interest when it required the debtors to assume the third-party’s debt to a different lender as a prerequisite to the loan. The Texas supreme court,

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148. Id.
150. See 35 Tex. Sup. Ct. J. at 92-94 (construing TEX. REV. CIV. STAT. ANN. art. 5069.101(a) (Vernon 1987)).
151. Id. at 93 (quoting Briones, 805 S.W.2d at 918). Prior to the Texas supreme court’s opinion, courts had identified the elements of usury as: (1) a loan of money, (2) an absolute obligation to repay, and (3) the exaction of greater compensation than allowed by law for the use, forbearance, or detention of the money. E.g., Najarro v. SASI Int’l, 904 F.2d 1002, 1005 (5th Cir. 1990); RTC v. Oaks Apartments Joint Venture, 753 F. Supp. 1332, 1337 (N.D. Tex. 1990); Holley v. Watts, 629 S.W.2d 694, 696 (Tex. 1982); Myles v. RTC, 787 S.W.2d 616, 617 (Tex. App.—San Antonio 1990, no writ).
153. Id. at 94 (citing Steves Sash & Door Co. v. Ceco Corp., 751 S.W.2d 473 (Tex. 1988); Preston Farm & Ranch Supply v. Bio-Zyme Enter., 625 S.W.2d 295 (Tex. 1981); Houston Sash & Door Co. v. Heaner, 577 S.W.2d 217 (Tex. 1979)).
154. 811 S.W.2d at 931.
155. 661 S.W.2d 926 (Tex. 1983). In *Alamo Lumber Co.* the Texas supreme court held that "a lender who requires as a condition to making a loan, that a borrower assume a third party's debt, as distinguished from a requirement that the borrower pay another one of his own debts, must include the amount of the third party's debt in the interest computation." Id. at 928.
156. 811 S.W.2d at 936.
however, determined that Alamo and its supporting authority\textsuperscript{157} were inapplicable when a lender requires that the borrower assume the third-party's debt to a different lender.\textsuperscript{158} The supreme court instead found that such a requirement is akin to either a bona fide charge or fee, and thus does not constitute interest under the Texas usury laws.\textsuperscript{159} Because the lender had no connection with the other lender and did not receive the monies that the debtor paid to the other lender on behalf of the third-party, the Texas supreme court held that the third-party's debt to the other lender did not constitute interest under the Texas usury statutes.\textsuperscript{160}

2. Whether Pleadings May Constitute a "Charge" for Usurious Interest

During this survey period, jurists have disagreed whether a demand for unlawful interest in a pleading may constitute a "charge" for usurious interest,\textsuperscript{161} thereby subjecting the pleader to liability under the Texas usury statutes.\textsuperscript{162} The Texas supreme court, however, has recently resolved much of

\textsuperscript{158} 811 S.W.2d at 936.
\textsuperscript{159} Id. at 936-37. The court reiterated the characterization of fees and charges as set forth in Sapphire Homes, Inc. v. Gilbert:

"Lenders often require borrowers to pay expenses incurred by the lenders in connection with loans, such as title policy premiums, recording fees, costs of supplemental abstracts and attorneys' fees. When such expenses are actually incurred and they are paid in good faith to those furnishing the services, and no part of the payment is received by the lender, they are not properly classified as interest in determining whether the loan is usurious."

Id. at 936 (quoting Sapphire Homes, Inc. v. Gilbert, 426 S.W.2d 278, 284 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.)).
\textsuperscript{160} Id. at 937.
\textsuperscript{161} Compare Carpet Serv. v. George A. Fuller Co., 802 S.W.2d 343, 345 (Tex. App.—Dallas 1990, writ granted) (en banc) (a divided appellate court held that "a demand for interest in violation of the limits fixed by the usury statutes, which demand is contained in a pleading, is not, by itself, a 'charging' of interest at statutorily forbidden rates."). aff'd No. D-0791, 1992 WL 12622 (Tex. Jan. 30, 1992) with RTC v. Oaks Apartments Joint Venture, 753 F. Supp. 1332, 1338 (N.D. Tex. 1990) (noting that "a petition or other pleading may constitute a usurious charge" and citing cases in support thereof); Sumrall v. Navistar Fin. Corp., 818 S.W.2d 548, 553-54 (Tex. App.—Beaumont 1991, no writ) (disagreeing with the Dallas court of appeals' rationale in Carpet Services "because it is based on the erroneous assumption that a claim by a creditor in a legal action is not a demand for payment directed to a debtor but, rather, is a demand upon the court"); cf. Haralson v. E.F. Hutton Group, 919 F.2d 1014, 1040 (5th Cir. 1990) (holding that plaintiff could not assert usury claim against lender based on lender's pleadings because she was not an "obligor" under the Texas usury statute).

this dispute in *George A. Fuller Co. v. Carpet Services*.

In *Carpet Services* a subcontractor brought a breach of contract suit against a contractor for failure to pay for the subcontractor's work. In its original petition, the subcontractor pleaded for a legal rate of prejudgment interest during interest-free periods. Because the trial court determined that the subcontractor's charge of interest did not result from either accident or bona fide error, the trial court held that the subcontractor's original petition contained a usurious charge of interest. Accordingly, the trial court held that the subcontractor forfeited all monies due it under the contract and further assessed a statutory penalty for usury against the subcontractor.

On appeal, the subcontractor contended that "a demand for interest at a usurious rate which is contained in a pleading should not be considered as the 'charging' of usurious interest as forbidden by statute." A divided en banc Dallas court of appeals agreed with the subcontractor's contention and held that a demand for usurious interest contained in a pleading is not, by itself, a charging of interest under the Texas usury statutes.

In its first ruling on this issue, the Texas supreme court affirmed the appellate court's decision and held "that a pleading asserting a claim for prejudgment interest for a period when no interest is due does not constitute a 'charge' of usurious interest for purposes of the Texas usury statute." The supreme court offered the following rationale in support of its holding.

First, the supreme court found that "neither the statute nor the statement of legislative intent mandates a holding that pleadings can constitute a charge of interest." Specifically, article 5069-1.06 of the Texas Revised Civil Statutes does not define a charge of interest, and the declaration of legislative intent provides no indication "that the legislature intended that the usury laws be applied to pleadings.

164. Id. at *1.
165. Id.
166. 802 S.W.2d at 344.
167. Id. at 344-45. In so holding, the Dallas court of appeals overruled Moore v. White Motor Credit Corp., 708 S.W.2d 465 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) and Rick Furniture Distributing Co., 634 S.W.2d 738 (Tex. App.—Dallas 1982, writ ref'd n.r.e.).
168. 1992 WL 12622, at *1-2. Notably, the supreme court did "not address the question presented by pleadings that claim other types of interest based on underlying documents that are usurious." Id. at *2 n.1.
169. Id. at *2.
170. Id. at *1 (construing TEX. REV. CIV. STAT. ANN. art. 5069-1.06(1) (Vernon 1987)).
171. Id. at *2. The supreme court focused on the express language of the declaration:

"It is the intent of the Legislature in enacting this revision [of the statute on interest] to protect the citizens of Texas from abusive and deceptive practices now being perpetrated by unscrupulous operators, lenders and vendors in both cash and credit consumer transactions . . . and thus serve the public interest of the people of this State."
The court next distinguished the facts and holding of Moore v. Sabine National Bank 172 from Carpet Services.173 In Sabine National Bank the Austin court of appeals held that the bank's notice of intention to repossess, original petition, and sequestration affidavit constituted a charge of interest under articles 5069-8.01 and 8.02 of the Texas Revised Civil Statutes.174 Unlike Carpet Services, the Austin court of appeals was not confronted with the issue of whether a demand for prejudgment interest in a pleading alone constitutes a charge of interest.175 Accordingly, the Texas supreme court criticized those appellate opinions that, in misplaced reliance upon Sabine National Bank, held a pleading for usurious prejudgment interest, by itself, is a usurious charge.176 The supreme court, therefore, found that the Dallas court of appeals "properly held that Sabine National Bank does not support the proposition that a pleading for usurious prejudgment interest, by itself, can constitute a charge of interest within the meaning of article 5069-1.06."177

In response to the petitioner's argument "that a pleading must be included within the meaning of the term 'charge' because it has a very broad meaning" under Texas authority,178 the Texas supreme court further restricted the holding of Hagar v. Williams179 upon which petitioner relied. In Hagar the Amarillo court of appeals held that a charge of interest means "unilaterally placing on an account an amount as interest."180 Under Hagar, therefore, a court could impose usury penalties on a creditor even though the creditor never gave notice of its charge or demand for payment to the debtor.181 The Texas supreme court in Carpet Services, however, disagreed that communication is not necessary to invoke a charge of usurious interest, stating:

Although a charge is unilateral, as opposed to by agreement, it still must be communicated outside the organization making the charge to be a charge within the meaning of article 5069-1.06. Therefore, we disapprove of Hagar to the extent that it holds that the term "charge" includes unilaterally placing on an account an amount due as interest without any other action. A charge must be communicated to the debtor. The communication need not be direct, as long as the charge is ultimately demanded from the debtor.182

174. See 527 S.W.2d at 211.
177. Id.
178. Id. at *3.
179. 593 S.W.2d 783 (Tex. Civ. App.—Amarillo 1979, no writ).
180. Id. at 788.
182. Id. Although Justice Mauzy concurred in the majority's ruling that a pleading for excessive prejudgment interest alone does not constitute a charge of usurious interest, he lam-
Finally, the supreme court addressed the nature of pleadings and why they should not form the basis of a usury claim.183 Pleadings serve to give the defendant notice of the plaintiff's claims and demand only that the trial court grant judgment.184 Unlike a demand for usurious interest, a plaintiff's claim for prejudgment interest is not demanded from the defendant and does not arise directly from a commercial or consumer credit transaction.185 Instead, a plaintiff's claim for prejudgment interest may be obtained only by court order and "serves to compensate the plaintiff for the delay between the plaintiff's injury and payment for that injury."186 Accordingly, the wrongs that a pleading for excessive prejudgment interest presents are not the abusive practices in commercial or consumer credit transactions that the Texas legislature sought to correct by its enactment of the Texas usury laws, and instead are best redressed by the court from whom the pleader seeks relief.187

3. Lender's Post-Failure Rate of Interest as a Basis for Usury

The failure of major Texas banks and the successor institutions' subsequent suits on notes executed prior to the banks' failures raise a question that provides a fairly recent source of usury litigation: What interest rate is applicable to a variable interest rate note upon the unforeseeable insolvency and failure of the bank supplying the prime or regional base rate reference? If the note provides for prime rate plus one percent, a borrower may argue that the applicable interest rate is only one percent because of the failure of the bank and thus its reference rate. Alternatively, a borrower may argue that the statutory rate of six percent, as set forth in article 5069-1.03 of the Texas Revised Civil Statutes, is the applicable rate of interest because of the absence of an agreed interest rate under these circumstances. On the basis of either argument, a borrower potentially may assert a claim for usury if the successor bank attempts to collect interest at a rate greater than either one or six percent.

In FDIC v. Blanton188 the Fifth Circuit has come closest to addressing these issues than any other opinion interpreting Texas law. In Blanton the
borrower executed a variable interest rate note in favor of FNB-Midland, which matured on September 30, 1983. Two weeks after the note’s maturation date, the Comptroller of the Currency declared FNB-Midland insolvent and closed the bank. The FDIC subsequently brought a deficiency suit on the note and prevailed at trial. The district court entered judgment in favor of the FDIC in an amount that included post-maturity prejudgment interest on the note.

On appeal, the borrower contended that the trial court incorrectly calculated the post-maturity prejudgment interest rate on the note and that this miscalculated rate was usurious. In support thereof, the borrower first argued “that the applicable postmaturity rate should be one percent because the contract specifies a prematurity rate equal to FNB-Midland Prime plus one percent, and upon FNB-Midland’s insolvency, FNB-Midland Prime evaporated, leaving one percent.” The Fifth Circuit responded that:

Even assuming the absence of a specific agreement as to postmaturity interest, settled Texas law permits the implication that the specified prematurity rate continues after maturity. Such an implication favors continuity in the rate of interest rather than elimination of interest upon the unforeseeable insolvency of the bank supplying the prime rate reference.

The borrower alternatively argued that no agreement on a post-maturity rate of interest existed and thus the statutory rate of six percent was the applicable rate of interest. The Fifth Circuit found the six percent statutory rate inapplicable, stating:

We conclude either that the parties did agree on a specific postmaturity rate, or that the evidence was such that the district court could properly fix the interest without reference to article 5069-1.03. We reiterate the settled law that a specific prematurity interest rate continues after maturity when the contract is silent as to postmaturity interest. This proposition alone lifts this Note out of the six-percent statute. A specific interest agreement persisted after maturity, even if the calculation varied.

The Fifth Circuit further stated that the trial court could have applied an analogous prime rate that was consistent with the parties’ intent, and suggested that such an analogous rate could be derived from either the assuming bank of FNB-Midland or larger Texas banks upon which FNB-Midland had based its own prime rate.

Although the note in Blanton had matured prior to the bank’s failure, the holding and rationale of Blanton may logically extend to a case involving a

189. *Id.* at 526.
190. *Id.* at 532.
191. *Id.*
192. *Id.* (citing Petroscience Corp. v. Diamond Geophysical, 684 S.W.2d 668, 668-69 (Tex. 1984)).
194. 918 F.2d at 532 (citation omitted).
195. *Id.*
196. *Id.* at 532-33 n.10.
BANKING LITIGATION

note that matures after the bank's failure. Specifically, Blanton supports the proposition that, when a selected reference rate in an interest rate formula fails due to the unforeseeable insolvency of the bank supplying the selected reference rate, continuity in the rate of interest consistent with the intent of the parties is favored over elimination of the term, and an analogous reference rate consistent with such intent may be applied. Accordingly, the mere failure of the mechanism for determining an interest rate alone does not result in a charge of usury. Instead, a borrower must show that no reasonable analogous reference rate, and thus no reasonable alternate construction of the parties' intention, exists.

4. May Non-Parties to Loan Transactions Be Liable for Usury

In Lupo v. Equity Collection Service197 a borrower asserted a claim for usury under the Texas Consumer Credit Code against, inter alia, the collection agency of the corporate lender.198 In response to the borrower's motion for summary judgment, the collection agency contended both bona fide error as an affirmative defense and the borrower's failure to state a cause of action against it. The collection agency, however, filed no summary judgment proof in support of its response. The collection agency also filed summary judgment wherein it asserted that it was not a party to the loan transaction on which the usury claim was based, and thus not subject to the Consumer Credit Code's penalties. The trial court granted the borrower's motion and denied the collection agency's motion.199

On appeal, the collection agency contended that a non-party to the original loan transaction could not be held liable for the statutory penalties under the Texas Consumer Credit Code.200 In a case of first impression, the Houston First District court of appeals held that such a party could be held liable.201 In support of its holding, the appellate court noted that although the statute limited those parties who may recover the statutory penalties, it did not limit those parties who may be held liable for the statutory penalties.202 As further rationale, the court offered the following policy considerations:

Otherwise, one who was not a party to the original loan transaction, such as a collection agency, could attempt to collect usurious interest without fear of the penalties for usury. A collection agency that collected interest above that allowed by law would profit from its collection. Without the threat of statutory penalties for usury, a collection agency would be free to attempt such a collection. We refuse to interpret the usury laws to allow such actions.203

Although the court's concern about collection agencies' potential "run amok" tactics is tenable, Lupo's application to national banks and their

197. 808 S.W.2d 122 (Tex. App.—Houston [1st Dist.] 1991, n.w.h.).
198. Id. at 123; see TEX. REV. CIV. STAT. ANN. art. 5069-8.02 (Vernon 1987).
199. 808 S.W.2d at 123.
200. Id. at 124.
201. Id. at 124-25.
202. Id. at 124 (construing TEX. REV. CIV. STAT. ANN. art. 5069-8.02 (Vernon 1987)).
203. Id.
agents is not. First, Lupo clearly does not stand for the proposition that an agent for a national bank is liable for penalties under state law rather than under the National Bank Act. None of the parties involved in Lupo purported to be national banks or agents of national banks, and the National Bank Act was not even considered. Second, Lupo did not consider whether the collection agency was acting as a disclosed agent for a disclosed principal, which negates the agent's liability under Texas common law. Finally, the opinion appears to conflict with established Texas precedent that only those who benefit directly or profit from the usurious transaction, rather than all who are connected with the collection of usurious interest, may be subject to statutory usury penalties.

5. Guarantors May Not Assert Usury

Established Texas precedent precludes a guarantor from asserting either a claim for or a defense of usury based on the underlying loan instrument.

204. As stated in note 162, supra, the National Bank Act's usury provisions generally preempt state usury law in actions against national banks. Notably, the National Bank Act specifically contemplates that national banks must and will have agents to accomplish the banks' business purposes. See 12 U.S.C. § 24 (1988 & Supp. II 1990). In fact, other provisions of the National Bank Act ascribe liability to a national bank if its agents violate the Act. See 12 U.S.C. § 93. Because a national bank may act through and is responsible for the actions of its agent, an agent acting for a national bank arguably should enjoy the protection, benefits and limitations of the National Bank Act, including its usury provisions.

205. See, e.g., Shank, Irwin, Conant & Williamson v. Durant, Mankoff, Davis, Wolens & Francis, 748 S.W.2d 494, 499 (Tex. App.—Dallas 1988, no writ) (applying the rule that an agent making a contract for a disclosed principal is not liable under that contract); Medical Personnel Pool v. Seale, 554 S.W.2d 211, 213 (Tex. Civ. App.—Dallas 1977, writ ref'd n.r.e.) (holding that failure to disclose she was acting as an agent would render agent as well as principal liable to a third party).

206. See, e.g., Stacks v. East Dallas Clinic, 409 S.W.2d 842, 845 (Tex. 1966) (clarifying that "benefit" refers to a direct benefit from the receipt and retention of the interest itself and holding that the mere incidental and transient possession of interest did not render defendant liable for usury); Commerce Trust Co. v. Best, 124 Tex. 583, 591, 80 S.W.2d 942, 947 (1935) ("This statute was intended to penalize one who exacts and receives the benefit of usury, not every one who may be connected with its collection."); Rheiner v. Varner, 627 S.W.2d 459, 465 (Tex. App.—Tyler 1981, no writ) (clarifying that to "charge" is to "unilaterally plac[e] on an account an amount due as interest" and holding that merely attempting to collect the amount due does not constitute a charge of interest); Employees Loan Co. v. Templeton, 109 S.W.2d 774, 778 (Tex. Civ. App.—Fort Worth 1937, no writ) (holding that plaintiff could not recover usury penalty from defendant based on transactions which occurred prior to defendant's possession of the note and from which the defendant received no benefit); cf. Crow v. Home Sav. Ass'n, 522 S.W.2d 457, 459-60 (Tex. 1975) (holding that absent evidence of a device to evade the usury laws, only the one who lends money to the borrower and overcharges for the use of that money is liable for usury).

207. See, e.g., Continental Ill. Nat'l Bank & Trust Co. v. Windham, 668 F. Supp. 578, 584 (E.D. Tex. 1987) (holding that defenses of unconscionability, fraud, misrepresentation, and breach of warranty could not be raised by guarantor); RepublicBank Dallas, N.A. v. Shook, 653 S.W.2d 278, 281 (Tex. 1983) (holding that guarantor may not use defense of usury); Houston Sash & Door Co. v. Heaner, 577 S.W.2d 217, 222 (Tex. 1979) (holding that usury defense is limited to parties to the transaction); Universal Metals & Mach. v. Bohart, 539 S.W.2d 874, 879 (Tex. 1976) (holding that a guarantor of payment may not assert the claim or defense of usury); Nautical Landings Marina v. First Nat'l Bank, 791 S.W.2d 293, 298 (Tex. App.—Corpus Christi 1990, writ denied) (holding that an individual guarantor could not assert a claim of usury against the bank); Rent Am. v. Amarillo Nat'l Bank, 785 S.W.2d 190, 197 (Tex. App.—Amarillo 1990, writ denied) (holding that a guarantor or a corporate debt may not
The Fifth Circuit recently reiterated this established rule in *FSLIC v. Grif-fin.*208 In *Colony Creek Ltd. v. RTC,*209 however, the Fifth Circuit subsequently relied on the presence of a usury savings clause in the underlying note, rather than a guarantor's *per se* inability to assert a defense of usury based on the note, to uphold the trial court's finding that the guarantors failed to show entitlement to their defense of usury.210

### B. Duty of Good Faith

During the prior Survey period, the Texas supreme court in *FDIC v. Coleman*211 held that a secured creditor did not owe a guarantor of indebtedness a duty of good faith requiring the secured creditor to liquidate the underlying collateral only in such a way as to minimize a deficiency on the debt.212 Addressing the significance of *Coleman,* last year's authors of this Article stated:

The *Coleman* case is significant in that the court refused to recognize any generalized duty of good faith and fair dealing in the banking transaction examined. In *Coleman,* the Texas Supreme Court took a general view of the existence of such a duty that contrasts with the position taken by Texas courts of appeals in two cases within the last several years. Although the *Coleman* decision in no manner overruled these other cases, *Coleman* does illustrate the reluctance of the Texas Supreme Court to find a duty of good faith and faith dealing, at least in the context of a banking relationship in which the parties have relatively equal bargaining power. *The probable result of Coleman will be to decrease the willingness of Texas courts to find such a duty in most, if not all, banking relationships.*213

A review of cases decided during the current Survey period clearly indicates both Texas courts' and the Fifth Circuit's extreme reluctance to find a duty of good faith and fair dealing in a creditor/debtor relationship,214 and

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208. 935 F.2d 691, 700 (5th Cir. 1991).
209. 941 F.2d 1323 (5th Cir. 1991).
210. Id. at 1325-26.
211. 795 S.W.2d 706 (Tex. 1990).
212. Id. at 707-10. For a thorough discussion of this opinion, see Peter G. Weinstock & Christopher T. Klimko, *Banking Law, Annual Survey of Texas Law* 45 Sw. L.J. 1, 43-45 (1991).
214. See, e.g., Clay v. FDIC, 934 F.2d 69, 71-72 (5th Cir. 1991) (affirming trial court's summary judgment denial of guarantor's claims of breach of duty of good faith and fiduciary duty against assignee of failed original lender under, *inter alia,* *Coleman*); Cockrell v. Republic Mortgage Ins. Co., 817 S.W.2d 106, 116 (Tex. App.—Dallas 1991, n.w.h.) (holding as a matter of law that lender owed no duty of good faith and fair dealing to borrower); SEI Business Sys. v. Bank One Texas, N.A., 803 S.W.2d 838, 839-40 (Tex. App.—Dallas 1991, n.w.h.) (holding that *Coleman* expressly precluded guarantor's claims of breach of duty of good faith against secured creditor); Security Bank v. Dalton, 803 S.W.2d 443, 447-49 (Tex. App.—Fort Worth 1991, writ denied) (holding that no special relationship existed between lender or its president and borrowers sufficient to create duty of good faith and fair dealing in light of *Coleman*).
thus substantiates these authors’ prediction. Regardless, two cases decided during this Survey period are worth additional discussion because of their specific application to the increasing number of borrowers’ claims of breach of duty of good faith and fair dealing that relate to the conduct of banks prior to their failure, but are asserted against the successor banks.215

1. Duty of Good Faith and the Application of the D’Oench, Duhme Doctrine and Section 1823(e)

In *Clay v. FDIC*216 guarantors of promissory notes sued the FDIC, as receiver for the failed original lender, and NCNB, which was the assignee of the promissory notes and guaranties by virtue of a purchase and assumption transaction with the FDIC. The guarantors asserted causes of action for, *inter alia*, breach of the duty of good faith and fair dealing and breach of a fiduciary duty allegedly owed by NCNB to the guarantors. The trial court granted the FDIC’s and NCNB’s motions for summary judgment on these causes of action, which the guarantors appealed.217

On appeal, the guarantors first contended that “the district court erred by holding that [the guarantors] waived their claims of breach of duty [of good faith] in the guaranty agreement.”218 The guarantors based their claims on the allegation that “NCNB did not properly oversee their loan.”219 The Fifth Circuit found this assertion to be a claim that NCNB did not act with due diligence.220 Accordingly, the Fifth Circuit held that NCNB's alleged conduct did not violate any contract-based duty of good faith under section 1.203 of the Texas Uniform Commercial Code, even assuming one existed, because the Code requires “honesty in fact” for “good faith,” not due diligence.221 Even assuming that a common law duty of good faith applied to these parties’ relationship, the Fifth Circuit further held that the guaranty agreement’s plain language waived any implied duty of good faith of NCNB.222

The guarantors next contended that “the district court erred by holding that there was no evidence reflecting a genuine issue concerning a fiduciary


215. See *Clay*, 934 F.2d at 72-73; *Security Bank*, 803 S.W.2d at 447-49.
216. 934 F.2d 69 (5th Cir. 1991).
217. Id. at 70-71.
218. Id. at 71.
219. Id.
220. Id.
221. See 934 F.2d at 71 (citing TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968)). Section 1.201(19) of the Code defines “good faith” as “honesty in fact.” Id. (citing TEX. BUS. & COM. CODE ANN. § 1.201(19) (Tex. UCC) (Vernon 1968)). Notably, the court was skeptical whether an implied contract-based duty of good faith even exists in guaranty agreements. Id. (citing Coleman, 795 S.W.2d at 708).
222. See id. at 71-72.
relationship between the parties."\textsuperscript{223} In support of their claim, the guarantors asserted that NCNB's "control over the loan was so great that they were rendered helpless to protect their own interests," and that a disparity in bargaining power between the parties created a "special relationship" sufficient to establish a fiduciary duty owed by the bank to the guarantors.\textsuperscript{224} The Fifth Circuit summarily rejected the guarantors' claims based on the absence of a general fiduciary relationship between a lender and a borrower under Texas law and on the findings that both parties were represented by competent legal counsel and conducted their transactions at arm's length.\textsuperscript{225}

Notably, the Fifth Circuit further held that the guarantors' claims of breach of good faith and breach of fiduciary duty against NCNB were barred by the \textit{D'Oench, Duhme} doctrine and 12 U.S.C. § 1823(e).\textsuperscript{226} The Fifth Circuit found that NCNB's alleged duty of good faith to the guarantors constituted an "agreement" under section 1823(e).\textsuperscript{227} Because the court already had determined that the guaranty agreements were insufficient to establish this duty, the court further found that proof of the guarantors' alleged agreement necessitated evidence outside the bank's records.\textsuperscript{228} Accordingly, the Fifth Circuit held that the guarantors could not prove their causes of action for breach of duty of good faith and breach of fiduciary duty because such duties must have been derived, if at all, from "secret agreements" outside the bank's records which are precluded by the \textit{D'Oench, Duhme} doctrine and section 1823(e). In short, the Fifth Circuit refused to find a duty of good faith and a fiduciary duty between the guarantors and the assignee bank when the guarantors could not prove the existence of such a duty from the face of the bank's records.\textsuperscript{229} On the basis of \textit{Clay}, therefore, the \textit{D'Oench, Duhme} doctrine and section 1823(e) arguably preclude any claim of an implied duty of good faith and fair dealing between such parties.

2. Consideration Only of Borrower's Relationship with Successor Bank

In \textit{Security Bank v. Dalton}\textsuperscript{230} the Fort Worth court of appeals determined, \textit{inter alia}, whether a successor bank and its officer owed a borrower a duty of good faith and fair dealing only by virtue of the borrower's "special relationship" with the predecessor bank and its officer.\textsuperscript{231} In \textit{Security Bank} the plaintiff-borrowers' relationship with the predecessor bank began in 1984 when their long-standing banker, Joe Ackley, became president of the predecessor bank and brought the borrowers' banking business to that bank. Four years later, the predecessor bank became insolvent, and its assets were sold.

\textsuperscript{223} \textit{Id.} at 72.
\textsuperscript{224} 934 F.2d at 72.
\textsuperscript{225} \textit{Id.}
\textsuperscript{226} \textit{Id.} at 72-73 (citing \textit{D'Oench Duhme} & Co. v. FDIC, 315 U.S. 447 (1942); 12 U.S.C. § 1823(e)). For a discussion of the \textit{D'Oench, Duhme} doctrine and 12 U.S.C. § 1823(e), see \textit{supra} part I(A).
\textsuperscript{227} 934 F.2d at 72.
\textsuperscript{228} \textit{Id.} at 73.
\textsuperscript{229} \textit{Id.}
\textsuperscript{230} 803 S.W.2d 443 (Tex. App.—Fort Worth 1991, writ denied).
\textsuperscript{231} \textit{Id.} at 445-49.
and transferred by the FDIC to Security Bank. Another banker, Gary Acker, became president and chairman of the board of Security Bank. At the time that Security Bank acquired the assets and assumed the liabilities of the predecessor bank, the bank held nine promissory notes signed by the plaintiff-borrowers. When one of the plaintiff-borrowers called Security Bank to determine where to send his loan payments, Acker informed the borrower that Security Bank had the borrowers' loans and that "business will be as usual." Subsequent to this conversation, Security Bank extended an unsecured loan to the plaintiff-borrowers, the plaintiff-borrowers withdrew approximately $70,000 from Security Bank, Security Bank refused to renew two earlier substantial loans to the plaintiff-borrowers, and Security Bank froze the balance in the plaintiff-borrowers' bank accounts to cover the two earlier loans now in default. The plaintiff-borrowers asserted that Security Bank and its president's actions were motivated by the Security Bank president's malice when the borrowers withdrew $70,000 from Security Bank. Based on this assertion and Security Bank's and Acker's conduct, the plaintiff-borrowers alleged, inter alia, that Security Bank and its president breached a duty of good faith to the plaintiff-borrowers.

At trial, the court submitted questions to the jury regarding whether Security Bank and its president breached their duty of good faith to these borrowers. In response, the jury found that Security Bank and its president had breached a duty of good faith and fair dealing. On appeal, Security Bank and its president contended that the trial court's submission of these jury questions was error because no duty of good faith and fair dealing existed as a matter of law.

The Fort Worth court of appeals first reiterated that a duty of good faith and fair dealing between a lender and a borrower does not exist absent a special relationship or an imbalance of bargaining power. Although the plaintiff-borrowers asserted that this duty arose under section 1.203 of the Texas Uniform Commercial Code, the appellate court found that the plaintiff-borrowers did not raise any allegation of dishonesty in fact, as required under section 1.203. Accordingly, the appellate court focused on whether a duty of good faith existed by virtue of either a special relationship or an imbalance in bargaining power between the parties.

In support of their argument that a special relationship existed, the plaintiff-borrowers cited their long-standing relationship with the predecessor bank and its president and the flexibility of that relationship. The plaintiff-borrowers further asserted that Security Bank's president's statement that

232. Id. at 445.
233. Id. at 446-47. The opinion provides the full text of these jury questions. Id.
234. 803 S.W.2d at 444.
235. Id. at 447.
236. Id. at 447-48 (citing Coleman, 795 S.W.2d at 708-09; Georgetown Assocs. v. Home Fed. Sav. & Loan Ass'n, 795 S.W.2d 252, 255 (Tex. App.—Houston [14th Dist.] 1990, writ dism'd w.o.j.).
237. Id. at 448 (citing TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968)).
238. Id. at 448-49.
“business would be ‘as usual’ led them to believe that this special banking relationship continued to exist.” The Fort Worth court of appeals, however, rejected the plaintiff-borrowers’ contention that a special relationship existed based on these circumstances, stating:

However, with the demise of [the predecessor bank] came the demise of any special relationship [the plaintiff borrowers] might have had with their lender. Security Bank is a separate entity from [the predecessor bank]. Security Bank had different owners than [the predecessor bank] and a new president, Gary Acker.

While [the plaintiff borrowers] may have done business with [the predecessor bank’s president] for years, Acker was unknown to them prior to his presidency at Security Bank. Thus, no relationship of “shared trust” could have existed between the parties.

Regarding the issue of imbalanced bargaining power, the Fort Worth court of appeals noted that the plaintiff-borrowers had long-standing business experience and had developed a substantial and profitable business. Accordingly, the appellate court found that the existence of imbalanced bargaining power was doubtful. Because the plaintiff-borrowers demonstrated neither a special relationship nor an imbalance of bargaining power between the parties, the appellate court held that the trial court should not have submitted jury questions regarding a duty of good faith and fair dealing and reversed the damages that the jury awarded in connection with this claim.

The Fort Worth court of appeals clearly refused to engraft a borrower’s prior relationship, albeit long-standing, with the predecessor bank onto the borrower’s relationship with the successor bank to find that the successor bank owed a duty of good faith and fair dealing to a borrower. Instead, the borrower and the successor bank’s relationship alone must establish the requisite special relationship or imbalanced bargaining power elements of a duty of good faith and fair dealing. In short, Security Bank absolves a successor bank from any continuing duty of good faith and fair dealing originally imposed on the predecessor bank, even though the conduct of both the predecessor and the successor banks may involve not only the same borrower but also the same loan transaction.

C. Notice and Commercial Reasonableness

Section 9.504 of the Texas Uniform Commercial Code governs a creditor’s sale or other disposition of collateral underlying a secured loan upon default. Generally, this section requires both prior reasonable notification of

239. 803 S.W.2d at 448.
240. Id. at 448-49.
241. See id. at 449.
242. See id.
243. Id. at 449, 454.
244. See TEX. BUS. & COM. CODE ANN. § 9.504 (Tex. UCC) (Vernon 1991). Section 9.504 does not apply to the disposition of real property securing indebtedness. See Pentad Joint Venture v. First Nat'l Bank, 797 S.W.2d 92, 97 (Tex. App.—Austin 1990, writ denied); Van Brunt v. BancTexas Quorum, N.A., 804 S.W.2d 117, 127 (Tex. App.—Dallas 1989, no writ);
the sale to the debtor and that every aspect of the sale be commercially reasonable. If the creditor neither gives the statutory notice nor conducts a commercially reasonable sale, then not only will the creditor be precluded from seeking a deficiency judgment, but further the creditor may be sub-

TEX. BUS. & COM. CODE ANN. §§ 9.104(10), 9.501(d) (Tex. UCC) (Vernon 1991); cf. FDIC v. Blanton, 918 F.2d 524, 531 (5th Cir. 1990) (holding that cases construing section 9.504 are inapplicable to claims regarding alleged defects in real property foreclosure sales). The Code, however, does address the rights of the creditor if the security agreement covers both real and personal property. See TEX. BUS. & COM. CODE ANN. § 9.501(d) (Tex. UCC) (Vernon 1991). In BancTexas Quorum, N.A. the Dallas court of appeals construed section 9.501(d) as follows:

The creditor may choose either to proceed as to both the real and personal property in accordance with real property law in one action or in separate actions. The creditor may also opt to proceed against the personal property under the Code, but has no option to proceed as to the real property under the Code.

804 S.W.2d at 128 (citation omitted).

245. See TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1991). Section 9.504(c) states in relevant part:

(c) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods no other notification need be sent.

Id.

Notably, Texas courts have held that a guarantor also is entitled to reasonable notification and further that a guarantor may challenge the collateral's sale as commercially unreasonable. See, e.g., FDIC v. Lanier, 926 F.2d 462, 464 (5th Cir. 1991) (noting that a guarantor is entitled to notice under Texas law); ITT Commercial Fin. Corp. v. Riethn, 796 S.W.2d 248, 255 (Tex. App.—Dallas 1990, no writ) ("[A] guarantor of the secured indebtedness has the same right as his principal to challenge the commercial reasonableness of a lender's sale following repossession."); Chase Commercial Corp. v. Datapoint Corp., 774 S.W.2d 359, 363 (Tex. App.—Dallas 1989, no writ) (citing cases holding that "a guarantor is treated as a debtor under the provisions of section 9.504").

246. The Code does not expressly provide that a creditor may not seek a deficiency because of its failure to comply with the Code's default provisions. See BancTexas Quorum, N.A., 804 S.W.2d at 129. Instead, the bench has imposed this restriction on the creditor. See Tanenbaum v. Economics Lab., 628 S.W.2d 769, 771 (Tex. 1982); BancTexas Quorum, N.A., 804 S.W.2d at 129. Texas courts, however, disagree whether a creditor's compliance only with the statutory notice requirement bars the creditor's subsequent deficiency suit. Compare Piney Point Inv. Corp. v. Photo Design, 691 S.W.2d 768, 770 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.) (holding that if creditor gives proper notice but fails to conduct commercially reasonable sale, then creditor's claim for deficiency is limited but not barred) with ITT Commercial Fin. Corp., 796 S.W.2d at 252-53 & n.1 (questioning soundness of Piney rule in light of broad language of Tanenbaum).

As noted earlier, the Code does not govern the disposition of real property securing indebtedness although it does set forth the creditor's rights when the security agreement encompasses both real and personal property. See supra note 244 and accompanying text. In BancTexas Quorum, N.A. a case involving a security agreement that covered both real and personal property, the Dallas court of appeals determined whether a bank was precluded from seeking a deficiency judgment after its foreclosure on a lien that secured a promissory note, because the bank failed to comply with section 9.504(c) with regard to its disposition of the debtor's personal property that also secured the note. See 804 S.W.2d at 126-30. Based on its construction of section 9.501(d) and the policy considerations underlying the Texas Uniform Commercial Code, the court held that any defect in the lender's disposition of personal property under
ject to liability for any loss that the debtor suffered as a result of the creditor's conduct.247

What constitutes either reasonable notification or commercial reasonableness is a fertile source of litigation between creditors and debtors primarily because of the Code's failure to delineate these terms.248 Further, the Code does not provide and Texas appellate courts do not agree whether the creditor bears the burden of proving reasonable notification and commercial reasonableness as elements of a deficiency suit or whether the debtor must raise these issues of collateral disposition as an affirmative defense to the deficiency suit.249 The outcome of this type of lawsuit thus pivots on the specific facts of each case, the trial court's placement of the burden of proof, and the interaction of section 9.504 with other statutory provisions of the Texas Uniform Commercial Code, as reflected by a review of selected recent cases.

I. Compliance with Section 9.504 as an Affirmative Defense and the Holder in Due Course Doctrine

The opinion of Smith v. FDIC250 is a clear example of the determinative impact of the characterization of commercial reasonableness as an affirmative defense on a creditor's deficiency suit. In Smith, the debtor executed a promissory note to the bank, which was secured by stock. When the debtor subsequently defaulted on the note, the bank both brought suit against the debtor on the note and sold the stock. Although the bank ultimately dismissed the suit against debtor, the FDIC, as the receiver for the bank when it failed, later reasserted the claim for collection against the debtor. The FDIC filed motions for summary judgment against the debtor, but both the motions and their supporting affidavits failed to address the earlier disposition of the stock, although a supplemental affidavit indicated that the proceeds from the stock's sale were applied to the note's balance. In response, the debtor asserted that "the FDIC failed to prove the collateral was dis-

section 9.504(c), thereby precluding a deficiency judgment on the note under the Code, had "no effect on its rights under the real property mortgage, including its right to seek a deficiency." Id. at 130.


249. Compare Gordon & Assocs. v. Cullen Bank/Citywest, N.A., 805 S.W.2d 490, 492 (Tex. App.—Corpus Christi 1990, no writ) ("A secured party seeking a deficiency judgment bears the burden of proving notice of sale and commercially reasonable disposition of the collateral."); ITT Commercial Fin. Corp., 796 S.W.2d at 251 ("Lender, as the plaintiff in its suit for a deficiency, had the burden to establish that the foreclosure sale was conducted in a commercially reasonable manner."); Chase Commercial Corp., 774 S.W.2d at 364-65 (the creditor bears the burden of pleading and proving both of these aspects before he can recover a deficiency) with Smith v. FDIC, 800 S.W.2d 648, 650 (Tex. App.—Houston [14th Dist.] 1990, writ dism'd by agr.) (holding that "the commercial reasonableness of a sale of collateral is a defense which must be raised by the debtor to the creditor to his proof"); Folkes v. Del Rio Bank & Trust Co., 747 S.W.2d 443, 445 (Tex. App.—San Antonio 1988, no writ) (failure to comply with commercial reasonableness requirement is an affirmative defense).

250. 800 S.W.2d 648 (Tex. App.—Houston [14th Dist.] 1990, writ dism'd by agr.).
posed of in a commercially reasonable manner” and that the “FDIC’s claim was barred because the [failed bank] failed ‘to assure a commercially reasonable disposition of the collateral.’”251 The trial court granted the FDIC’s motion for summary judgment.252

The debtor appealed the trial court’s ruling on the basis that “the FDIC failed to plead and prove that the collateral which secured the note was disposed of in a commercially reasonable manner,” thereby asserting that commercial reasonableness was an essential element of the FDIC’s deficiency suit.253 The FDIC, however, contended that the issue of commercial reasonableness was an affirmative defense to be raised by the debtor. Although the Houston Fourteenth District court of appeals acknowledged that a creditor’s compliance with section 9.504 is a prerequisite to a deficiency suit and noted the conflict among Texas courts regarding whether the requirements of section 9.504 are elements of the creditor’s deficiency suit or matters of the debtor’s defense,254 the appellate court held:

We disagree with those cases holding that disposition of collateral in a commercially reasonable manner is an element of a secured creditor’s cause of action. We think the better line of authority holds that commercial reasonableness is a defense to be raised by the debtor. Therefore, we hold that the commercial reasonableness of a sale of collateral is a defense which must be raised by the debtor to put the creditor to his proof.255

The significance of this holding results from its interplay with the appellate court’s other holding in Smith that the FDIC enjoyed holder in due course status.256 Specifically, a holder in due course takes an instrument free from, inter alia, “all defenses of any party to the instrument with whom the holder has not dealt . . . .”257 Hence, by virtue of the court’s holdings that commercial reasonableness is an affirmative defense258 and that the FDIC enjoyed holder in due course status,259 the appellate court ultimately ruled

251. Id. at 649. The debtor filed both a response to the FDIC’s motion for summary judgment and a cross-motion for summary judgment. See id.
252. Id. at 650.
253. Id.
254. See 800 S.W.2d at 650.
255. Id.
256. See id. at 650-52. In Smith, the court set forth the definition of “holder in due course” pursuant to section 3.302 of the Texas Uniform Commercial Code:
A holder in due course takes an instrument for value, in good faith, and without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person; provided, the holder does not purchase the instrument as part of a bulk transaction not in the regular course of business of the transferor.
Id. at 650 (construing TEX. BUS. & COM. CODE ANN. § 3.302 (Tex. UCC) (Vernon 1968)).
257. TEX. BUS. & COM. CODE ANN. § 3.305(b) (Tex. UCC) (Vernon 1968).
258. See 800 S.W.2d at 650-51.
259. Id. at 651-52. Notably, the FDIC did not meet the technical requirements of a holder in due course as set forth in section 3.302, because the FDIC acquired the debtor’s note as part of a bulk purchase and assumption transaction. Id. at 651. Instead, the court afforded holder in due course status to the FDIC based on the opinion of Campbell Leasing v. FDIC, 901 F.2d 1244 (5th Cir. 1990), and its opinion of NCNB Texas Nat’l Bank v. Campise, 788 S.W.2d 115 (Tex. App.—Houston [14th Dist.] 1990, writ denied).
that the FDIC took the debtor's note free from the debtor's defense of commercial unreasonableness. Smith, therefore, effectively nullifies any required showing by a holder in due course of commercial reasonableness in the sale of collateral as part of a deficiency suit when the issue of commercial reasonableness is a matter of affirmative defense.

2. Agreements to Sell the Collateral

In Adcock v. First City Bank, a case of first impression, the San Antonio court of appeals determined whether an agreed sale of collateral to bring a promissory note current and reduce the remaining indebtedness was subject to the notice and commercial reasonableness requirements of section 9.504. In Adcock a bank made a loan to a corporation which was personally guaranteed by the defendants and secured by stock owned by one of the defendant-guarantors. During the term of the indebtedness, the corporation was in arrears on its payments to the bank. One defendant-guarantor and a bank officer agreed that the stock would be sold to bring the note current. Accordingly, the proceeds from the sale of the stock were applied in part to the corporation's indebtedness. Subsequent to the collateral sale, the corporation executed a renewal note upon which the bank brought a deficiency suit against the guarantors. The guarantors, in turn, asserted that the bank had not complied with the collateral disposition requirements of section 9.504 with regard to the sale of the stock. Based on the jury's finding that "an agreement existed between the Bank and [one guarantor] and that the collateral was sold pursuant to that agreement," the trial court entered judgment in favor of the bank allowing its recovery of the deficiency from the guarantors.

On appeal, the guarantors contended that the bank did not plead or prove, as a condition precedent to the deficiency suit, that "(1) notice was given prior to the sale or disposition of the stock; and (2) the shares were disposed of in a commercially reasonable manner pursuant to section 9.504 of the Texas Business and Commerce Code." The guarantors thus asserted that the bank was precluded from recovering a deficiency judgment. Although the appellate court noted that section 9.504 clearly applied to a secured creditor's sale of collateral after default by the debtor, the court further noted that no Texas cases addressed whether section 9.504 applied "when the parties sell collateral by agreement to bring the note current and lower the remaining indebtedness."

Based on the following rationale, the San Antonio court of appeals held that "the agreed sale of stock was not a sale after default governed by the

260. See 800 S.W.2d at 652.
261. 802 S.W.2d 305 (Tex. App.—San Antonio 1990, no writ).
262. Id. at 306.
263. Id. at 305-06. The corporation's ultimate bankruptcy apparently precipitated the bank's deficiency suit. See id. at 306.
264. Id. at 305-06.
265. 802 S.W.2d at 306.
266. Id.
provisions of section 9.504." When a debtor is in default, a creditor may either renegotiate the loan, or "reduce the claim to judgment, foreclose on the collateral, or otherwise enforce the security interest by any available judicial procedure." By choosing to renegotiate the corporation's indebtedness, rather than proceed under the Code, the appellate court first determined that the bank "effectively waived the claimed default at that time . . . ." The appellate court next determined that imposing the requirements of section 9.504 on an agreed sale of collateral, thereby enabling the debtor to avoid liability for any remaining deficiency, would take undue advantage of lenders who act in good faith to renegotiate indebtedness. Specifically, the court stated:

To hold that an agreed sale of collateral is subject to the notice and commercial reasonableness provisions would put any lender in a precarious situation. Creditors, acting in good faith, would not be able to work out a repayment plan with debtors without first giving notice of any action concerning the collateral, even though already agreed to or requested by the debtor himself. The debtor would, in essence, be given the ability to agree to the sale and then immediately avoid any further liability because the proper notices were not given . . . . To allow the debtor to avoid liability for any deficiency which remains after an agreed sale would improperly take advantage of the secured creditor's good faith in seeking to bring the loan current and avoid foreclosure.

*Adcock*, therefore, puts a debtor to an election if the creditor gives the debtor the option to renegotiate the indebtedness and its underlying collateral. The debtor may agree to renegotiate and subject the underlying collateral to a contractual sale, thereby conceivably avoiding a subsequent deficiency suit. In this instance, the debtor may attempt to impose contractual requirements on the sale but realistically also may lack sufficient bargaining power to effectuate meaningful collateral disposition requirements. Regardless, the debtor will waive not only the statutory protections of section 9.504 but further the primary contentions to a deficiency suit. Alternatively, the debtor may choose not to renegotiate the indebtedness, thereby practically guaranteeing the creditor's unilateral disposition of the underlying collateral and assuring herself a suit on the remaining deficiency, if any. Under this alternative, however, the debtor clearly will be entitled to the protections afforded by section 9.504, and thus afforded subsequent judicial protection from a deficiency suit in the event the creditor fails to comply with the Texas statutory requirements of collateral disposition.

267. *Id.* at 307.
269. *Id.* (citing *TEX. BUS. & COM. CODE ANN.* § 9.501(a) (Tex. UCC) (Vernon Supp. 1990)).
270. 802 S.W.2d at 306.
271. *Id.*
272. *Id.* at 306-07. In further support of its holding, the appellate court found that the renewal note was binding on the guarantors and that the guarantors did not assert that the "indebtedness had been extinguished because of the stock sale four months prior" at the time that the corporation executed the renewal note. *Id.* at 307.
3. Court Ordered Sale of the Collateral

In Gordon & Associates v. Cullen Bank/Citywest, N.A.273 the Corpus Christi court of appeals determined whether a court ordered sale of collateral was deemed conclusively to be commercially reasonable by virtue of section 9.507(b).274 In Gordon a bank brought a suit to recover on two promissory notes and an attendant guaranty agreement. In connection with the debtor's execution of the promissory notes, the debtor also executed security agreements granting to the bank security interests in the debtor's equipment, accounts and general intangibles. The bank moved for summary judgment on the notes and further asserted its entitlement to foreclose on the security interests.275 In response, the debtors contended in part that the bank "[had] not established that the collateral was sold in a commercially reasonable manner," and thus the bank could not recover a deficiency judgment.276 The trial court, however, granted summary judgment.277 Prior to granting the bank's motion for summary judgment, the trial court ordered a sale of the collateral, pursuant to the terms of the security agreements, on the basis that the collateral "would depreciate or be wasted if not sold prior to judgment," and further ordered that the proceeds from the sale be credited to the judgment.278

On appeal, the debtors argued that "the trial court erred in awarding [the bank] a deficiency judgment because the sale of the collateral was not conducted in a commercially reasonable manner."279 In ruling on the debtor's point of error, the appellate court first clarified that the secured party bears the burden of proving compliance with section 9.504 when seeking a deficiency judgment.280 Although the bank asserted that its suit against the debtors did not seek a deficiency judgment, the appellate court stated in response:

The instant case involves a suit on promissory notes whereby certain offsets must be made prior to judgment. [One debtor's] affidavit states that [the] Bank did not properly credit their accounts after it sold the collateral. [The] Bank does not establish, as a matter of law, the commercial reasonableness of the alleged sale of collateral. It was incum-

273. 805 S.W.2d 490 (Tex. App.—Corpus Christi 1990, no writ).
274. Id. at 493. Section 9.507(b) states in relevant part:
A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable.
275. 805 S.W.2d at 491.
276. Id. at 492.
277. Id.
278. Id. (quoting trial court's Order for Sale of Property).
279. Id.
280. See 805 S.W.2d at 492 (citing Daniell v. Citizens Bank, 754 S.W.2d 407, 409 (Tex. App.—Corpus Christi 1988, no writ)). The appellate court further noted that "[w]hether collateral has been sold in a commercially reasonable manner is generally a question of fact." Id. (citing Daniell, 754 S.W.2d at 410; Achimon v. J.I. Chase Credit Corp., 715 S.W.2d 73, 76 (Tex. App.—Dallas 1986, writ ref'd n.r.e.)).
bent upon the Bank to establish commercial reasonableness as a matter of law in order to recover on its summary judgment.\textsuperscript{281}

The bank further argued that its sale of the collateral was \textit{per se} commercially reasonable because of the trial court's order allowing the sale, by virtue of section 9.507(b) which states in relevant part that a disposition of collateral that has been approved in any judicial proceeding is deemed conclusively to be commercially reasonable.\textsuperscript{282} The appellate court, however, distinguished the trial court's mere allowance of the collateral's sale from the requisite approval of the sale under section 9.507(b).\textsuperscript{283} Although the trial court permitted the bank to sell the collateral, the trial court did not review the sale to determine whether the bank conducted it in a commercially reasonable manner.\textsuperscript{284} Accordingly, the Corpus Christi court of appeals held that a fact issue regarding commercial reasonableness existed which precluded the bank's entitlement to a deficiency judgment as a matter of law.\textsuperscript{285}

4. Fifth Circuit's Construction of Section 9.504

In \textit{FDIC v. Lanier}\textsuperscript{286} the Fifth Circuit addressed the myriad issues that the application of section 9.504 presents to a court, and thus this opinion provides a good example of the federal bench's construction of this Texas statute. Defensive Security Southwest, Inc. (Defensive Security), Defensive Fire Control, Inc. (Defensive Fire), and Unisec, U.S.A., Inc. (Unisec) distributed and installed fire alarm and security systems. Defensive Security executed a promissory note made payable to a bank and a security agreement granting the bank a security interest in its accounts receivable and inventory. Further, four individuals contemporaneously gave the bank a continuing guaranty. Subsequent to this transaction, the shareholders of Defensive Security, Defensive Fire, and Unisec reorganized these entities under a single holding company, D-1 Enterprises, Inc. (D-1), and made the three entities wholly-owned subsidiaries of D-1. The bank approved this reorganization and gave D-1 a revolving line of credit which was evidenced by a promissory note (the D-1 Note). The accounts receivable and inventory of D-1 and two of its wholly-owned subsidiaries and stock in D-1 were pledged as collateral for the D-1 Note. Further, three of the four individuals executed a new continuing guaranty. Notably, the remaining principal on the

\begin{itemize}
  \item \textsuperscript{281} \textit{Id.} at 492-93 (citing \textit{Daniell}, 754 S.W.2d at 410).
  \item \textsuperscript{282} \textit{Id.} at 492-93 (citing \textit{Daniell}, 754 S.W.2d at 410).
  \item \textsuperscript{283} \textit{Id.} at 492-93; see \textit{TEX. BUS. \\ & COM. CODE ANN. § 9.507(b)} (Tex. UCC) (Vernon 1991).
  \item \textsuperscript{284} See 805 S.W.2d at 493.
  \item \textsuperscript{285} \textit{Id.} Notably, the appellate court acknowledged that the bank established its right to recover on the promissory notes, but reversed the trial court’s granting of the bank’s motion for summary judgment on the basis that:
  \begin{itemize}
    \item [A] fact issue remains because the Bank chose to have the court order the sale of the mortgaged property. The results from the sale have not been set out or allowed by the trial court. As such, the Bank failed to prove its entitlement to a proper deficiency judgment.
  \end{itemize}
  \textit{Id.} (footnote omitted).
  \item \textsuperscript{286} 926 F.2d 462 (5th Cir. 1991).
\end{itemize}
original promissory note that Defensive Security executed was incorporated as part of the revolving line of credit.

After the bank renewed the revolving line of credit several times, the bank decided to call the D-1 Note and foreclose on the underlying collateral. In response, D-1 and its wholly-owned subsidiaries filed for chapter 11 bankruptcy. Once the bankruptcy court authorized the bank to foreclose on the underlying collateral, the bank sent notice to the debtor and the guarantors informing them of the bank's intent "to sell the collateral at either a public or private sale ten days after the letter was sent."\(^{287}\) Notably, the bank sold the inventory for $100,000 at a private sale \textit{four months} after the letter was sent.\(^{288}\)

Subsequent to the sale, the bank brought a deficiency action against the individual guarantors in state court, which the FDIC ultimately removed to federal court after it intervened in its corporate capacity as purchaser and liquidator of the bank's assets.\(^{289}\) Once in federal court, the FDIC sought summary judgment against the individual guarantors.\(^{290}\) The federal district court granted the FDIC's motion as to liability only against the three individual guarantors who executed the second continuing guaranty,\(^{291}\) and ultimately awarded the FDIC damages against these same guarantors.\(^{292}\) Two of the individual guarantors appealed the district court's finding of liability, but not the court's damage calculations.\(^{293}\) Specifically, the guarantors asserted on appeal that the notice of the collateral's sale that the bank provided was either inadequate, defective, or even invalid, and that the sale of the collateral was commercially unreasonable.\(^{294}\)

The guarantors levelled four alternative attacks at the bank's notice of the collateral's sale.\(^{295}\) They first contended that the notice was defective because it did not specify whether the collateral would be disposed by public or private sale.\(^{296}\) In response, the Fifth Circuit rejected this basis "as a reason to declare the notice inadequate" in light of Texas state law precedent.\(^{297}\)

\(^{287}\) \textit{Id.} at 464.  
\(^{288}\) \textit{Id.}  
\(^{289}\) \textit{Id.}  
\(^{290}\) \textit{Id.}  
\(^{291}\) See \textit{926 F.2d} at 464.  
\(^{292}\) \textit{Id.}  
\(^{293}\) \textit{Id.}  
\(^{294}\) \textit{Id.} at 464-67.  
\(^{295}\) \textit{Id.} at 465-66. The bank's notice provided: [The Bank] will sell the [property] at either a public or private sale ten (10) days after the date of this communication. The Bank fully intends to give reasonable notice of such sale, but circumstances attendant to the property are such that the value of the property threatens to decline speedily, therefore the sale may take place immediately. Proceeds from such sale shall be applied as provided by Section 9.504, Vernon's Annotated Statutes. There may be a deficiency due and owing the Bank on the debt after the application of the proceeds.  
\(^{296}\) \textit{Id.} at 465. For the text of the bank's notice, see supra note 295 and accompanying text.  
\(^{297}\) \textit{Id.} (citing \textit{Hall v. Crocker Equip. Leasing}, 737 S.W.2d 1, 3 (Tex. App.—Houston [14th Dist.] 1987, writ denied)).
The court held that "[t]he notice is not defective simply because it does not specifically state that the goods would be sold privately." 298 The Fifth Circuit, however, premised its holding on the sale ultimately being a private one, because section 9.504(c) expressly requires that the secured creditor must provide notice of both the place and time of any public sale. 299

The guarantors next contended that the bank's notice was invalid because the "sale took place four months, rather than ten days, after the [notice] was sent." 300 The Fifth Circuit first noted that the guarantor's assertion ignored the distinction between a private and a public sale under section 9.504: 301

While section 9.504 provides that a secured creditor must provide both the time and place of any public sale, to allow the debtor the chance to show up at the public sale, the requirements for a private sale are less stringent. For a private sale, the creditor only need provide notice "of the time after which any private sale or other intended disposition is to be made." The commentary to this section provides that "[r]easonable notification' is not defined in this Article; at a minimum it must be sent in such time that persons entitled to receive it will have sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire." 302

Although recognizing that a sale conducted much later than the time indicated in the notice might become stale, the Fifth Circuit also acknowledged and agreed with "leading commentators and cases that 'generally allow substantial lapses of time between original notice and subsequent private sales.'" 303 Accordingly, the Fifth Circuit held: "We believe that a Texas court would find that the sale of collateral four months after notification of the debtor was not so untimely as to mandate a finding that the creditor was required to renotify the debtor of the planned disposition." 304

The guarantors further asserted that the bank did not even send them a notice of collateral disposition, because "the letter refers to the possibility of the bank's sending further notice of the impending sale, if possible." 305 The Fifth Circuit, however, construed the notice's words "will sell" as a clear statement of the bank's intent to sell the collateral after ten days had passed. 306 The court also found that the bank was not required to send a supplemental notice to the guarantors as the private sale neared fruition, although the bank's original notice indicated that the bank might provide more specific notice later. 307 In short, the Fifth Circuit held that once the bank sent proper notice, which it did, the bank was not required to provide

298. Id.
299. Id. at 465 n.1.
300. 926 F.2d at 465.
301. Id.
302. Id. (citations omitted). The Fifth Circuit further noted that the Code did not provide a specified period during which the collateral at issue must be disposed. Id.
303. Id. at 466 (citing 2 J. White & R. Summers, Uniform Commercial Code § 27-12, at 606, § 27-14, at 611 (3d ed. 1988)).
304. 926 F.2d at 466.
305. Id. For the text of the bank's notice, see supra note 295 and accompanying text.
306. Id.
307. Id.
additional notice regardless of its stated intent to do so in the original notice.  

The guarantors finally contended that the bank's notice of the collateral's disposition was defective "because it failed to identify the addressee as a debtor who would personally be liable for any deficiency," which would be a fatal defect to the notice in another jurisdiction. In response, the Fifth Circuit first noted that neither the court's research nor any authority cited by either party even indicated that Texas law had adopted this position, and thus refused to engraft this requirement onto section 9.504 under Texas law. Instead, the court found that Texas law does not require the secured creditor to set forth all the rights and liabilities of the debtor in the notice; rather, Texas law requires that the notice "be read in conjunction with other documents signed by the debtor [and] construed in light of the Texas Uniform Commercial Code . . . ." Specifically, the debtor remains liable for the deficiency, if any, under section 9.504(b), and both the security agreement and the bank's notice reiterated the debtor's liability for any remaining deficiency after the application of the collateral sale's proceeds to the indebtedness. Under these facts, the Fifth Circuit held that the bank's failure to specifically state in its notice that the recipient of the notice was "personally liable" for the deficiency was not a fatal defect.

Regarding the issue of commercial reasonableness, the guarantors contended that the collateral's disposition was commercially unreasonable because the sale yielded $100,000, which was $400,000 less than the distributor's cost of the inventory and approximately $80,000 to $150,000 less than the amount that an independent distributor testified that he would have been willing to pay for the collateral. The guarantors, however, did not also assert the existence of procedural irregularities, bad faith, or any other reason to explain the allegedly low sale price. The Fifth Circuit held that the purported "deficiency [was] not sufficiently large to overturn the district court's decision that the sale was not commercially unreasonable." In support of its holding, the court first noted that a lower than expected sale price alone does not establish a commercially unreasonable

308. Id.
309. 926 F.2d at 466. The guarantors informed the court that "this defect would be fatal in Nebraska." Id. (citing American Honda Fin. Corp. v. Bennett, 232 Neb. 21, 439 N.W.2d 459, 462 (1989)).
310. Id.
311. Id.
312. Id.
313. See 926 F.2d at 466.
314. Id. The court characterized the guarantors' assertion as "requir[ing] the bank to notify them more explicitly of something that they should have known from reading the law, rereading the original contract, or by consulting common sense." Id.
315. Id. at 467.
316. Id. The Fifth Circuit acknowledged that "Texas appellate courts are split as to where the burden of proof resides on the issue of commercial reasonableness." 926 F.2d at 467. Rather than take a stand on this issue, the Fifth Circuit found that the FDIC could recover the deficiency even if the FDIC bore the burden of proving that the collateral's sale was conducted in a commercially reasonable manner. Id.
sale under the Code and Texas law.317 Accordingly, the court found compelling the fact that the guarantors offered no procedural irregularities, assertions of bad faith, or reason to explain the price received.318 In light of the allegation of only a low sale price, rather than an improperly conducted sale, the Fifth Circuit thus refused to infer commercial unreasonableness under these circumstances.319

III. LENDER COLLECTION ACTIONS

A. Summary Judgment

Lawsuits on promissory notes and guaranties “are particularly suited for disposition by summary judgment.”320 To establish an entitlement to judgment as a matter of law in such a suit, the owner or holder of the note or guaranty must prove the following elements of its claim: “(1) the existence of the notes and guaranties; (2) that Defendants signed the instruments; (3) that Plaintiff is the current [owner and] holder of the instruments; and (4) that a sum certain is due and payable.”321

In NCNB Texas National Bank v. Goldencrest Joint Venture the federal district court addressed the sufficiency of NCNB’s motion for summary judgment on two promissory notes and two guaranties.322 Although the district court found that NCNB met its burden of proof with regard to the first three elements of its cause of action on the notes and guaranties, it denied NCNB’s motion for summary judgment, holding that NCNB failed to satisfy the fourth element necessary to establish liability on the notes and the guaranties, for the reasons set forth below.323

The notes in question provided for a post-default rate of interest of “the highest rate permitted by applicable law or, if no such maximum rate is established by applicable law, then at the Applicable Rate plus five percent (5%) per annum.”324 The applicable rate was defined in the notes as the prime rate of First RepublicBank Dallas (FRBD), original payee of the notes, plus one-and-a-half percent per annum. NCNB’s summary judgment evidence included an affidavit that stated the amount of interest due, but failed to state what interest rate had been used in calculating this sum. Defendants challenged the sufficiency of the affidavit, raising the now fairly

318. Id. at 462.
319. Id.
322. Id. at 33.
323. Id. at 35.
324. Id.
common argument that because FRBD failed, its prime rate ceased to exist, thus making the applicable rate equal to zero plus one-and-a-half percent. Consequently, defendants argued, the proper post-default interest rate to be charged on the notes should have been only six-and-a-half percent interest. Defendants alternatively argued that NCNB must use the six percent interest rate set forth in article 5069-1.03 of the Texas Revised Civil Statutes, which provides the applicable rate of interest when the parties have failed to agree on a rate of interest. NCNB apparently failed to address the interest rate issue in either its original motion for summary judgment or in its reply to defendants’ response to NCNB’s motion for summary judgment.325

The federal district court held that NCNB failed to meet its burden of proof with regard to the sum certain due and owing because, according to the court, it was unclear “what the appropriate interest rate should be, and what interest rate NCNB actually used . . . .”326 In so holding, the court found no evidence in the summary judgment record of either the highest rate permitted by applicable law or what constituted the applicable rate subsequent to the closing of FRBD. This result may have been avoided if NCNB had argued and provided evidence of what constituted the highest rate permitted by applicable law, especially in light of the fact, as noted in the opinion, that article 5069-1.04 of the Texas Revised Civil Statutes applied to the notes.327

In Jernigan v. Bank One, Texas, N.A.328 the Houston Fourteenth District Court of appeals addressed the third element of summary judgment proof in a suit on a promissory note. In that case, the appellate court reversed the trial court’s granting of a summary judgment in favor of Bank One because Bank One failed to prove it was either the owner or holder of the note in question.329 The problem with the note in Jernigan was the appearance of an indorsement to the Federal Reserve Bank of Dallas signed by an officer of MBank Houston, N.A., the original payee of the note. The summary judgment evidence provided by Bank One included an affidavit of one of its vice presidents in which he testified that Bank One was the lawful owner and holder of the note. Although the appellate court recognized that “such an affidavit with its accompanying sworn documents has been held sufficient to uphold a summary judgment on a promissory note,” the court found that the “internally inconsistent” summary judgment evidence precluded Bank One’s entitlement to judgment as a matter of law.330 Specifically, although the affidavit of Bank One’s vice president stated that Bank One was the owner and holder of the note, the Federal Reserve Bank indorsement provided evidence that the Federal Reserve Bank and not Bank One was the owner of the note. Additionally, the summary judgment evidence failed to either explain the circumstances surrounding the Federal Reserve Bank in-

325. Id.
326. 761 F. Supp. at 35.
327. Id.
328. 803 S.W.2d 774 (Tex. App.—Houston [14th Dist.] 1991, n.w.h.).
329. Id. at 775.
330. Id. at 777.
endorsement or provide any evidence of further negotiation of the instrument from the Federal Reserve Bank to MBank, the FDIC or Bank One. Moreover, the affidavit of Bank One's vice president failed to assert that Bank One was in possession of the original note. Based on these facts, the appellate court held that Bank One failed to establish as a matter of law that it was either the owner or holder of the instrument upon which it had brought suit. In light of Jernigan, banks would be well-advised to be aware of the indorsement issue when filing a motion for summary judgment and ensure that the summary judgment proof is consistent with their holder status.

Affiliated Capital Corp. v. Musemeche reaffirms the principle that the burden of proof with regard to owner and holder status is met by producing a photocopy of the note and providing accompanying testimony that the photocopy is a true and correct copy of the note owned and held by the payee, when neither proof to the contrary nor evidence of any subsequent assignments, transfers or indorsements exists.

Two additional summary judgment cases decided during the Survey period also are noteworthy. In Athari v. Hutcheson the Texas supreme court reaffirmed its decision in Shumway v. Horizon Credit Corp. regarding the sufficiency of contractual waivers. In Athari the note's waiver provision stated that the note could be accelerated "without further demand, notice or presentment." Following Shumway, the court held that "[t]he word 'notice' effectively waived Athari's right to notice of acceleration, but did not clearly and unequivocally waive Athari's separate right of notice of intent to accelerate." Because the waiver provision was ineffective to waive Athari's right to notice of intent to accelerate and Athari denied receipt of notice of intent to accelerate, the Texas supreme court reversed the lower court's granting of summary judgment in favor of the holders of the note.

The second noteworthy case is Bixenstine v. Palacios, in which the Corpus Christi court of appeals reiterated that unsworn deposition testimony does not constitute proper summary judgment evidence. Additionally, Bixenstine discussed the liability of an accommodation maker. Specifically, the court held that "[u]pon signing a note as an accommodation maker, the accommodating party becomes liable to the payee as a surety on

331. Id. at 776.
332. Id. at 777.
335. Id. at 218.
336. 801 S.W.2d 896 (Tex. 1991).
337. 801 S.W.2d 890 (Tex. 1991).
338. 801 S.W.2d at 897.
339. Id. (citing Shumway, 801 S.W.2d at 890).
340. 805 S.W.2d 889 (Tex. App.—Corpus Christi 1991, n.w.h.).
341. Id. at 891.
342. Id. at 892.
the instrument for his comaker.” Conversely, an accommodation maker “is not liable to the party accommodated and may, as against the accommodated party, offer oral proof of his status.”

B. Guarantors

In Bank of El Paso v. T.O. Stanley Boot Co. the Bank of El Paso, f/k/a Cielo Vista Bank, (the Bank of El Paso) brought suit against the defendants for recovery on promissory notes and guaranties and sought judicial foreclosure of its security interests in the defendants’ bootmaking equipment. The defendants raised various lender liability claims and defenses. At trial, the jury denied the Bank of El Paso any recovery and awarded the borrowers over $6,000,000 in damages for fraud, breach of contract, deceptive trade practice violations, duress, usury, and impairment of collateral. All of the borrowers’ claims were based on an alleged agreement on behalf of the Bank of El Paso to extend a line of credit in the amount of $500,000 to the borrowers.

Although the Bank of El Paso appealed the trial court’s judgment on a number of points, only those points involving usury and impairment of collateral that the guarantors asserted are relevant to this discussion. Two of the borrowers alleged that they had been required to guarantee the existing personal note of a third party as a condition to obtaining a loan from the Bank of El Paso. These guarantors asserted that this requirement constituted usury under Texas law. Initially, the court noted that Texas courts have held that usury arises “where a lender requires a borrower to pay or assume a third party’s debt as a condition to making a loan.” Under the facts of Stanley Boot, however, the court held that usury did not occur because the guarantors were merely asked to guarantee the loan of a third party, and not to assume or pay that loan. Moreover, the court reiterated that guarantors may not assert the defense of usury, which “is a defense available only to the obligor on a note.”

The guarantors also raised the defense of impairment of collateral, to which the court similarly responded that the guarantors lacked standing.

In so holding, the court noted that “[t]he Texas Supreme Court has held recently that a guarantor is not a party to a promissory note, and a guaranty is not an instrument, as defined in the Tex. Bus. & Com. Code Ann.

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343. Id. (citing Ward v. Vaughn, 298 S.W.2d 862, 866 (Tex. Civ. App.—Galveston 1957, no writ)).
344. “[A]n accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it.” Id. (citing TEX. BUS. & COM. CODE ANN. § 3.415(a) (Tex. UCC) (Vernon 1968)).
345. 805 S.W.2d at 892 (citing Darden v. Harrison, 511 S.W.2d 925, 927 (Tex. 1974)).
347. Id. at 281-82.
348. Id. at 290 (citing Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 928 (Tex. 1984)).
349. Id.
350. Id.
351. 809 S.W.2d at 290.
§ 3.102(a)(5) (Vernon 1968), but rather a contract.”

The court did find, however, that if the guarantors became liable and paid the debt, then they would be provided with standing. Finally, the court found that “the guarantors explicitly waived impairment of collateral relief in their guaranty agreements.”

In *Vastine v. Bank of Dallas* the Texas supreme court addressed a guarantor’s suretyship defense of material alteration of contract. In that case, Vastine argued that he was released from liability on his guaranty when the terms of the note he guaranteed were materially altered without his consent. The Texas supreme court reversed a summary judgment granted to the Bank of Dallas, finding that a material issue of fact existed based on Vastine’s defense of material alteration. The court reiterated black letter law in Texas that a guarantor may rely and insist upon the terms and conditions of the guaranty being strictly followed, and if the creditor and principal debtor vary in any material degree from the terms of their contract, then a new contract has been formed and the guarantor is not bound to it.

C. Offset

In *Mobil Oil Corp. v. Texas Commerce Bank-Airline* the Houston First District court of appeals addressed a bank’s offset rights in an account assigned to another creditor. Mobil Oil Corporation (Mobil) sued Texas Commerce Bank-Airline (TCB) and P. A. Luhm (Luhm), alleging that TCB wrongfully offset a savings account assigned to Mobil and wrongfully returned the remainder of the account to Luhm. Luhm had assigned a savings account at TCB to Mobil as security for goods purchased on credit by Luhm from Mobil. Despite the assignment, Luhm attempted to withdraw the balance of the savings account, at which time TCB offset Luhm’s debts to it with a portion of the savings account and then returned the remainder to Luhm. Overturning the trial court’s granting of summary judgment in favor of TCB, the appellate court held that TCB had wrongfully offset the account, stating “[w]hen a bank knows it holds funds for the benefit of someone other than its depositor, it cannot seize that money to pay itself.”

According to the court, TCB wrongfully disregarded the assignment, of which it had knowledge, and disbursed the funds. The court also acknowledged that “[w]hen a customer deposits funds with a bank, the bank impliedly agrees to disburse those funds only in accordance with the deposi-
IV. SUNDRY BANKING LITIGATION ISSUES

A. Loan Participations

In *City National Bank v. United States* the Fifth Circuit held the FDIC liable for breach of contract as a lead lender in a loan participation acquired from a failed bank. The loan participants sued the FDIC and the United States for violating the participation agreement and for breaching common law duties. The Fifth Circuit held that the FDIC was not grossly negligent in its handling of the loans; however, the court held that the FDIC was liable for breach of contract in not disbursing to the participants all payments to which they were entitled in proportion to their participation interest. The Fifth Circuit declined the government's invitation to find liability on a tort theory and held that the breach of contract claim fell outside the Federal Tort Claims Act's waiver of sovereign immunity.

B. Assignment of Rents

Since the seminal opinion of *Taylor v. Brennan* Texas real estate attorneys have waited for guidance on the difficult issue of taking an assignment of rents in connection with a loan transaction. Although the Texas supreme court has not addressed this matter recently, the Fifth Circuit issued an important opinion during the survey period. In *FDIC v. International Property Management* the Fifth Circuit affirmed a summary judgment in favor of

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361. *Id.* (citing *La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 564 (Tex. 1984)).

362. 907 F.2d 536 (5th Cir. 1990). The FDIC in its corporate capacity purchased this loan from the FDIC-receiver of First National Bank of Midland.

363. The FDIC was sued for breach of contract, breach of fiduciary duty, breach of duty of good faith, and declaratory relief, and an accounting was sought. The United States was sued for gross negligence. The district court consolidated the cases. *Id.* at 538.

364. The participation agreement limited the lead bank's liability for mistakes in performance to gross negligence. Further, the participation agreement allowed the FDIC to act autonomously without consulting the participants. *See id.* at 541.

365. *Id.* at 543. The participants alleged entitlement and were found to have a right to their share of funds earned from a renewal and extension agreement that the FDIC executed. The Fifth Circuit reversed the district court's judgment notwithstanding the verdict on the breach of contract cause of action and remanded the case to the district court for damage calculations because the court found that the jury verdict was not supported by the evidence. *Id.* at 545-46.

366. According to the Fifth Circuit, the United States took the position that the banks' cause of action sounded solely in tort in the hope that all the banks' claims would be dismissed as falling within the discretionary function exception to Federal Tort Claims Act liability. 907 F.2d at 546 n.9.

367. 621 S.W.2d 592 (Tex. 1981). In *Taylor* the Texas supreme court determined that the assignment of rents at issue was an assignment made for security, a collateral assignment, rather than an absolute assignment. Because Texas is a lien theory state, a mortgagee is not the owner of the property and is not entitled to its possession, rents or profits. *Id.* at 593. Therefore, the court followed the common law rule that an assignment of rents does not become operative until the mortgagee obtains possession of the property, impounds the rents, secures the appointment of a receiver, or takes some other similar action. *Id.* at 594. The court found a collateral assignment in *Taylor* after an examination and construction of the deed, deed of trust, and assignment of rentals.

368. 929 F.2d 1033 (5th Cir. 1991). The Fifth Circuit interpreted Texas substantive law;
the conservator of the mortgagee that gave the lender an immediate right to
the rents upon the mortgagor’s default. The Fifth Circuit determined that
the assignment of rents clause in the deed of trust passed immediate title to
the rental proceeds to the mortgagee, with the enjoyment of the rents post-
poned as long as the mortgagor was not in default. The court followed the
Taylor analysis by examining the intent of the parties to determine whether
the assignment of rents clause created an absolute assignment.\textsuperscript{369} The court
classified this assignment of rents clause as a “contingent present assign-
ment.”\textsuperscript{370} Although the Fifth Circuit noted that assignment of rents clauses
generally are not construed as absolute, the court reasoned that the clear
intent of the documents established an exception to this rule.\textsuperscript{371}

An example of the lender’s predicament in trying to enforce an assignment
of rentals is presented in the other case published in this area during the
survey period. In \textit{NCNB Texas National Bank v. Sterling Projects}\textsuperscript{372} the
Dallas court of appeals upheld the denial of an injunction to prevent the
borrower from dissipating rents collected prior to the filing of the suit.\textsuperscript{373} At
argument, the lender conceded that the assignment was not absolute and the
court found that the rents were held only as additional security and not
absolutely assigned.\textsuperscript{374} Under the Taylor rule, the lender was not entitled to
rents collected before it took some kind of affirmative action.\textsuperscript{375}