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Banking Law

Colleen A. Coyne

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BANKING LAW

Colleen A. Coyne*

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I. CASE LAW

A. DIRECTORS' AND OFFICERS' LIABILITY

1. *Business Judgment Rule*

IN *FDIC v. Benson*¹ the United States District Court for the Southern District of Texas affirmed its holding in *FDIC v. Brown*² and held that the Texas business judgment rule³ bars claims for ordinary negligence and breach of fiduciary duty against former disinterested directors of failed financial institutions. In *Benson*, the FDIC argued that the business judgment rule functions only as a defense to a negligence or breach of duty action brought by shareholders against a bank officer or director.⁴

The court, relying upon *Brown*, disagreed with the FDIC and found that "the Texas business judgment rule does not function simply as a defense to claims of negligence or breach of fiduciary duty by corporate directors."⁵ The court stated that "the Texas business judgment rule is a substantive rule of law that requires of the FDIC both pleading and proof to avoid its reach."⁶ The court rejected the FDIC's argument that the business judgment rule applies only to suits brought against bank officers and directors on behalf of the shareholders in their own interest.⁷ In conclusion, the court found that the business judgment rule precluded any of the FDIC's claims for simple negligence that were not already barred by the statute of limitations.⁸

In *FDIC v. Harrington*⁹ the United States District Court for the Northern District of Texas also followed the reasoning of *Brown* in its assessment of the business judgment rule under Texas law. The plaintiffs, relying on *FDIC v. Wheat*,¹⁰ argued that the defendants were liable for common law acts of simple negligence. The court rejected the plaintiffs' argument.¹¹ Specifically, the *Harrington* court refused to adopt an interpretation of the *Wheat* case that would, in effect, overrule the *Gearhart* decision.¹²

The court in *Harrington* addressed the inherent tension between the duty of care and the protection afforded by the business judgment rule, citing the Fifth Circuit's statement in *Gearhart*: "Texas courts to this day will not

1. 867 F. Supp. 512, 521 (S.D. Tex. 1994).

2. 812 F. Supp. 722 (S.D. Tex. 1992).

3. The business judgment rule is defined in *Gearhart Indus., Inc. v. Smith Int'l, Inc.*, 741 F.2d 707, 721 (5th Cir. 1984) as "a corporate director who acts in good faith and without corrupt motive will not be held liable for mistakes of business judgment that damage corporate interests."

4. *Benson*, 867 F. Supp. at 521.

5. *Id.* (citing *Brown*, 812 F.Supp. at 724).

6. *Id.*

7. *Id.*

8. *Id.* at 522.

9. 844 F. Supp. 300 (N.D. Tex. 1994).

10. 970 F.2d 124 (5th Cir. 1992).

11. *Harrington*, 844 F. Supp. at 305.

12. *Id.* at 307.

impose liability upon a noninterested corporate director unless the challenged action is ultra vires or tainted by fraud."¹³ The *Harrington* court "believes *Gearhart* provides the more accurate statement of Texas law regarding officer and director liability" than does *Wheat*.¹⁴ The *Harrington* court reviewed the relationship between the fiduciary duties owed by officers and directors and the business judgment rule. According to *Harrington*, the officers and directors have three fiduciary duties: 1) the duty of obedience, 2) the duty of loyalty, and 3) the duty of care.¹⁵ The duty of obedience forbids ultra vires acts (acts outside the scope of corporate power).¹⁶ The duty of loyalty requires that officers and directors act in good faith, and forbids them from engaging in "interested" transactions.¹⁷ Lastly, the duty of care requires directors and officers to manage corporate affairs with diligence and prudence.¹⁸ The court also cited the Texas Supreme Court formulation of the business judgment rule which was cited in the *Brown* case: the "negligence of a director, no matter how unwise or imprudent, does not constitute a breach of duty if the acts of the director were 'within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved.'"¹⁹

Therefore, the *Harrington* court concluded that officers and directors of five failed banks and the holding companies for those banks could not be held liable for simple negligence, negligence per se, or breach of fiduciary duty.²⁰ Because the court concluded that Texas common law holds officers and directors liable only for acts of gross negligence, which is the same standard under section 1821(k) of Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA),²¹ the court did not address the issue of whether FIRREA preempts state common law actions.²² The court held that under the Texas business judgment rule, officers and directors are liable only for gross negligence.²³

In *FDIC v. Wheat*²⁴ the Fifth Circuit rejected the FDIC's argument that the business judgment rule did not preclude an action for negligence against disinterested directors of a bank. In *Harrington* the court recognized that "*Wheat* is open to divergent interpretations" but concluded that the Fifth Circuit did not intend to overrule *Gearhart*.²⁵ Several subsequent cases have limited the *Wheat* decision further on other grounds.

13. *Id.* at 306 (citing *Gearhart*, 741 F.2d at 721).

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 306 (citing *Brown*, 812 F. Supp. 724; *Cates v. Sparkman*, 11 S.W. 846, 849 (Tex. 1889)).

20. *Id.*

21. 12 U.S.C. § 1821(k) (Supp. I 1989).

22. *Harrington*, 844 F. Supp. at 305 n.5.

23. *Id.* at 305.

24. 970 F.2d 124 (5th Cir. 1992).

25. *Harrington*, 844 F. Supp. at 307.

The court in *FDIC v. Mijalis*²⁶ noted that *Wheat* failed to find error in the trial court's failure to submit a jury instruction on FDIC's duty to mitigate since the FDIC had, in fact, mitigated to the extent legally possible. However, *Mijalis* held that the *Wheat* decision would not be construed as imposing a duty on the FDIC to mitigate. Instead, *Mijalis* held that the FDIC was not subject to the affirmative defense of mitigation of damages when it sues directors or officers in its corporate capacity to recover losses sustained by an insolvent financial institution.²⁷ In *RTC v. Acton*²⁸ the court held, as in *Harrington*, that the Texas common law requires gross negligence for officer and director liability. Finally, *FDIC v. Belli*²⁹ stated that *Wheat* should not be read as defining when the FDIC's cause of action accrues for statute of limitations purposes. *Belli* disagreed with the Third and Seventh Circuits in holding that the cause of action accrues when it comes into existence, rather than when the FDIC becomes receiver for a defunct bank.³⁰

2. Director and Officers Standard of Care

*Resolution Trust Corporation v. Miramon*³¹ involved a failed Louisiana savings and loan association, the South Savings & Loan Association of Slidell, Louisiana. In 1989, the RTC became the receiver for the failed thrift. In August, 1992, the RTC brought suit against the former officers and directors of South Savings, seeking to recover losses caused by the officers' and directors' alleged negligence, breach of fiduciary duty, and gross negligence. The defendants moved to dismiss the claims of negligence and breach of fiduciary duty, contending that these theories failed to state a claim on which relief could be granted. In response to the defendants' motion for dismissal of the negligence and breach of fiduciary duty allegations, the RTC asserted that federal common law survived FIRREA. Accordingly, the RTC argued that it was allowed to maintain its actions against the directors and officers based on simple negligence. The district court disagreed with the RTC and found that FIRREA set a federal standard of care of gross negligence, and further held that any federal common law to the contrary was preempted.

On appeal, the *Miramon* court held that FIRREA establishes gross negligence as the federal standard of care for directors or officers of federally insured deposit institutions and preempts the federal common law.³² The issue in *Miramon* was whether the RTC could sue directors or officers of federally insured deposit institutions for simple negligence and

26. 15 F.3d 1314, 1323 (5th Cir. 1994).

27. *Id.* at 1324.

28. 844 F. Supp. 307 (N.D. Tex. 1994).

29. 981 F.2d 838, 841-42 (5th Cir. 1993).

30. *Id.* at 841.

31. 22 F.3d 1357 (5th Cir. 1994).

32. *Id.* at 1360-61.

breach of fiduciary duty under the federal common law.³³ The court agreed with the Seventh Circuit in *RTC v. Gallagher*³⁴ which concluded that section 1821(k) of FIRREA preempted the federal common law and that the sole cause of action against directors and officers under federal law was for gross negligence.³⁵ Upon considering the plain language of section 1821(k), the *Miramon* court found that Congress did "speak directly" to the issue of "the federal standard of care for directors and officers of federally insured deposit institutions thus preempting any resort to federal common law."³⁶ The language of the statute states that "a director or officer . . . may be held personally liable for monetary damages in any civil action . . . for gross negligence . . . as such terms are defined and determined under applicable State law."³⁷ The *Miramon* court rejected the RTC's interpretation of the savings clause, which stated that "[n]othing in this paragraph shall impair or affect any right of the Corporation under other applicable law."³⁸ The court noted that the RTC's interpretation of the savings clause would violate "the elementary canon of construction that a statute should be interpreted so as not to render one part inoperative."³⁹ The court noted that "it simply makes no sense that Congress would establish a cause of action in one sentence and then render it a nullity in the next."⁴⁰ The court found the RTC's arguments, which were based on the statute's legislative history, insufficient to change its conclusion.⁴¹ Therefore, the court held that FIRREA establishes gross negligence as the federal standard of care for directors or officers of federally insured deposit institutions and preempts the federal common law.⁴² The statutory retention of the RTC's rights under "other applicable law" does not preserve the right to bring federal common law actions for simple negligence.⁴³

The court reserved judgment on whether FIRREA preempts state common law standards that allow causes of action against bank directors

33. *Id.* at 1359. See also *RTC v. Chapman*, 29 F.3d 1120 (7th Cir. 1994). In *Chapman*, the Seventh Circuit rejected the RTC's argument that they could assert simple negligence claims against directors of federal institutions under state law and held that state law is inapplicable to claims against directors of federally chartered institutions. *Id.* at 1123. The court applied the Internal Affairs Doctrine, under which matters relating to the governance of a corporation are determined under the laws of the jurisdiction of incorporation. *Id.* at 1122.

34. 10 F.3d 416 (7th Cir. 1993).

35. *Miramon*, 22 F.3d at 1359-60.

36. *Id.* at 1360.

37. *Id.* at 1361 (citing 12 U.S.C. § 1821(k) (Supp. I 1989)).

38. *Id.* (citing 12 U.S.C. § 1821(k) (Supp. I 1989)).

39. *Id.* (citations omitted).

40. *Id.* at 1362.

41. *Id.*

42. *Id.* at 1364.

43. *Id.* at 1359 (citing 12 U.S.C. § 1821(k) (Supp. I 1989)).

and officers based on simple negligence.⁴⁴ At least two other circuits have held that such suits are not pre-empted.⁴⁵

In *FDIC v. Harrington*,⁴⁶ previously discussed, the court also considered whether section 1821(k) of FIRREA creates a federal liability standard for officers and directors of federally-insured depository institutions. The court reasoned that the statute requires a showing of gross negligence or greater violations of the duty of care.⁴⁷ The court in *Harrington*, as in *Miramon*, addressed the last clause of the section which reads "[n]othing in this paragraph shall impair or affect any right of the Corporation under other applicable law."⁴⁸ The *Harrington* court, relying upon the statutes' plain meaning, and on well-reasoned opinions from other district courts and the Seventh Circuit, held that no federal common law cause of action exists for the simple negligence of officers and directors.⁴⁹ In other words, FIRREA does not preserve a federal common law cause of action against officers and directors for conduct less culpable than gross negligence.⁵⁰

3. *Fiduciary Duty to Customers*

Another Texas court was asked to determine whether a bank owed a fiduciary duty to its customers. In *Crutcher v. Continental National Bank*⁵¹ the court followed the Fifth Circuit rulings and held that the bank did not owe a duty to their former customers. The *Crutcher* court stated that the relationship between a bank and its customers does not create a special or fiduciary relationship, except in limited circumstances, which did not exist in *Crutcher*.⁵² This suit was filed against the bank by two former customers who alleged breach of fiduciary duty when the bank released the customers' unrecorded liens in several trailers. The court also held that the bank did not breach the common law duty to exercise ordinary care, since it could not foresee or anticipate that another person would engage in negligent, unlawful or criminal activity.⁵³

4. *Notice of Claims Under Directors and Officers' Liability Policy*

In *FDIC v. Mijalis*⁵⁴ the Fifth Circuit reviewed a district court decision from the Western District of Louisiana and held that general demands for regulatory compliance made by the FDIC upon a bank did not qualify as

44. *Id.* at 1363 n.9.

45. *FDIC v. Canfield*, 967 F.2d 443, 448 (10th Cir.) (en banc), *cert. denied*, 113 S. Ct. 516 (1992); *FDIC v. McSweeney*, 976 F.2d 532, 538 (9th Cir. 1992), *cert. denied*, 113 S. Ct. 2440 (1993).

46. 844 F. Supp. 300 (N.D. Tex. 1994).

47. *Id.* at 304-05.

48. *Id.* at 303; *Miramon*, 22 F.2d at 1361.

49. *Harrington*, 844 F. Supp. at 304.

50. *Id.* at 305.

51. 884 S.W.2d 884 (Tex. App.—El Paso 1994, writ denied).

52. *Id.* at 886.

53. *Id.* at 887.

54. 15 F.3d 1314 (5th Cir. 1994).

“claims,” within the meaning of a claims-made policy and that financial information submitted by the bank during the loan renewal process did not qualify as “notice” of potential claims under the insurance policy. In reaching this conclusion, the court first addressed whether the FDIC’s communications to the individual defendants during the policy periods were “claims” within the meaning of that term as used in the insurance policies. The court pointed to its prior holding that “the determination of whether a given demand is a ‘claim’ within the meaning of a claims-made policy requires a fact-specific analysis to be conducted on a case-by-case basis.”⁵⁵ The court noted that “a claim is clearly made when an outside party files suit on a demand based on an act or omission of an officer or director.”⁵⁶ The court further noted that the policy at issue envisioned “claims” as being “closely related to legal obligations to pay money,” and therefore applied its definition of the term “claim” used in *FDIC v. Barham*: “a demand which necessarily results in a loss—i.e., a legal obligation to pay—on behalf of the directors.”⁵⁷ Relying on *Barham*, the court reasoned that the appropriate inquiry is whether the communications at issue referred to demands that would necessarily result in losses to the directors resulting from a failure to comply with the relevant banking regulations.⁵⁸ The court concluded that most of the documents relied on by the FDIC are easily dismissed since they fell outside of the *Barham* definition of “claim.”⁵⁹ There was one “arguable exception” to this conclusion: the FDIC did warn the members of the bank’s board of directors through a letter that it was considering recommending civil money penalties under Federal Reserve Regulation O.⁶⁰ The court did not need to decide whether this letter satisfied the narrow definition of “claim” established in *Barham* because the court reasoned the insurance policies at issue excluded from the definition of “loss” any “fines or penalties imposed by law.”⁶¹ Therefore, the court stated that “the threatened ‘civil money penalties’ are clearly excluded from coverage under the policies.”⁶² Since the court concluded that *Barham* is controlling and that no claims were made on the bank or its directors during the policy periods as required under the relevant insurance policies, the court did not consider whether the district court “correctly interpreted the policies not to require the insured to give notice to [the insurance company] of claims made as a condition precedent to coverage.”⁶³

The court next considered whether the insurance coverage was triggered under the policy because the insureds gave written notice to the insurance company during the policy periods of occurrences that might

55. *Id.* at 1331.

56. *Id.*

57. *Id.* at 1332; *Barham*, 995 F.2d 600, 604 (5th Cir. 1993).

58. *Mijalis*, 15 F.3d at 1332.

59. *Id.* at 1333.

60. *Id.* at 1333 (citing 12 C.F.R. § 215(b), (d) (regulating insider lending)).

61. *Id.*

62. *Id.*

63. *Id.* at 1334.

have given rise to claims being made against the insureds. More specifically, the FDIC argued that the bank's renewal application submitted before the expiration of the 1983 policy disclosed the existence of the cease and desist order, which the FDIC had previously used as "an occurrence that subsequently gave rise to the claims asserted" against the directors.⁶⁴ The insurance company (International) responded by stating that the documents relied upon by the FDIC were not legally sufficient to comprise notices of potential claims and that "non-specific communications merely disclosing that events have occurred do not satisfy the requirement of notice of potential claims."⁶⁵ International relied on the Fifth Circuit's *Barham* opinion and on *McCullough v. Fidelity & Deposit Company*.⁶⁶ International also pointed toward the cases relied upon in *Barham* and *McCullough*, which construed insurance policies such as the ones at issue in *Mijalis* to require specific notices from the insured to the insurer in order to trigger "notice of potential claims" coverage.⁶⁷ The court affirmed its prior holding in *McCullough* that "notice of an institution's worsening financial condition is not notice of an officer's or director's act, error, or omission."⁶⁸ The *McCullough* court also held that "the proper focus of the district court's inquiry is whether the insured has objectively complied with such a notice provision, and not whether the insurer has subjectively drawn inferences that potential claims exist from the materials submitted by the insured."⁶⁹ Despite subtle differences between the insurance policy in *Mijalis* and those in the cases relied upon, the court refused to conclude that the notice of potential claims clause was materially different from those involved in *Barham* and *McCullough*. The policies at issue in *Mijalis* required the individual defendants to give International "written notice as soon as practicable 'of any occurrence which may subsequently give rise to a claim being made against the Insureds in respect of any . . . Wrongful Act' done or alleged to have been done by the insureds while acting as directors or officers of the Bank."⁷⁰ The court stated that subjective inferences elicited from general information are irrelevant to the question of adequate notice.⁷¹ Additionally, evidence of the insurance company's subjective knowledge was also irrelevant.⁷²

5. *Deposit Insurance*

In *Hartford Casualty Insurance Company v. FDIC*⁷³ the Fifth Circuit reviewed a United States District Court for the Southern District of Texas

64. *Id.*

65. *Id.* at 1335.

66. 2 F.3d 110 (5th Cir. 1993).

67. *Mijalis*, 15 F.3d at 1335.

68. *Id.*

69. *Id.* (citing *McCullough*, 2 F.3d at 113 (emphasis omitted)).

70. *Id.* at 1336.

71. *Id.*

72. *Id.*

73. 21 F.3d 696 (5th Cir. 1994).

denial of a motion for summary judgment of the FDIC. The Fifth Circuit held that section 1821(f)(4) of FIRREA which placed claims involving deposit insurance within the exclusive jurisdiction of the federal courts of appeal applied retroactively; that section 1821(f)(4) of FIRREA imposing the sixty-day time limit on requests for review of final determinations by the FDIC did not apply retroactively; that the petition for review was not untimely; and that the FDIC did not act arbitrarily or capriciously in deciding the coverage dispute.⁷⁴ In *Hartford Casualty*, the insurance company sued the FDIC seeking to recover \$492,000 in deposit insurance. The issues which arose on appeal were whether the Fifth Circuit had jurisdiction over Hartford's appeal; whether Hartford's claim against the FDIC was filed in a timely manner; if the FDIC acted arbitrarily and capriciously in determining that the certificates of deposit belonged to Hartford; and whether, under various equitable principles, the FDIC's offset of the six certificates of deposits against the debts owed was wrongful.⁷⁵ With respect to subject matter jurisdiction, the Fifth Circuit cited its prior decision in *Nimon v. RTC*⁷⁶ where the court determined that 12 U.S.C. section 1821(f)(4) placed claims involving deposit insurance within the exclusive jurisdiction of the federal courts of appeals. In order to clarify its basis for subject matter jurisdiction, the Fifth Circuit addressed the question of whether section 1821(f)(4) applied retroactively to the present case and concluded that it in fact did.⁷⁷ The court pointed towards a recent United States Supreme Court case which "clarified the circumstances in which a new statute which itself does not explicitly state whether it applies to pending cases should be applied retroactively."⁷⁸ The Supreme Court in *Landgraf v. USI Film Products*⁷⁹ decided that certain provisions of the Civil Rights Act of 1991 should be applied retroactively to pending cases. In arriving at this decision, the Supreme Court endorsed "the traditional presumption against applying statutes affecting substantive rights, liabilities, or duties to conduct arising before their enactment."⁸⁰ However, the Supreme Court also stated that, regardless of the general presumption against statutory retroactivity, "in many situations, a court should 'apply the law in effect at the time it renders its decision.'"⁸¹ Generally, the situations involved procedural changes to the existing law, including statutes which merely change jurisdiction.⁸² Such a circumstance does not take away any substantive rights but rather changes the tribunal that is to hear the case.⁸³ The Fifth Circuit also pointed towards its own precedents which have held that "amendments

74. *Id.* at 700-06.

75. *Id.* at 700.

76. 975 F.2d 240, 244 (5th Cir. 1992).

77. *Hartford Casualty*, 21 F.3d at 700.

78. *Id.*

79. 114 S. Ct. 1483 (1994).

80. *Id.* at 1504.

81. *Id.* at 1501 (citations omitted).

82. *Hartford Casualty*, 21 F.3d at 700.

83. *Id.* at 701.

to statutes which affect procedural or remedial rights generally apply to pending cases, where such change does not deprive a party of its 'day in court.'"⁸⁴ The court noted that it had retroactively applied 12 U.S.C. section 1819(b)(2), which permits the FDIC to remove cases in which it is a party to federal court, to pending cases.⁸⁵ The Fifth Circuit concluded that "[s]ection 1821(f)(4) changes the forum which hears deposit insurance disputes; it does not alter any substantive rights of the parties nor does it deprive any party of its day in court."⁸⁶ Therefore, the Fifth Circuit held that section 1821(f)(4) applied retroactively to govern *Hartford*, thereby granting the Fifth Circuit jurisdiction in the appeal.⁸⁷

The Fifth Circuit next considered the FDIC statute of limitations argument, which maintained that Hartford did not timely petition for review of the FDIC's deposit insurance determination.⁸⁸ The FDIC relied upon 12 U.S.C. section 1821(f)(5), which states: "Any request for review of a final determination by the Corporation shall be filed with the appropriate circuit court of appeals not later than 60 days after such determination is ordered."⁸⁹ The FDIC argued that the sixty-day time limit began to run in the present case on the effective date of FIRREA, August 9, 1989. According to the FDIC, since Hartford did not file its suit until June 24, 1991, such filing was untimely. The court noted that, in contrast to its decision to retroactively apply other sections of FIRREA, retroactive application of section 1821(f)(5) in the present case would "extinguish claims which were valid before the statute's effective date and deprive Hartford of a forum, even though it acted properly under law existing at the time its claims arose."⁹⁰ The court held that to begin running the statute of limitations period from the date of FIRREA's enactment would be "manifestly unjust," and would violate the holding in *Bradley v. School Board*,⁹¹ since it would "infringe upon or deprive a person of a right that had matured," and would impose "unanticipated obligations . . . upon a party without notice or an opportunity to be heard."⁹²

The court next reviewed the insurance coverage dispute by reviewing the FDIC-C under the Administrative Procedure Act. The Fifth Circuit noted that it must affirm the FDIC-C's determinations unless they are "found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law."⁹³ Hartford, as the appellant, had the burden of proving that the FDIC's determination was arbitrary and capri-

84. *Id.* at 701; *NCNB Texas Nat'l Bank v. P & R Inv. No. 6*, 962 F.2d 518, 519 (5th Cir. 1992).

85. *P & R Inv. No. 6*, 962 F.2d, at 519.

86. *Hartford Casualty*, 21 F.3d at 701.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* at 702.

91. *Id.*; 416 U.S. 696 (1974).

92. *Id.*; *Bradley*, 416 U.S. at 720.

93. *Hartford Casualty*, 21 F.3d at 704 (citations omitted).

cious.⁹⁴ The court noted that it would be deferential to an administrative agency's interpretations of its own regulations.⁹⁵ In reviewing the FDIC's actions, the court concluded that the FDIC did not act arbitrarily or capriciously in arriving at its decision.⁹⁶

Lastly, the court considered Hartford's offset claims. Hartford argued that the FDIC's offset of the six certificates of deposit against the debt owed was wrongful and asked the court to impose a constructive trust or in the alternative to grant some similar type of equitable relief.⁹⁷ The court noted, however, that Hartford's equitable claims were based on actions taken by the FDIC-R, rather than the FDIC-C.⁹⁸ Because the FDIC-R had been dismissed in *Hartford* pursuant to a settlement agreement, and because the appeal related only to Hartford's insurance claims, the court stated "the offset claims are not open. Under the dual capacities doctrine, the FDIC-C may not be held liable for acts committed by the FDIC-R, i.e., the FDIC acting in one capacity is not subject to defenses or claims based on its acts in other capacities."⁹⁹

In *First American Bank v. RTC*¹⁰⁰ the Fifth Circuit reviewed a final determination of the Resolution Trust Corporation and ruled in favor of a bank stating that the RTC had abused its discretion by denying federal deposit insurance coverage for an investment by the bank.¹⁰¹ In April 1989, the bank purchased a \$98,000 certificate of deposit from Spindletop Savings Association (Old Spindletop). A few months later Old Spindletop failed and was placed into receivership. First American Bank subsequently purchased a \$99,000 certificate of deposit from the newly chartered institution, Spindletop Savings Association, F.A. (New Spindletop). In June 1990, New Spindletop failed and was placed into receivership. The RTC then sold both of the Spindletop certificates of deposit to First City Texas-Beaumont, N.A. In June 1990, First American Bank redeemed one of the certificates of deposit. First City, however, refused to honor the other certificate of deposit.

First American Bank submitted a claim to the RTC through its administrative procedures, but the RTC declined to pay, taking the position that no coverage existed. The Fifth Circuit rejected the RTC's argument that the bank, through its own fault, had deposited more than \$100,000 in a single institution and under 12 U.S.C. section 1818(q) was uncovered with respect to amounts over \$100,000.¹⁰² Finding that the RTC's argument was "untenable," the Fifth Circuit construed section 1818(q) to mean exactly what it said: that any assumed term deposit shall be accorded *sepa-*

94. *Id.*

95. *Id.* (citation omitted).

96. *Id.* at 705.

97. *Id.* at 706.

98. *Id.*

99. *Id.* (citing *Texas Am. Bancshares, Inc. v. Clarke*, 954 F.2d 329, 335 (5th Cir. 1992)).

100. 30 F.3d 644 (5th Cir. 1994).

101. *Id.* at 645.

102. *Id.* at 648.

rate deposit insurance during the statutory grace period.¹⁰³ The court interpreted the word "separate" as used in section 1818(q) to mean "apart from and in addition to" any other deposit insurance that may or may not exist at the time of assumption.¹⁰⁴ The court concluded that the insurance on the first certificate of deposit was apart from and in addition to the coverage applicable to the second certificate of deposit because it was a new time deposit made at the assuming institution after the assumption of Old Spindletop's liabilities.¹⁰⁵

6. "Whistleblower Clause Under FIRREA"

In *Ellis v. NCNB Texas National Bank*¹⁰⁶ a former employee filed suit against a bank alleging that he was fired because he talked to the FDIC about possible wrongdoing at the bank. The employee argued that the bank had violated the FIRREA "whistleblower clause."¹⁰⁷ Finding FIRREA's whistleblower statute to be analogous to the burden of proof rules established in Title VII retaliation cases, the court applied the same standards and held that the plaintiff must first establish a prima facie case of retaliation.¹⁰⁸ Once the plaintiff meets its burden of proof, the defendant is afforded the opportunity to rebut the presumption of retaliation by showing its actions were motivated by legitimate, nondiscriminatory reasons.¹⁰⁹ The court stated that it was

persuaded that the proper balance can be struck by allowing the plaintiff who raises a genuine issue of material fact regarding the believability of an employer's legitimate, nondiscriminatory reasons to present his case to the factfinder and by tailoring jury instructions and questions to anchor a finding of pretext necessarily in a finding of unlawful discrimination.¹¹⁰

In this case, however, the court concluded that the former employee had not met this standard and therefore the bank was entitled to summary judgment.¹¹¹

7. Defenses

a. Mitigation of Damages

In *Mijalis*, discussed previously,¹¹² the court also addressed the affirmative defense of mitigation of damages. Specifically, *Mijalis* addressed whether the mitigation of damages defense is inapplicable to the FDIC in suits against officers and directors of failed financial institutions.¹¹³

103. *Id.*

104. *Id.* (emphasis omitted).

105. *Id.*

106. 842 F. Supp. 243 (N.D. Tex. 1994).

107. 12 U.S.C. § 1831j(a) (Supp. I 1989).

108. *Ellis*, 842 F. Supp. at 249.

109. *Id.* at 247.

110. *Id.* at 249.

111. *Id.* at 249 and 251.

112. 15 F.3d 1314 (5th Cir. 1994).

113. *Id.* at 1323.

Mijalis held that the “FDIC is not subject to the affirmative defense of failure to mitigate damages when it sues former directors and officers in its corporate capacity to recover losses sustained by an insolvent financial institution and covered by the national insurance fund.”¹¹⁴ *Mijalis* relied upon public policy arguments which prohibit defendant directors and officers from asserting such a defense against the FDIC, because risks of error in judgment by FDIC personnel should be borne by the directors and officers who were wrongdoers in the first instance rather than by the National Insurance Fund. Furthermore, *Mijalis* reasoned that the mitigation of damages defense should not be applied against the FDIC because the conduct of the FDIC should not be subjected to “judicial second guessing,” and because the FDIC does not owe a duty to the failed financial institutions or their former directors and officers.¹¹⁵ Another approach relied upon by *Mijalis* was “to view the FDIC’s conduct in managing failed banks as insulated from affirmative defenses such as mitigation of damages by the discretionary function exception to the Federal Tort Claims Act.”¹¹⁶ Specifically, the *Mijalis* court followed the Seventh Circuit’s reasoning in *FDIC v. Bierman*.¹¹⁷ In *Bierman* the Seventh Circuit relied both upon policy considerations that favor liberating the FDIC from the duty to mitigate damages and the discretionary function exception to the Federal Tort Claims Act (FTCA).¹¹⁸ The policy considerations included: (a) the risk of errors in judgment by FDIC personnel should be borne by the directors and officers who were wrongdoers in the first instance rather than by the national insurance fund; (b) the FDIC should not be subjected to judicial second-guessing; and (c) the FDIC owes no duty to failed financial institutions or to their former directors and officers.¹¹⁹ The *Bierman* court took note of the Supreme Court’s recent decision in *United States v. Gaubert*,¹²⁰ where the Court concluded that exempting the FDIC from the affirmative defenses of contributory negligence and mitigation of damages was consonant with the purpose of the discretionary function exception to the FTCA. In sum, the *Bierman* court held that “the discretionary exception to the FTCA and the lack of a duty to the wrongdoers . . . prevent the assertion of affirmative defenses against the FDIC.”¹²¹ The *Mijalis* court noted that some district courts within the Fifth Circuit have arrived at different decisions from the *Mijalis* decision.¹²²

114. *Id.* at 1324.

115. *Id.*

116. *Id.*

117. 2 F.3d 1424, 1438-41 (7th Cir. 1993).

118. 28 U.S.C. § 2671 (1988).

119. 2 F.3d at 1424-38.

120. 499 U.S. 315, 326 (1991) (holding that actions taken by the Federal Home Loan Bank Board in supervising a savings and loan at the day-to-day operational level could come within the discretionary function exception to the FTCA).

121. *Bierman*, 2 F.3d at 1441.

122. *Mijalis*, 15 F.3d at 1323.

b. Federal Statute of Limitations

The United States Court of Appeals for the District of Columbia recently held that the federal five-year statute of limitations applies broadly to administrative proceedings initiated by federal agencies.¹²³ *3M Company v. Browner* involved an Environmental Protection Agency proceeding to assess civil money penalties against 3M Company for violation of the Toxic Substances Control Act. The court held that the five-year period begins to run on the date the violation occurs, regardless of when the agency discovers the violation.¹²⁴ Clearly, this case will have a significant impact on the bank regulatory agencies. The ruling would substantially alter the financial exposure of many institutions, as well as former bank officers, directors and counselors with regard to pending or contemplated agency actions for alleged wrongdoing that occurred more than five years ago.

The Court of Appeals rejected the government's request for rehearing on May 9, 1994. After receiving an extension to file an appeal, the Justice Department decided not to appeal the ruling to the U.S. Supreme Court. The implication for bankers and their lawyers is that if 28 U.S.C. section 2462 is construed as applying in bank regulatory actions, civil money penalties assessed against bankers for wrongdoing that occurred more than five years ago must be dismissed under section 2462. Questions remain as to how broadly the decision will be applied to bank regulatory actions, including whether it will apply to punitive actions.

B. SECURED TRANSACTIONS

1. Lien Avoidance

Lenders should be aware that a trustee appointed in a Chapter 13 bankruptcy proceeding has broad powers that include lien-avoidance. In *In re Maddox*¹²⁵ the Fifth Circuit rejected a creditor's argument that a debtor may not use 11 U.S.C. section 522(f) to avoid nonpossessory, non-purchase-money security interests in property that is exempt under Texas law. The court held that *Owen v. Owen*¹²⁶ overruled *In re McManus*.¹²⁷ Therefore, the debtor can rely on 11 U.S.C. section 522(f) to avoid non-possessory, nonpurchase-money security interests in property exempt under Texas law. The creditor also argued that the Chapter 13 trustee did not have standing to move for lien-avoidance. The court rejected this argument and held that a Chapter 13 trustee does have standing pursuant to 11 U.S.C. section 1302, which gives Chapter 13 trustees broad powers that include the power to move for lien-avoidance when they have an interest in the asset.¹²⁸

123. *3M Co. v. Browner*, 17 F.3d 1453 (D.C. Cir. 1994).

124. *Id.* at 1462.

125. 15 F.3d 1347 (5th Cir. 1994).

126. 500 U.S. 305 (1991).

127. 681 F.2d 353 (5th Cir. 1982).

128. *Maddox*, 15 F.3d at 1355.

2. Commercial Reasonableness

Under the rule established in *Greathouse v. Charter National Bank-Southwest*¹²⁹ secured creditors in Texas bear the burden of pleading and proving that the disposition of collateral was conducted in a commercially reasonable manner. The Court of Appeals of Texas enforced this rule in *Gordon & Associates, Inc. v. Cullen Bank/Citywest, N.A.*¹³⁰ The trial court in *Gordon* granted Cullen Bank a summary judgment against Gordon & Associates in an action to recover a deficiency caused by the failure of the net proceeds of the sale of a dragline, loader and backhoe to fully satisfy Gordon's indebtedness on two promissory notes. On appeal, the Corpus Christi Court of Appeals found that the bank failed to adequately prove, for summary judgment purposes, that it had satisfied the requirements of section 9.504 of the Texas Business and Commerce Code (Vernon 1991) and denied the bank's motion for summary judgment due to the existence of a material fact question concerning commercial reasonableness and notice.¹³¹ The appellate court explained that, pursuant to Texas Business and Commerce Code section 9-507(2), certain nonexclusive circumstance exist in which a disposition is presumptively commercially reasonable. These circumstances include a recognized market for the type of merchandise at issue, a usual manner of sale in such market, evidence of current prices in the market at the time of sale, established commercial practices among dealers in the merchandise or creditor's committee or representative of creditors approval or judicial approval prior to the disposition.¹³² The appellate court determined that because Cullen offered no evidence that any of these factors applied to the sale of the collateral, there was no presumption of commercial reasonableness under section 9-507(2).¹³³ The court further determined that the evidence failed to show that the expenses incurred for the sale were reasonable or to show any accounting to the debtor for the proceeds of the sale.¹³⁴ The court noted that the purchase of the collateral by the bank, when considered with the subsequent failure of the bank to notify the debtor of the purchase, raised a question of fact as to whether the bank had elected to retain the collateral in satisfaction of its debt under section 9-505 of the Texas Business and Commerce Code.¹³⁵ Accordingly, the court held that the bank was not entitled to summary judgment and remanded the case for retrial.

In another court of appeals decision involving alleged lack of notice of disposition, the bank received a more favorable outcome than in *Gordon*. In *Bray v. Cradle Co.*¹³⁶ the debtor, Bray, had secured its debt to the

129. 851 S.W.2d 173 (Tex. 1992).

130. 880 S.W.2d 93 (Tex. App.—Corpus Christi 1994, n.w.h.).

131. *Id.* at 96.

132. *Id.* at 96-97.

133. *Id.* at 97.

134. *Id.*

135. *Id.* at 98.

136. 880 S.W.2d 813 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

bank with a note receivable from a third party. The bank took possession of the collateral note. When the bank failed, its successor directed the third party note maker to make all future payments on the collateral note directly to the holder instead of to Bray. Defaults occurred on Bray's note to the bank and on the third party collateral note. The holder then accelerated the third party collateral note. While the holder collected only part of the unpaid balance of the collateral note, the holder nonetheless credited the debtor's note balance with the entire balance due on the collateral note. The holder then sued the debtor for the remaining deficiency.

The court rejected the debtor's claim that the holder had wrongfully disposed of the collateral because there was no notice of disposition. Relying on *Cullen Frost Bank v. Dallas Sportswear Co., Inc.*¹³⁷ the court reasoned that "intangible collateral" such as instruments, chattel paper, or accounts can be liquidated under section 9.502 of Texas Business and Commerce Code without notice to the debtor.¹³⁸ The court noted that section 9.502 only requires notice to the third party account debtor, not the party obligated on the debt secured by the third party obligation.¹³⁹ The court also noted that collection from the third party account debtor was not a "disposition" of the collateral, but merely realization of the balance due on the cash flow of an existing obligation.¹⁴⁰ Such a realization did not constitute a sale that must comply with the requirements of commercial reasonableness under section 9.504.¹⁴¹ The court was careful to note that, as in *Cullen*, the promissory note was "intangible collateral," not "general intangibles" as defined in section 9.106 of the Texas Business and Commerce Code.¹⁴² While not discussed by the court, the bank avoided a dispute over the issues of implied covenants of good faith or commercial reasonableness by applying credit to the debtor's note in an amount equal to the remaining unpaid balance of the third party collateral note.

A Texas federal district court refused to impose upon a bank a duty to dispose of collateral in *FDIC v. Floyd*.¹⁴³ In *Floyd* the debtor executed a note to a bank secured by stock in a corporation. The bank failed and the FDIC was appointed as receiver. The debtor defaulted on payment of the note. The FDIC failed to sell the stock and the stock later became worthless. The FDIC sued the debtor to collect on the note. The debtor argued that section 9.207 of the Texas Business and Commerce Code placed the burden of proof on the FDIC to establish that it disposed of the collateral in a commercially reasonable manner.¹⁴⁴ The court re-

137. 730 S.W.2d 668 (Tex. 1987).

138. *Bray*, 880 S.W.2d at 816.

139. *Id.*

140. *Id.* at 819.

141. *Id.* at 819-20.

142. *Id.* at 816.

143. 854 F.Supp. 449 (N.D.Tex. 1994).

144. *Id.* at 452.

jected the debtor's argument and held that since the FDIC did not dispose of the collateral the question of proving a commercially reasonable disposition was not an issue.¹⁴⁵ While not discussed by the court, an argument could be made that by failing to sell the stock, the FDIC had elected a strict foreclosure resulting in the application of the rule established in *Tanenbaum v. Economics Laboratory, Inc.*¹⁴⁶

C. DEPOSIT ACCOUNTS

In *Lee v. Gutierrez*¹⁴⁷ the court held that a depositor's individual retirement accounts (IRAs) at an insolvent savings and loan association were not "special accounts," but mere "general accounts" not entitled to priority in liquidation of the savings and loan's assets.¹⁴⁸ It is the responsibility of depositors, not of an S&L, to decide how deposits are invested.¹⁴⁹ Quoting *Hudnall v. Tyler Bank & Trust Co.*¹⁵⁰ the court stated:

When money or its equivalent is deposited in a bank without any special agreement, the law implies that it is to be mingled with the other funds of the bank, the relation of the debtor and creditor is created between the bank and the depositor, and the deposit is general. In such a transaction the bank becomes the owner of the fund.¹⁵¹

The bank had a responsibility for the administration of the IRA account, but was not responsible for the decline in the value of the depositor's investment decision. *Lee*, again quoting *Hudnall*, further stated:

When, on the other hand, money or its equivalent is so deposited with an accompanying agreement that the identical thing deposited shall be returned, or that the same shall be paid out for a specific purpose, the relation thus created is not that of debtor and creditor. Such a transaction is a special deposit, and the bank is liable only as bailee. In such a case the fund is a trust fund, the bank acquires no title thereto, and is a mere trustee for the safe-keeping, return, or disbursement of the fund, according to the special contract by which the deposit is made.¹⁵²

The court held that "[t]he depositor who creates the IRA is both the settlor and the primary beneficiary of the trust, and the funds deposited constitute the corpus of the trust. IRAs are a unique type of trust in that

145. *Id.* at 453.

146. 628 S.W.2d 769 (Tex. 1982) (holding that where a buyer requested a creditor to take back collateral in full satisfaction of debt, where the creditor took back the collateral with no indication in the record as to whether it would do so, and where at some later date the creditor determined that the collateral could not be economically repaired and scraped the collateral, and then sued for a deficiency judgment, the creditor retained the collateral in full satisfaction of the indebtedness, and therefore elected to be governed by section 9.505 of Texas Business and Commerce Code providing that a creditor may not sue for deficiency after he retains the collateral).

147. 876 S.W.2d 382 (Tex. App.—Austin 1994, writ denied).

148. *Id.* at 385.

149. *Id.* at 386.

150. 458 S.W.2d 183, 186 (Tex. 1970).

151. *Lee*, 876 S.W.2d at 385.

152. *Id.* (quoting *Hudnall*, 458 S.W.2d at 186).

the settlor/beneficiary has the sole authority to determine how the trust corpus is invested.”¹⁵³ Again relying upon *Hudnall*, the court concluded that “[t]he legal presumption is that money deposited with a bank in an interest-bearing instrument is to be commingled with other funds at the bank, creating a debtor/creditor relationship between the bank and the depositor, in the absence of an agreement to the contrary.”¹⁵⁴ The court also relied upon regulations promulgated by the FDIC in reaching the conclusion that IRA accounts should be treated as general deposits under Texas law.¹⁵⁵

In *U.S. v. Hord*,¹⁵⁶ the court held that the mere act of opening a checking account was not “execution of a scheme” to defraud the bank within the meaning of 18 U.S.C. section 1344(a)(1).¹⁵⁷ However, the five deposits of bogus checks constituted execution of a scheme to defraud because these were the events that triggered possible credit being given to the defendant’s account.¹⁵⁸ The court also held that the deposit of the bogus checks was a “false statement” under 18 U.S.C. section 1014.¹⁵⁹ Rejecting the defendant’s argument that his entire course of conduct constituted one scheme to defraud, the court held that each deposit was a separate “execution of a scheme” to defraud the bank.¹⁶⁰

D. FORECLOSURES

1. The “Durrett Rule”

In a significant decision by the United States Supreme Court, the rule established in *Durrett v. Washington National Insurance Co.*¹⁶¹ was overruled. Since *Durrett*, bankruptcy trustees, or “debtors in possession,”¹⁶² have often attempted to use the fraudulent transfer statutes to set aside foreclosure sales. However, the United States Supreme Court has recently put this practice to rest in *BFP v. Resolution Trust Corporation*.¹⁶³ The Bankruptcy Code empowers a trustee to avoid “fraudulent transfers.”¹⁶⁴ To set aside a fraudulent transfer, the trustee must either show that the transfer was made with “actual intent to hinder, delay, or de-

153. *Id.*

154. *Id.* at 386.

155. *Id.* at 387 (citing 12 C.F.R. § 330.13 (1993)).

156. 6 F.3d 276 (5th Cir. 1993).

157. *Id.* at 280.

158. *Id.* at 283-87.

159. *Id.* at 286.

160. *Id.* at 282.

161. 621 F.2d 201 (5th Cir. 1980).

162. A Chapter 11 debtor, or a “debtor in possession,” has the rights and powers of a bankruptcy trustee. See, 11 U.S.C. §§ 1101, 1107(a) (1988).

163. 114 S. Ct. 1757 (1994).

164. 11 U.S.C. § 548; see also, 11 U.S.C. § 544(b) (1988 & Supp. V 1993) (giving a trustee the power to avoid any transfer of property that is avoidable under applicable non-bankruptcy law by a creditor holding an allowed unsecured claim). By this section, a bankruptcy trustee can also invoke state fraudulent transfer statutes; for example, Chapter 24 of the Texas Business and Commerce Code.

fraud" a creditor of the debtor,¹⁶⁵ or the trustee must show that the debtor received less than a "reasonably equivalent value" in exchange for such transfer while the debtor was insolvent.¹⁶⁶ The issue of fraudulent transfers has arisen in the context of foreclosure sales when the purchase price at the foreclosure sale is less than the fair market value of the property. In such an event, bankruptcy trustees have argued that the foreclosure sale was for less than a "reasonably equivalent value" and should thus be avoided as a fraudulent transfer.

In *BFP v. Resolution Trust Corporation* the Supreme Court settled a division among the federal courts of appeal and held that "reasonably equivalent value" for foreclosed property is the price in fact received at the foreclosure sale, so long as all the requirements of the state's foreclosure law have been followed; that is, the sale was procedurally regular and not collusive.¹⁶⁷ Prior to this decision, courts in Texas followed the "Durrett Rule" set forth by the Fifth Circuit of Appeals in *Durrett v. Washington National Insurance Co.*¹⁶⁸ In *Durrett*, property valued at \$200,000 was purchased at a foreclosure sale for \$115,400. The Fifth Circuit held that the foreclosure sale would be set aside as a fraudulent transfer noting that:

We have been unable to locate a decision of any district or appellate court dealing only with a transfer of real property as the subject of attack under section 67(d) of the Act,¹⁶⁹ which has approved the transfer for less than 70 percent of the market value of the property.¹⁷⁰

From this comment comes the "Durrett Rule" which required that any foreclosure sale for less than seventy percent of fair market value be voided as a fraudulent transfer.

In *BFP v. Resolution Trust Corporation*, however, the Supreme Court expressly rejected the "Durrett Rule." This case involved the purchase of a home at a foreclosure sale for \$433,000 by Mr. Paul Osborne. The home, which had been owned by a partnership entity known as "BFP" was alleged to be worth over \$725,000. The foreclosure sale was not collusive and had been conducted in compliance with California law. Three months later, BFP filed for bankruptcy relief under Chapter 11 and brought an action against Osborne in its capacity as debtor-in-possession to set aside the foreclosure sale as a fraudulent transfer. In holding that

165. See 11 U.S.C. § 548(a)(1) (1988 & Supp. V 1993); TEX. BUS. & COM. CODE ANN. § 24.005(a)(1) (Vernon 1987).

166. See 11 U.S.C. § 548(a)(2) (1988 & Supp. V 1993); TEX. BUS. & COM. CODE ANN. §§ 24.005(a)(2), 24.006(a) (Vernon 1987). Besides showing insolvency, the trustee can alternatively show that the debtor became insolvent as a result of such transfer, that the debtor was engaged in a business or transaction for which any property remaining with the debtor was an unreasonably small capital, or that the debtor intended to incur debts that would be beyond its ability to pay as they became due.

167. 114 S. Ct. at 1765.

168. 621 F.2d 201.

169. Current version at 11 U.S.C. § 548 (1988 & Supp. V 1993).

170. 621 F.2d at 203.

the foreclosure sale could not be set aside as a fraudulent transfer, the Supreme Court noted that:

[f]raudulent transfer law and foreclosure law enjoyed over 400 years of peaceful coexistence in Anglo-American jurisprudence until the Fifth Circuit's unprecedented 1980 decision in *Durrett*. To our knowledge no prior decision had ever applied the "grossly inadequate price" badge of fraud under fraudulent transfer law to set aside a foreclosure sale.¹⁷¹

Thus, the Court concluded that "a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with."¹⁷² The holding in *BFP v. Resolution Trust Corporation* is significant to Texas lenders who credit bids at foreclosure sales, as well as other purchasers. The case eliminates the possibility that the sale could be set aside in the event of a subsequent bankruptcy filing by the borrower, so long as the sale is procedurally regular and otherwise complies with state law.

2. *Constitutionality of Section 51.003 of the Texas Property Code*

The Waco Appeals Court recently upheld the constitutionality of section 51.003 of the Texas Property Code. Section 51.003 permits a debtor to ask a court to determine a foreclosed property's fair market value as of the date of foreclosure in order to determine whether the fair market value exceeds the foreclosure sale price.¹⁷³ If the court determines that the property's fair market value exceeds the sale price, the statute requires that the excess be applied to any remaining deficiency. In *Lester v. First American Bank*,¹⁷⁴ the bank challenged the constitutionality of section 51.003 claiming that it violated the contract clause of the Texas Constitution. The court concluded that the contract clause does not prohibit the legislature from protecting mortgagors from foreclosure sales which will or may result in lenders collecting more than the amount owing on the mortgage.¹⁷⁵ Accordingly, the court held that the contract clause of the Texas constitution does not void section 51.003 on the ground that it impairs the obligation of contract.¹⁷⁶

3. *Notice*

In *Glauer v. State Farm Life Insurance Co.*¹⁷⁷ the court stated that for a mortgagee to recover any deficiency remaining on the note, the mortgagee must prove four elements: (1) the amount due on the note at the time

171. 114 S. Ct. at 1764.

172. *Id.* at 1765.

173. TEX. PROP. CODE ANN. § 51.003 (Vernon Supp. 1993).

174. 866 S.W.2d 361 (Tex. App.—Waco 1993, writ denied).

175. *Id.* at 367.

176. *Id.*

177. 1994 WL 470355, 1994 LEXIS 2198 (Tex. App.—Houston [1st Dist.], Aug. 31, 1994, n.w.h.) (No publication).

of the foreclosure; (2) that proper notice of acceleration was given; (3) that a valid foreclosure sale was made; and (4) that it has given credit to the mortgagor for the amount received at the trustee's sale and any other legitimate credit.¹⁷⁸ The court agreed that a note holder must notify the maker of its intent to accelerate the note before exercising its right to accelerate; however, the court refused to find that "proper notice of intent to accelerate" constituted a fifth element of proof.¹⁷⁹ The court concluded in *Glaser* that the mortgagee had complied with all four elements. Therefore, the mortgagee was entitled to the deficiency judgment.

The court recognized that acts and conduct of the parties after the execution of the note do not violate the parol evidence rule.¹⁸⁰ The court further acknowledged that where the holder of the note is the payee and not a holder in due course, the payee holds the note subject to all defenses available in an action on a simple contract.¹⁸¹ One such defense may be that the written contract has been modified by a later oral agreement.¹⁸² The mortgagor in this case argued that there was an oral agreement with the mortgagee in which the mortgagee agreed to release the mortgagor from liability under the note or to bid the amount of the note at the foreclosure sale in order to lessen the amount of the deficiency. The court concluded that a fact question existed as to whether the mortgagor could prove the existence of the oral argument and reversed and remanded on this issue.¹⁸³

4. *Ad Valorem Tax Liens and 28 U.S.C. Section 1825(b)(2)*

In *Matagorda County v. Law*¹⁸⁴ the Fifth Circuit held that the local taxing authorities were not permitted to foreclose on property subject to an FDIC lien without the FDIC's consent. The taxing authorities sought a personal judgment against the debtor for taxes and penalties, and foreclosure of its liens without the permission of the FDIC and without preserving the lien the FDIC had acquired from the insolvent lending institution, Bay City Bank & Trust Company. The state court entered a summary judgment against the debtor, Russell Law, in favor of the taxing authorities for delinquent taxes, penalties and interest and decreed the existence of a lien to secure that sum. The court, however, denied foreclosure of that lien absent consent of the FDIC, requiring that any foreclosure be subject to the FDIC's lien. From that ruling the taxing

178. *Id.* at *4 (citing *Thompson v. Chrysler First Business Credit Corp.*, 840 S.W.2d 25, 28 (Tex. App.—Dallas 1992, no writ); *Carruth Mortgage Corp. v. Ford*, 630 S.W.2d 897, 899 (Tex. App.—Houston [1st Dist.] 1982, no writ)).

179. *Id.* at *5.

180. *Id.* at *5 (citing *Cockrell v. Republic Mortgage Ins. Co.*, 817 S.W.2d 106, 115 (Tex. App.—Dallas 1991, no writ); *Dameris v. Homestead Bank*, 495 S.W.2d 52, 55 (Tex. Civ. App.—Houston [1st Dist.] 1973, no writ)).

181. *Id.* at *6.

182. *Id.*

183. *Id.* at *7.

184. 19 F.3d 215 (5th Cir. 1994).

authorities appealed. The Fifth Circuit rejected the appellant's argument that their ad valorem tax lien was superior to the consensual mortgage lien acquired by the FDIC, holding that

the priority of the relative liens [was] not the determinative question to be addressed.¹⁸⁵ The court determined that "[t]he decisive question is whether or not the court below was correct in ruling that the appellants' ad valorem tax lien could not be foreclosed without the permission of the FDIC, regardless of the relative priority of the liens."¹⁸⁶

The FDIC contended that the court should give its Tax Policy Statement and Accompanying Legal Memorandum deference in interpreting 12 U.S.C. section 1825(b)(2).¹⁸⁷ The court, as in *Irving Independent School District v. Packard Properties*,¹⁸⁸ rejected this argument and declined to accord deference to the FDIC's Tax Policy Statement and Legal Memorandum because it found that the statute at issue in that case, section 1825(b)(3), clearly compelled an interpretation different from the FDIC's.¹⁸⁹ In determining whether to give such deference to the FDIC's Tax Policy Statement and Legal Memorandum, the Fifth Circuit determined that the key issue of whether or not the statute at issue, section 1825(b)(2), is ambiguous.¹⁹⁰ Section 1825(b)(2) provides that "[n]o property of the Corporation shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of the Corporation. . . ."¹⁹¹ This court concluded, as in *Irving Independent School District*,¹⁹² that congressional intent, as codified in section 1825, is clear and unambiguous in that there was no need for an extraneous interpretation of the FDIC's Tax Policy Statement nor its accompanying Legal Memorandum.¹⁹³ The Fifth Circuit followed a well established federal law in *Matagorda County* when it concluded that the equitable interest of the lienholder constituted "property" as used in section 1825(b)(2).

The court also rejected the appellant's argument that 28 U.S.C. section 2410 controlled the outcome of the case.¹⁹⁴ The court concluded that section 1825 was a more specific and recent statute which prevailed over section 2410, a more general older statute.¹⁹⁵ The Fifth Circuit also rejected the taxing authority's argument that this suit relied on events occurring before the 1989 enactment of FIRREA, therefore making its application retroactive. The court determined that for purposes of prohibition contained in the statute, it did not matter when the lien came into

185. *Id.* at 218.

186. *Id.* (emphasis omitted).

187. 12 U.S.C. § 1825(b)(2) (1988 & Supp. V 1993)

188. 970 F.2d 58, 61 (5th Cir. 1992).

189. *Id.* at 220.

190. *Id.*

191. 12 U.S.C. § 1825(b)(2).

192. *Irving Indep. School Dist. v. Packard Properties*, 970 F.2d 58, 63 (5th Cir. 1992).

193. *Matagorda County*, 19 F.3d at 220.

194. *Id.* at 222.

195. *Id.*

existence, the attempted enforcement occurred in 1991 subsequent to the enactment.¹⁹⁶ This was the triggering event that is prohibited by FIRREA.¹⁹⁷

The taxing authorities also asserted that the district court erred in holding that 12 U.S.C. section 1825 prohibits a foreclosure of the ad valorem tax liens without awarding the tax authority's recovery against the FDIC for the amount of value secured by the tax lien. The taxing authority argued, in other words, that the FDIC has effectively "taken" the property of the taxing authority without just compensation as required by United States Constitution. The *Matagorda* court noted that the Supreme Court had identified three "particularly significant" factors in deciding whether just compensation under the Constitution is required: 1) the economic impact of regulation on the claimant, 2) the extent to which the regulation has interfered with distinct investment-backed expectations, and 3) the character of the governmental action.¹⁹⁸ In applying these factors to determine whether compensation by the government is required to be made, the Fifth Circuit followed the principle that as long as some strands remain in the bundle, the fact that the taxing authorities suffered economic loss did not create a taking.¹⁹⁹ The taxing authority, on the other hand, asserted that "the tax lien itself is the affected property right."²⁰⁰ They argued that the FDIC's power to delay foreclosure made the entire lien worthless for the periods of delay and further, made the entire lien completely worthless when the FDIC finally gave its consent if the accumulation of debt (interest) on the property made it unmarketable. Thus, the ultimate question concerning the court was whether or not a delay in allowing the taxing authority to foreclose their lien constituted a taking. The Fifth Circuit concluded that

[w]hile the operation of § 1825 creates a delay which impairs the ability of the Taxing Units to collect on their tax lien, mere delay—at least the period of delay experienced to this point—does not infringe on Appellants' total "bundle" of rights to the point of creating a compensable taking.²⁰¹

The Fifth Circuit, in *Donna Independent School District v. Balli*,²⁰² adhered to the precedent followed in *Matagorda County*. In *Donna* the court rejected the taxing authority's argument that the FDIC's liens were subordinate to the tax lien and thus extinguished in a tax sale. The taxing authority also asserted that the operation of section 1825(b)(2) amounted to a compensable taking under the Fifth Amendment. The court commented that this was a "closer question." The court quoted *Matagorda County*, noting that "[u]nmitigated delay, coupled with diminishment of

196. *Id.*

197. *Id.* at 222-23.

198. *Id.* at 223 (citing *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104 (1978)).

199. *Id.* at 224-25.

200. *Id.* at 224.

201. *Id.*

202. 21 F.3d 100 (5th Cir. 1994).

distinct investment-backed expectations, *may, at some point*, infringe on the entire 'bundle' of rights enjoyed by the [taxing units] to the point that a compensable taking occurs."²⁰³

The court in *Donna* found that "[t]he delay in *Matagorda County* was 27 months; the FDIC acquired its liens in August of 1990 and the judgment decreeing the tax liens was entered on November 10, 1992. We characterized that period as 'approaching' the maximum permissible without being a taking."²⁰⁴ The court determined in *Donna* that the delay in this case was significantly longer.²⁰⁵ The FDIC acquired the First National Bank of Weslaco lien on February 20, 1987 and the Hidalgo County Bank & Trust lien on July 27, 1989. Judgment decreeing the tax liens was not entered until April 1, 1993. The court further stated that

[w]e would likely find a taking herein but for a critical distinction between the facts of this case and those of *Matagorda County*. There, the adjudged value of the property was \$330,660 and the outstanding balance on the notes underlying the FDIC lien was \$891,000 plus interest. "As a practical matter," we found that the taxing units could not sell the property with the FDIC lien in place. Here, by contrast, the value of the property is \$529,578 and the outstanding balance on the Balli notes is \$196,689.73 plus interest.²⁰⁶

The court concluded that "[u]nlike *Matagorda County*, the survival of the FDIC liens does not prevent a tax sale. The causal connection between the delay and the statutory protection accorded the FDIC's liens is significantly attenuated. We perceive no taking cognizable under the fifth amendment in this factual scenario."²⁰⁷

E. LENDER LIABILITY

1. Usury

The cases in this Survey period²⁰⁸ indicate a continuation of the trend noted in the last Survey²⁰⁹ toward a conservative application of Texas usury laws — although in most of the cases the party asserting the existence of usury found itself in the unenviable position of attempting to overturn fact findings made by the court or the jury at trial. To the financial institutions good news arrived regarding insufficient fund charges. A number of cases considered the *Holley*²¹⁰ elements of a usury claim, and

203. *Id.* at 101 (citing *Matagorda County*, 19 F.3d at 225) (emphasis the court's).

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.*

208. Cases covered appear in volumes 857 S.W.2d through 883 S.W.2d, 990 F.2d through 35 F.3d, and 832 F. Supp. through 861 F. Supp. Certain cases appearing in the covered volumes were covered in last year's Survey and are not discussed.

209. Shawna P. Johannsen, Roy C. Snodgrass III & Patrick O'Daniel, *Banking, Annual Survey of Texas Law*, 47 SMU L. REV. 683, 711 (1994).

210. *Holley v. Watts*, 629 S.W.2d 694 (Tex. 1982).

there appears to be some inclination to limit the reach of *Alamo Lumber v. Gold Co.*²¹¹

a. *Alamo Lumber*

For over ten years, the Texas Supreme Court's holding in *Alamo Lumber Co. V. Gold* has created significant problems to counsel structuring multi-party borrowing arrangements. The facts in *Alamo Lumber* were reasonably straightforward and exemplify the expression regarding hard cases and bad law. Addie Gold²¹² signed a note for \$75,000 payable to First National Bank of Pleasanton; the proceeds went to her son, Stetson G. (Bubba) Reed. Plaintiff defaulted on that note, and the bank instituted foreclosure proceedings on property securing payment of the note. At this time Bubba had an unpaid open account with Alamo Lumber Company (Alamo). Bubba proposed that Alamo purchase Mrs. Gold's note and extend the payment date on the condition that Mrs. Gold also assume Bubba's open account obligation. Alamo did so, and Mrs. Gold signed a note payable to Alamo in an amount equal to Bubba's open account debt to Alamo plus certain other fees. 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."²¹³

The first reported appellate decision which purported to address the application of *Alamo Lumber* to guaranties came in 1991.²¹⁴ Among various defenses asserted by guarantors was the contention that the requirement by the lender that the guarantors guarantee existing debt of an individual as a condition to the bank's granting to a corporation another loan constituted a violation of the rules set forth in *Alamo Lumber*. The court of appeals held that by virtue of the guarantors' guaranty of the debt of the individual, the guarantors did not "assume or pay" the debt and, as such, were not entitled to step into the shoes of the obligated individual.²¹⁵ As phrased by the court, "[t]he application of usury as a defense will be permitted only where a lender requires a borrower to PAY or ASSUME a third party's debt as a condition to making a loan. . . ."²¹⁶ The guarantors "were asked to *guarantee, not assume or pay*" the note.²¹⁷

211. 661 S.W.2d 926 (Tex. 1983).

212. Plaintiff was described in the court of appeals' opinion as "a widow living . . . on a modest fixed income." *Gold v. Alamo Lumber Co.*, 623 S.W.2d 453, 454 (Tex. App.—Beaumont 1981, writ granted).

213. *Alamo Lumber*, 661 S.W.2d at 928.

214. *Bank of El Paso v. T.O. Stanley Boot Co.*, 809 S.W.2d 279 (Tex. App.—El Paso 1991, *aff'd in part, rev'd in part on other grounds*), 847 S.W.2d 218 (Tex. 1992).

215. *Id.* at 290.

216. *Id.*

217. *Id.*

Two years later the Austin Court of Appeals issued its opinion in *Moore v. Liddell, Sapp, Zivley, Hill & LaBoon*.²¹⁸ The plaintiff sued his creditor's attorneys²¹⁹ asserting that the law firm, as an agent of the creditor, violated Texas usury law by charging usurious interest in the making of demand and filing of suit on the creditor's behalf seeking payment of a note executed by the plaintiff and payment of debts of another individual which were guaranteed by the plaintiff. The court assumed that the guaranty of the other individual's debt was required as a condition for the extension of the loan to the plaintiff and that the demand letter sent by the defendant law firm constituted a charge.²²⁰ The court held that *Alamo Lumber* did not apply because the plaintiff was "only required to guarantee the subsequent loans to" the other individual.²²¹ Citing *T.O. Stanley* as a case where the court refused to extend the application of *Alamo Lumber* to a guaranty, the *Moore* court held that "*Alamo Lumber* does not apply to the immediate situation of a guaranty of another's debt as a condition for a loan."²²²

The next step in the succession occurred during this Survey period in *Sterling Property Management, Inc. v. Texas Commerce Bank National Ass'n*,²²³ which involved an appeal of a summary judgment granted in favor of the bank on borrower's usury claims. Sterling Texas Contractor, Inc. and Metro Draperies, Inc. each executed a renewal promissory note payable to the bank, and each guaranteed payment of the other's renewal note. Neither company had been liable on the other's debt prior to the date the guaranties were executed.

For purposes of the bank's motion the district court assumed that the bank had required the cross guaranties as a condition of the loan renewals granted to each of the note makers. The Fifth Circuit characterized the dispute as being in essence "whether guaranties of payment, which unconditionally and absolutely guarantee payment, are contingent liabilities under *Moore*."²²⁴ The guarantors' argument was that, as guarantors of payment, they were primarily liable for the debt "just as if they had assumed the debt."²²⁵ The court disagreed and held that the fact that the guarantor of payment was a primary obligor did not mean that its liability was not contingent.²²⁶ As such, the guarantor did not "assume" the other

218. 850 S.W.2d 291 (Tex. App.—Austin 1993, writ denied) (discussed in last year's Survey, *supra* note 209, at 716).

219. Plaintiff was presumably relying on *Lupo v. Equity Collection Serv.*, 808 S.W.2d 122 (Tex. App.—Houston [1st Dist.] 1991, no writ).

220. *Moore*, 850 S.W.2d at 293-94.

221. *Id.*

222. *Id.* at 294. It is not clear that the *T.O. Stanley* opinion in fact stands for the proposition for which it was cited, and, in any event, the facts in *T.O. Stanley* were significantly different from those in the *Moore* case in that the guarantors in the *T.O. Stanley* case were not borrowers with respect to any debt.

223. 32 F.3d 964 (5th Cir. 1994).

224. *Id.* at 967.

225. *Id.*

226. *Id.*

party's debt and, therefore, could not assert a claim of usury based on *Alamo Lumber*.²²⁷

*Wilgus v. Green*²²⁸ presented a more straightforward analysis of the issues presented by *Alamo Lumber*. The Greens owned and operated a marina in Louisiana. In 1979, they sold the marina to four individuals, the Smallwoods and the Evans, for cash and a note. The note was secured by a mortgage and a vendor's lien. Thereafter, the purchasers formed Evans-Smallwood, Inc. (Corporation) to operate the marina. Over the next few years interest was paid on the note, but no principal payments were made. Subsequently, the Smallwoods bought the Evans' stock in the Corporation. After default, and under threat of foreclosure, the Smallwoods and the Corporation signed a foreclosure settlement agreement with the Greens which provided that, in return for forbearance of foreclosure, the Corporation would pay all delinquent interest, make two payments on the note, and pay attorneys' fees. Two years thereafter Wilgus purchased 600,000 shares of the Corporation from the Smallwoods.

In September 1987 Wilgus made the August 1987 payment. The Greens' attorney requested documents showing that the Corporation had assumed the note (beyond the two payments agreed to be made pursuant to the forbearance agreement) originally executed by the Evans and the Smallwoods. The letter also advised Wilgus that, unless Wilgus paid the note or showed he had an obligation on the note, the plaintiff would not be required to give Wilgus notice before any foreclosure. Payments were made by the Corporation in August and September of 1987, and a partial payment was made in October 1987. However, each payment was late, and plaintiff sent a notice of acceleration and demand for payment in full to Wilgus individually and the Corporation. Ultimately, the Greens sued Wilgus and the Corporation seeking payment due on the note for the fourteen months Wilgus apparently operated the marina. Wilgus counterclaimed asserting that the plaintiff charged usurious interest by demanding the note be paid by Wilgus or the Corporation.

Wilgus argued that in the foreclosure settlement agreement the Greens required the Corporation to assume a debt owed by another (*i.e.*, the Evans and the Smallwoods), and that such assumed debt constituted usurious interest under *Alamo Lumber*.²²⁹ In upholding a judgment *n.o.v.* in favor of plaintiff, the court noted that the difference between this case and *Alamo Lumber* was that there was no other loan to which the debt required to be assumed could constitute interest.

227. *Id.* at 968. Neither *T.O. Stanley, Moore*, nor *Sterling* considered whether a claim for receipt of usurious interest would arise upon payment under a guaranty although *Sterling* involved the entry of a judgment in favor of a creditor on such a guaranty. Additionally, the court in *Sterling* did not consider the issue raised in last year's Survey regarding savings clauses and the triggering of usurious interest upon the occurrence of a contingency. See *supra* note 209, at 717.

228. 882 S.W.2d 6 (Tex. App.—Tyler 1994, writ denied).

229. *Id.* at 7.

To fall under the rule of *Alamo Lumber*, Evans-Smallwood, Inc. had to be a borrower when required to assume the debt of a third party. There was no evidence that Green and Evans-Smallwood, Inc. were in a lender-borrower relationship outside the single note in question, which Evans-Smallwood, Inc. had to assume.²³⁰

b. NSF Charges

The last Survey discussed the court of appeals holding that there was sufficient evidence for a jury to determine whether insufficient funds charges (NSF Fees) were interest. During this Survey period, the Texas Supreme Court reversed and rendered judgment that the plaintiffs take nothing against the bank on the usury cause of action.²³¹ In 1983, Tony's Tortilla Factory, Inc. (Tony's) borrowed from First Bank \$380,000 repayable over a five-year term and also established a \$60,000 revolving line of credit. In April 1984, Tony's started experiencing financial difficulties, and by December 1984, its two checking accounts with the bank were overdrawn by \$72,000 and \$16,000, respectively. During that same period, 2165 checks for which there were insufficient funds had been written, and the bank had imposed NSF Fees of \$20 per check, totalling approximately \$47,000.²³² In December 1984, a consolidating loan for \$500,000 was made and the balance in the checking accounts became positive. In 1986, Tony's defaulted on the debt to the bank, whereupon the bank commenced foreclosure proceedings. Tony's sued the bank, asserting, inter alia, that the NSF Fees were interest and, as such, were in excess of the amount permitted by Texas law. The trial court directed a verdict in favor of the bank on the usury claim. The court of appeals reversed this portion of the judgment, holding that there was sufficient evidence for the jury to decide whether the NSF Fees constituted interest on a loan.

The issue as phrased by the Texas Supreme Court was "whether a bank's fee for checks drawn on an account with insufficient funds ['NSF fee'] constitutes usury."²³³ The court noted that fees for additional charges supported by distinctly separate consideration are not interest and thus do not violate Texas usury laws.²³⁴ It was undisputed that each NSF Fee "was assessed as a processing fee for the additional work required in connection with handling the bad check,"²³⁵ the decision to impose an NSF Fee was a separate decision from the decision of whether to honor the bad check, and the same NSF Fee was charged to all customers in any circumstance and had no relation to the amount of the check. The

230. *Id.* at 8 (citation omitted). This is a variation of the point made at *supra* note 222 - the guarantors in *T.O. Stanley* were not borrowers under any note.

231. *First Bank v. Tony's Tortilla Factory, Inc.*, 877 S.W.2d 285 (Tex. 1994).

232. The opinion does not explain the calculation of the fees.

233. *Tony's Tortilla Factory*, 877 S.W.2d at 285.

234. *Id.* at 287 (citing *Texas Commerce Bank v. Goldring*, 665 S.W.2d 103 (Tex. 1984); *Gonzales County Sav. & Loan Ass'n v. Freeman*, 534 S.W.2d 903 (Tex. 1976); and *Greever v. Persky*, 165 S.W.2d 709 (Tex. 1942)).

235. *Id.* at 287-88.

court held there was separate consideration (an implied promise to repay the advance) for the advance of the funds to cover the checks.²³⁶ The NSF Fee was for separate consideration and as a matter of law did not constitute interest.²³⁷

c. Elements of a Usury Claim

As established in *Holley v. Watts*²³⁸ the elements of a usury claim are “(1) a loan of money; (2) an absolute obligation that the principal be repaid; and (3) the exaction of a greater compensation than allowed by law for the use of the money by the borrower.”²³⁹

In *Catalina v. Blasdel*²⁴⁰ the Texas Supreme Court considered a floor plan arrangement under which either Catalina or Blasdel could purchase used cars for Blasdel’s inventory. A car would be paid for by the typical envelope draft containing the automobile title by which Catalina would hold the title to cars so purchased. Floor plan fees of \$60 per vehicle (for vehicles costing less than \$500) or ten percent of the purchase price (for vehicles costing more than \$500) were imposed. If a vehicle was not sold within thirty days, a second floor plan fee calculated as described was payable; and if a vehicle was not sold after sixty days, Blasdel paid one-half of the principal plus a third fee. The full amount of the purchase price was payable only if the vehicle was sold, lost, or stolen. The trial court found in Catalina’s favor. The Texas Supreme Court reversed the court of appeals and upheld the trial court’s finding that the agreement was not a usurious transaction.²⁴¹ Where usury is not apparent from the face of a contract, the issue of usury is a question of fact,²⁴² and in light of the findings of the trial court, Blasdel could not prevail if there was any evidence inconsistent or contrary to the factual contention that the transaction was in fact a loan disguised as a device to evade the usury laws.²⁴³ The court stated that in *Holley v. Watts*,²⁴⁴ an absolute obligation to repay was recognized as an essential element of “the usury provision there at issue” but disclaimed reaching the issue of whether the legislature may or

236. *Id.* at 288.

237. *Id.*

238. 629 S.W.2d 694 (Tex. 1982).

239. *Id.* at 696.

240. 881 S.W.2d 295 (Tex. 1994).

241. *Id.* at 296.

242. *Id.* (citing *Greever v. Persky*, 140 Tex. 64, 165 S.W.2d 709 (1942)).

243. *Id.* at 296-97. The court found that there was evidence to support the finding that repayment of amounts advanced to purchase the automobiles was contingent. The court noted that one factor considered by the courts in determining the existence of usury is whether repayment of a debt is based on a contingency. *Id.* Since there was evidence to support such a finding, there was no usury. This can be compared to the opinion in *Najarro v. SASI Int'l, Ltd.*, 904 F.2d 1002, 1010 (5th Cir. 1990), *cert. denied*, 498 U.S. 1048 (1991) where the Fifth Circuit characterized “more recent Texas cases” as adopting a rule that if there is any contingency by which a lender might receive usurious interest the note is usurious.

244. 629 S.W.2d 694 (Tex. 1982).

has provided for usury penalties under "other statutory provisions which do not require an absolute obligation to repay."²⁴⁵

*Bexar County Ice Cream Co., Inc. v. Swenson's Ice Cream Co.*²⁴⁶ involved a suit by a franchisor and two of its subsidiaries (collectively, "Swenson's") against a franchisee and two guarantors of the franchisee's obligation to the franchisor (collectively, "BCIC"). BCIC alleged that late payment fees of fifteen percent per annum provided under the franchise agreement constituted usurious interest. A full month's late charge at such rate was imposed if a royalty which was required to be paid by the 15th day of a month was not paid by the 21st day of the month. Citing cases involving late charges on lease payments and condominium assessments,²⁴⁷ the court held that the obligation to pay the franchise fees did not constitute a loan of money but rather was consideration for the purchase and use of a license.²⁴⁸ Thus, the first of the *Holley v. Watts* elements²⁴⁹ was not satisfied. Additionally, there is no usury if repayment of principal depends on a contingency.²⁵⁰ Since the payment of the "principal" depended on a contingency and there was no lending or credit transaction, there was no usury.²⁵¹

In *Ravkind v. Mortgage Funding Corp.*²⁵² the court considered a claim brought by an attorney that a transaction structured as a sale of note payments was in fact a loan of money. In 1978, Ravkind purchased land on a thirty-year note which provided for a monthly payment of \$770.56. In 1980, he entered into a contract for deed under which the purchaser agreed to make 240 monthly payments of \$2,390.10 to Ravkind, who in turn agreed to use \$770.56 to make the monthly payments on the underlying note. The contract for deed was nonrecourse to the "purchaser."²⁵³ In 1986, Ravkind signed two documents in a transaction with Mortgage Funding Corporation (MFC). MFC paid Ravkind \$58,000 for the right to receive the next sixty monthly payments due under the contract for deed net of the payment Ravkind was to make on the underlying note. Ap-

245. *Catalina*, 881 S.W.2d at 297 n.3. In its footnote, the court said that such an absolute obligation was recognized as a "statutory element" under the usury provision there at issue.

246. 859 S.W.2d 402 (Tex. App.—San Antonio 1993, writ denied).

247. *Maloney v. Andrews*, 483 S.W.2d 703 (Tex. Civ. App.—Eastland 1972, writ ref'd n.r.e.); *Potomac Leasing Co. v. Housing Auth. v. City of El Paso*, 742 S.W.2d 712 (Tex. App.—El Paso 1987, writ denied); *Tygett v. University Gardens Homeowners Ass'n*, 687 S.W.2d 481 (Tex. App.—Dallas 1985, writ ref'd n.r.e.); and *Apparel Mfg. Co. v. Vantage Prop., Inc.*, 590 S.W.2d 447 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.).

248. *Swenson's*, 859 S.W.2d at 406.

249. There must be a loan of money. *Holley v. Watts*, 629 S.W.2d 694, 696 (Tex. 1982).

250. *Swenson's*, 859 S.W.2d at 407 (citing *Pansy Oil Co. v. Federal Oil Co.*, 91 S.W.2d 453 (Tex. Civ. App.—Texarkana 1936, writ ref'd). *But see* *Najarro v. SASI Int'l. Ltd.*, 904 F.2d 1002, 1010 (5th Cir. 1990).

251. *Id.* at 407. "Interest" is defined in Chapter 1 of the Texas Credit Code as "the compensation allowed by law for the use or forbearance or detention of money . . ." TEX. REV. CIV. STAT. ANN. art. 5069-1.01(a) (Vernon 1987). The *Tygett* opinion holds that in order for there to be a "detention," there must be a lending transaction between the parties. *Tygett*, 687 S.W.2d at 483.

252. 881 S.W.2d 203 (Tex. App.—Houston [1st Dist.] 1994, n.w.h.).

253. *Id.* at 204.

proximately one year later, MFC sold forty-eight of the net payments to Chrysler First Financial Services Corporation (Chrysler) for \$60,386.

In 1987, the purchasers ceased making payments under the contract for deed. Ravkind did not advise MFC of such default but continued to remit the net amount which otherwise would have been owing. In 1989, Ravkind made a prepayment in full to MFC and Chrysler. In 1990, Ravkind sued MFC and Chrysler and alleged that the transaction was in reality a \$58,000 second mortgage loan to be repaid in sixty monthly installments of \$1,619.54 each, with a fifteen percent prepayment penalty.²⁵⁴ The allegations were that the interest paid was equivalent to a rate of 20.25% per annum, which was in excess of the lawful ceiling in effect at that time, and the fifteen percent prepayment charge was prohibited by law.²⁵⁵ Ravkind did not deny the execution or validity of the documents nor contend the documents failed to describe accurately the true nature of the transaction or were a sham or subterfuge to avoid or evade the usury laws.²⁵⁶ Instead, Ravkind asserted that the purchase agreement on its face evidenced a loan; apparently he relied primarily on a "full recourse" provision if certain payment obligations were not met and on certain references to MFC and Chrysler as "second mortgagees." The court held that the sale of a note at a discount does not constitute a loan.²⁵⁷ The documents expressly and unambiguously showed that the transaction was an assignment of rights to receive note payments purchased at a discount, and that there was only a contingent obligation by Ravkind to repay sums. Accordingly, Ravkind's usury claim fell short since two of the three *Holley* elements could not be satisfied.

*James v. Frame*²⁵⁸ (*Frame II*) was the third chapter regarding a complicated fraud scheme which ultimately demonstrated the vagaries of Texas usury law. The Fifth Circuit upheld the district court's imposition of usury penalties against payees who were found to have been defrauded by the maker of the notes involved. The Fifth Circuit had previously held in *Frame v. S-H, Inc. (Frame I)*²⁵⁹ that the transactions at issue were structured identically to those which the court had held to be usurious in *Najarro v. SASI International, Ltd.*²⁶⁰

In *Frame I*, the Fifth Circuit affirmed the trial court's entry of a judgment against the note maker based on various abuses of the discovery process but reversed and remanded for an evidentiary hearing on the issue of damages. The claims involved were attempts by investors to re-

254. Apparently, the assignment agreement provided a fifteen percent prepayment penalty in the event the sums under the note were paid in advance of the scheduled due date.

255. The basis on which the prepayment penalty was allegedly prohibited was not specified by the court.

256. *Ravkind*, 881 S.W.2d at 206.

257. *Id.* (citing *Redman Indus. v. Couch*, 613 S.W.2d 787 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.)).

258. 6 F.3d 307 (5th Cir. 1993).

259. 967 F.2d 194, 204 (5th Cir. 1992).

260. 904 F.2d 1002 (5th Cir. 1990), *cert. denied*, 498 U.S. 1048 (1991).

cover money they had allegedly advanced to defendant Frame in connection with a scheme by Frame to defraud them. The investor would advance funds to a Frame-controlled entity to be used for the purpose of purchasing European gray-market perfume for import and sale in the United States.²⁶¹ The investor would transfer funds to a Frame entity. Frame would acknowledge receipt of the funds by letter in which she agreed to return the capital in six weeks, plus a sum equal to approximately three percent of the capital contribution. The sum was called a commission. At the same time Frame provided the letter, she also provided a promissory note in the amount of the "capital contribution." The note was due in six weeks and did not provide for any interest.²⁶²

The identical structure (involving some of the same defendants) had previously been held usurious as a matter of law.²⁶³ The *Najarro* court had held that even if payee's argument that the advance was intended to be an investment rather than a loan were true, nevertheless the substance of the transaction was a loan because there was an absolute obligation to repay the principal.²⁶⁴ The *Najarro* plaintiffs/payees, citing *Pansy Oil Co. v. Federal Oil Co.*,²⁶⁵ contended that because the commission payments were contingent on there being a profit from the enterprise, such profit should not constitute interest. The court noted that more recent Texas cases seem to have adopted a contrary view and that more recent pronouncements by the Texas Supreme Court seem to favor the view that a contract is usurious as a matter of law if there is any contingency under which a lender can receive more than the maximum rate permitted.²⁶⁶ The *Najarro* court distinguished *Pansy Oil*²⁶⁷ as well as other Texas cases on the basis that in such cases the amount to be paid for the use of the money was entirely uncertain, whereas, in the case presented to the Fifth Circuit, there was a twenty-five percent return agreed to in the contract.²⁶⁸ Finally, the court rejected the argument that the defendant maker of the note should be estopped to assert usury because defendant solicited the money and structured the transaction.²⁶⁹

The Fifth Circuit's opinion in its *Frame I* opinion directed the district court to take into account the *Najarro* decision; it noted that the amount which the payees could recover would be reduced by appropriate usury penalties.²⁷⁰ Following remand, the district court applied the usury penalties although the district court judge apparently felt that it was inappro-

261. *Frame*, 967 F.2d at 197.

262. *Id.*

263. *Najarro v. SASI Int'l, Ltd.*, 904 F.2d 1002 (5th Cir. 1990), *cert. denied*, 498 U.S. 1048 (1991).

264. *Id.* at 1007 (citing *Johns v. Jaeb*, 518 S.W.2d 857 (Tex. Civ. App.—Dallas 1974, no writ); *Maxwell v. Estate of Bankston*, 433 S.W.2d 229 (Tex. Civ. App.—Texarkana 1968, no writ)).

265. 91 S.W.2d 453 (Tex. Civ. App.—Texarkana 1936, writ ref'd).

266. *Najarro*, 904 F.2d at 1010.

267. *Pansy Oil*, 91 S.W.2d 453 (Tex. Civ. App.—Texarkana 1936, writ ref'd).

268. *Najarro*, 904 F.2d at 1010.

269. *Id.*

270. *Frame*, 967 F.2d at 204.

priate to apply usury penalties because "usury is not a valid counterclaim when one sues on a note that is void by reason of common law fraud."²⁷¹ The reason the district court apparently made such observation is not clear; from the two Fifth Circuit opinions in this matter, it appears that the fraud was committed by the maker of the note, not the payee, and there does not appear to be any holding that the maker's liability on a note executed by it should somehow be reduced by reason of its own fraud.

d. Other Significant Usury Cases

The Survey period presented more "charging" cases. Thus, in *People's State Bank of Clyde v. Andrews*,²⁷² the bank sent Andrews a demand letter on a note which Andrews had not executed but which the bank alleged he had assumed. The bank then sued Andrews as well as the original makers of the note. Andrews contended that the bank's demand on and suit against him constituted the charging of usury. At trial, the court instructed a verdict in Andrews' favor on the issue of his assumption of the debt. The trial court also entered judgment that the bank had charged Andrews interest in excess of the lawful amount and awarded penalties of approximately \$160,000.²⁷³

The court also entered judgment in favor of the bank against the original makers. By the time of the appeal, the original makers had satisfied the judgment. Since the debt had been paid in full, the court of appeals held that the bank's appeal of the instructed verdict as to Andrews' liability was moot. With respect to the usury claim, the court held that merely sending a demand letter to a party cannot make a party an obligor on a note.²⁷⁴ Since Andrews both maintained he was not, and had been found not to be, liable on the note, as a stranger to the note he was not entitled to an award of usury penalties.²⁷⁵

The most creative charging allegation appeared in *Pearcy Marine, Inc. v. Acadian Offshore Services*.²⁷⁶ Percy Marine, Inc. (Percy) sold a vessel to Acadian Offshore Services, Inc. (Acadian). As part of the transaction, Acadian delivered a \$450,000 promissory note to Percy under which no payments were due for approximately two years. Slightly over one year after the execution and delivery of the note, Percy asked Acadian to make an early payment on the note. Acadian agreed pursuant to a letter agreement under which Acadian agreed to make a \$75,000 prepayment on the promissory note in exchange for Percy's agreement to

271. *James v. Frame*, 6 F.3d 307, 309 (5th Cir. 1993).

272. 881 S.W.2d 520 (Tex. App.—Eastland 1994, n.w.h.).

273. *Id.* at 521.

274. *Id.* at 522.

275. *Id.* See also *O'Quinn v. Beanland*, 540 S.W.2d 526 (Tex. Civ. App.—San Antonio 1976, no writ) (where the court declined to allow a party who avoided an obligation under a note based on mental incompetency to assert a claim based on usury arising out of the note); *In re T.E. Mercer Trucking Co.*, 16 B.R. 180 (Bankr. N.D. Tex. 1981) (holding that a void debt could not be the subject of a usury claim).

276. 832 F. Supp. 192 (S.D. Tex. 1993).

excuse any interest on the note from April 1, 1991, through February 22, 1992.²⁷⁷ Additionally, Percy agreed to “promptly and fairly resolve” all sums owed under charters for two other vessels, either by immediate payment or by offset against the note. The sums so owed apparently totalled approximately \$400,000.

Percy contended the \$75,000 payment by Acadian prior to the date it was due in fact constituted a loan by Acadian to Percy, the \$400,000 charges Percy agreed to resolve constituted interest on the \$75,000 loan, and the interest forgiven also constituted interest on the note.²⁷⁸ Percy was required to prove that it received a loan of principal which Percy had an absolute obligation to repay.²⁷⁹ There was no evidence from which a conclusion to that effect could be drawn. As described by the court, “Acadian no more became Percy’s creditor than a homeowner becomes the creditor of his bank when he pays off his mortgage early.”²⁸⁰ With respect to the \$400,000 sum, the court analogized any advantages to Acadian as legitimate charges for Acadian’s right to relinquish its right not to make an early payment.²⁸¹ Even if the \$75,000 advance payment were a loan, the interest forgiven did not constitute interest on the “loan;” it was simply a renegotiation of the original terms.²⁸²

With respect to the effect of the acceptance of the disputed \$400,000 charges, should the \$75,000 payment be treated as a loan, the court found that if Percy were not obligated to pay the costs prior to the letter agreement, the letter agreement itself did not impose such an obligation. If Percy did owe these charges, then an agreement to pay the charges could not constitute charging interest.²⁸³ The court concluded that Texas courts would not so strictly construe the term “undisputed” as to make a lender liable for insisting that a borrower pay debts which the lender in good faith believes the borrower to be liable for as a condition of entering into some other obligation; rather, the transaction should be viewed as one akin to a settlement which is subject to speculative value.²⁸⁴

In *D&S Kingsway Ventures v. Texas Capital Bank — Richmond*²⁸⁵ the bank sued the appellants to recover on a past due note. The debtor asserted usury. The first contention was that the bank’s first amended petition constituted a charge of usurious interest because it did not reflect a credit for sums received at a foreclosure sale. Appellants also contended

277. Percy estimated the interest it would have received but forgave was between \$17,000 and \$20,000. *Id.* at 194.

278. *Id.* at 195, 197.

279. *Id.* at 196 (citing *Holley v. Watts*, 629 S.W.2d 694 (Tex. 1982); *Najarro v. SASI Int’l, Ltd.*, 904 F.2d 1002 (5th Cir. 1990), *cert. denied*, 498 U.S. 1048 (1991)).

280. *Id.*

281. *Id.* at 197 (characterizing such “charge” as the complement to a prepayment penalty).

282. *Id.*

283. *Id.* at 198 (citing *In re Casbeer*, 793 F.2d 1436, 1446 (5th Cir. 1986) (“[t]here is no usury when a borrower agrees to pay his undisputed prior obligations to the lender, as part of the consideration for a new loan . . .”).

284. *Id.*

285. 882 S.W.2d 573 (Tex. App.—Houston [14th Dist.] 1994, n.w.h.).

that the bank "received" usurious interest when it received foreclosure sale proceeds but failed to credit them to the note. The court found both claims without merit.²⁸⁶

As to the first amended petition, the court cited *Carpet Services*²⁸⁷ to hold that the pleading did not constitute a charge.²⁸⁸ The appellants then contended that Second Amended Petition was an admission that the bank received usurious interest and asserted that testimony in the record showed that foreclosure sale proceeds were not applied to reduce note principal. The court noted that no citations to the record were included, and that in fact there was evidence to the contrary. The court found there to be sufficient evidence to support the adverse finding on appellant's usury claim.²⁸⁹

In *Miller v. University Savings Ass'n*²⁹⁰ appellant Miller signed a guaranty in favor of University Savings Association (University) in conjunction with a loan by University to another entity (Borrower). Following default by the Borrower on the loan, the creditor accelerated the note and made demand on the guarantor to make the payment required under the guaranty. The usury contention was that by seeking the entry of a judgment charging Miller interest at the rate provided in the note guaranteed, when in fact he was only liable for interest at the legal rate of six percent per annum, appellee charged usurious interest.

With respect to the specification of an interest rate, the court held that the guaranty agreement incorporated the terms of the note, and that the note itself provided for interest at the maximum lawful rate.²⁹¹ Additionally, the court noted that the guarantor's liability was limited to ten percent of the principal and interest on the note and ten percent of the attorneys' fees.²⁹²

Another case decided during the Survey period which considered whether a contract specified a rate of interest was *Ocean Transport, Inc. v. Greycas, Inc.*,²⁹³ which involved a counterclaim for usury by guarantors who were sued by a lender for payment under their guaranties.²⁹⁴ The promissory note at issue in *Greycas* provided for payments in an amount equal to a factor multiplied by the face amount of the promissory note, the first installment being due on the date of the note and the subsequent

286. *Id.* at 575.

287. *George A. Fuller Co. of Texas v. Carpet Servs., Inc.*, 823 S.W.2d 603 (Tex. 1992).

288. *D&S Kingsway*, 882 S.W.2d at 575. Apparently, appellants contended the First Amended Petition constituted a charge because that pleading had been replaced by a Second Amended Petition.

289. *Id.* at 575.

290. 858 S.W.2d 33 (Tex. App.—Houston [14th Dist.] 1993, writ denied).

291. *Id.* at 36.

292. *Id.* at 37.

293. 878 S.W.2d 256 (Tex. App.—Corpus Christi 1994, writ denied).

294. The court did not address the standing of the guarantors to assert such a usury claim. See *Federal Sav. & Loan Ins. Corp. v. Griffin*, 935 F.2d 691, 701 (5th Cir. 1991), *cert. denied*, *Griffin v. First Gibraltar Bank FSB*, 502 U.S. 1092 (1992); *Houston Sash and Door Co. v. Heaner*, 577 S.W.2d 217 (Tex. 1979).

179 installments being due on the same day of each month thereafter.²⁹⁵ The jury found that the parties did agree to a calculable rate of interest. Although the appellant and one other witness testified that the interest rate could not be calculated because the first payment was due on the date of execution and, therefore, was a loan for zero days, at least four witnesses called by Greycas testified that they could so calculate the interest rate.²⁹⁶ The court of appeals held that the trial court must necessarily have determined the note to be ambiguous and therefore, the jury was required to resolve the ambiguity. The court then found that there was evidence to support the jury's finding.²⁹⁷

The appellants also argued that the past due rate of interest specified in the note which was equal to the lesser of the maximum legal rate or five percent in excess of Citibank's prime rate was incalculable as a matter of law and, therefore, limited to six percent per annum. The court found both to be specified rates which were agreed upon and referred to a source which could be made certain by proof. There was testimony by a witness as to what the overdue rate was, and the court held that such overdue rate was not incalculable as a matter of law.²⁹⁸

Another attorney besides Ravkind²⁹⁹ did not fare well in his attempt to assert a usury claim.³⁰⁰ Although the precise nature of the usury claim cannot be determined from the facts provided in the opinion, the court held that a suit alleging that a note provided for usurious interest which was brought five and one-half years after the first interest payment was barred by the statute of limitations.³⁰¹ It cannot be determined from the opinion whether the only usury claim asserted related to the first payment.

The court declined to give a debtor two bites at a usury apple in *El Paso Natural Gas Co. v. Berryman*³⁰². Berryman sued El Paso Natural Gas (El Paso) and El Paso Development Company (Development) for usury in connection with a sale to him by Development. He asserted at trial that El Paso was liable as the alter ego of Development and received a directed verdict from the trial court on that issue. Berryman sought only two times the usurious interest, and judgment to that effect was entered. The court of appeals affirmed this part of the judgment but reversed and remanded as to the alter ego issue. After remand, Development and Berryman settled, and the parties stipulated that this satisfied in full Development's liability. Thereafter, Berryman filed new pleadings against El Paso seeking additional usury penalties to which it

295. *Greycas*, 878 S.W.2d at 264.

296. *Id.*

297. *Id.*

298. *Id.* at 265.

299. *Ravkind v. Mortgage Funding Corp.*, 881 S.W.2d 203 (Tex. App.—Houston [1st Dist.] 1994, n.w.h.). See *supra* note 252 and accompanying text.

300. *Aguilar v. Anderson*, 855 S.W.2d 799 (Tex. App.—El Paso 1993, writ denied).

301. TEX. REV. CIV. STAT. ANN. art 5069-1.06(3) (Vernon 1987).

302. 858 S.W.2d 362 (Tex. 1993).

otherwise would have been entitled had it sought them in the first suit. The court held that El Paso's liability, if any, was at best only derivative of Development's liability, and that by discharging Development's liability, Berryman had no further claim against El Paso.

The Corpus Christi Court of Appeals³⁰³ held that a lender did not violate Chapter 3 of the Credit Code³⁰⁴ in imposing a late charge calculated as a percentage of the full monthly payment when only a portion was late. The court found the lender's provision consistent with the Credit Code.³⁰⁵ The court did not reach the question of the legality of the lender's practice of "pyramiding" late charges — applying payments first to unpaid late charges and the balance to the scheduled payment, the effect of which was to make the debtor "perpetually in default on their loan payments."³⁰⁶ The trial court had found such practice not to violate the Credit Code. The debtor had the burden of proof; the debtor did not establish illegality as a matter of law; and there was not a sufficient basis to overturn the trial court's fact findings.

Finally, both the Texas Supreme Court³⁰⁷ and the Fifth Circuit³⁰⁸ held that Article XVI, section 11 of the Texas Constitution applies only to lending and credit transactions and does not apply to an award of pre-judgment interest by a court.

2. *Duty of Good Faith and Fair Dealing*

In *McMillan v. MBank Fort Worth, N.A.*³⁰⁹ the court was asked to determine the propriety of the district court's judgment notwithstanding the verdict on claims arising from the alleged breach of an oral loan agreement. McMillan asserted breach of contract and breach of the duty of good faith and fair dealing. The jury awarded McMillan \$2,658,778 on its breach of contract claim and \$1,800,000 on its bad faith claim. The jury also awarded the bank \$4,500,000 on its counterclaims, which sum represented the outstanding balance on its loan. On appeal, the plaintiff contended, among other things, that the judgment n.o.v. was improper. The court, however, did not undertake this inquiry because it concluded that the *D'Oench, Duhme* doctrine barred the plaintiff's claims arising from the alleged breach of oral agreement as a matter of law.³¹⁰ The court further noted that "the FDIC-Receiver, as it is urging the affirmance of a favorable judgment that it inherited as an asset when it became receiver of Mbank, may raise the *D'Oench, Duhme* doctrine as a defense for the

303. *Allied Finance Co. v. Rodriguez*, 869 S.W.2d 567 (Tex. App.—Corpus Christi 1993, no writ).

304. TEX. REV. CIV. STAT. ANN. art. 5069-3.01, *et seq.* (Vernon 1987).

305. TEX. REV. CIV. STAT. ANN. art. 5069-3.15(5) (Vernon 1987).

306. *Rodriguez*, 869 S.W.2d at 573.

307. *Sage Street Assocs. v. Northdale Constr. Co.*, 863 S.W.2d 438 (Tex. 1993).

308. *Axelson, Inc. v. McEvoy-Willis*, 7 F.3d 1230 (5th Cir. 1993).

309. 4 F.3d 362 (5th Cir. 1993).

310. *Id.* at 368; *cf.* *Bowen v. FDIC*, 915 F.2d 1013, 1015 (5th Cir. 1990) (reversing jury verdict without examining evidence because claims barred as a matter of law by the *D'Oench, Duhme* doctrine).

first time on appeal.”³¹¹ Relying on *D’Oench, Duhme* and *Beighley v. FDIC*,³¹² the court concluded, “[s]imply put, transactions not reflected on the bank’s books do not appear on the judicial radar screen either.”³¹³ The plaintiff further alleged that *D’Oench, Duhme* did not bar their claims because they did not lend themselves to a scheme or arrangement whereby banking authorities would likely be misled. The court, however, disagreed and held that the mere act of failing to properly record an oral loan agreement satisfied *D’Oench, Duhme’s* requirement that a borrower engage in a misleading arrangement.³¹⁴

For guidance on how to avoid the imposition of, and liability for, breaching the duty of good faith and fair dealing, lenders should review the facts in *FDIC v. Perry Brothers, Inc.*³¹⁵ In *Perry Brothers* the court recognized that

[w]hile the relationship between debtor and creditor alone does not lend itself to a general imposition of the duty of good faith and fair dealing, Texas courts nonetheless recognize that a duty of good faith and fair dealing may arise: (a) by agreement; (b) in particular circumstances, between the parties as a result of a long-standing, special relationship of trust and confidence between them (although mere subjective intent alone cannot so create the duty of good faith and fair dealing); and (c) may arise when an imbalance of bargaining power exists—at least when the defendant is responsible for the imbalance.³¹⁶

The court found that all three situations existed in *Perry Brothers*.³¹⁷

Perry Brothers involved a variety store chain based in Lufkin, Texas, which had a long-standing relationship with NationsBank of Texas, N.A. In 1988 NCNB, predecessor to NationsBank of Texas, N.A., orally promised to renew at maturity, Perry Brothers’ line of credit on the same terms as those in the 1988 loan. When the loan matured in July, 1989, however, NationsBank refused to renew the line of credit on the earlier terms. Perry Brothers argued that because it had relied upon the lender’s earlier assurances to renew and further, because the lender had actively discouraged Perry Brothers from pursuing alternative financing, it was forced, under economic duress, to execute the 1989 loan documents on terms different from those in the 1988 loan documents. The court agreed with Perry Brothers and determined that the bank’s actions “reflected conscious, callous disregard for Perry Brothers’ rights, interests and legitimate expectations” and thus, constituted a breach of contract.³¹⁸ Com-

311. *McMillan*, 4 F.3d at 368.

312. 868 F.2d 776, 784 (5th Cir. 1989).

313. *McMillan*, 4 F.3d at 368 (citing *Bowen*, 915 F.2d at 1015-16).

314. *Id.* at 369. The court noted that “[c]ontrary to the plaintiff’s suggestion, the FDIC-Receiver’s knowledge of the alleged oral loan agreement is irrelevant under *D’Oench, Duhme*.”

315. 854 F. Supp. 1248 (E.D. Tex. 1994).

316. *Id.* at 1259.

317. *Id.*

318. *Id.* at 1256.

paring *Perry Brothers* with *Security Bank v. Dalton*³¹⁹ the court, while recognizing that the general relationship between a borrower and its lender does not by itself give rise to a duty of good faith and fair dealing, did nonetheless recognize that such an extraordinary relationship may arise in unusual cases, and found that *Perry Brothers* was such an unusual case.³²⁰

In finding that an extraordinary relationship existed between Perry Brothers and NationsBank, the court observed that NationsBank had expressly agreed to continue the special relationship developed between Perry Brothers and its predecessor, First Republic Bank-Lufkin. Furthermore, because Perry Brothers relied upon NationsBank's promises, an imbalance of bargaining power existed which the court found had been exploited by the bank. The court concluded that because NationsBank had promised to assume the role of its predecessor failed bank, the parties had "an extraordinary banking relationship—one clearly marked by the parties' *shared trust*."³²¹ Of significance to the court's analysis was the bank's knowledge that Perry Brothers had commenced a multi-year restructuring of its operations and was extremely vulnerable until such restructuring was completed. The bank's record consistently provided that the 1989 line of credit was essential to Perry Brothers accomplishing its restructure and staying in business.

The court found that NationsBank had a "hidden agenda" in its dealings with Perry Brothers. The court found that the bank's dishonesty was further evidenced by its affirmative assurances to Perry Brothers that the bank would not set off the company's checking accounts while the parties were engaged in workout negotiations, when in fact, at the same time the bank was busy monitoring Perry Brothers' cash accounts and developing a plan to set off so as to maximize its collections before year end. The court concluded that NCNB's efforts to maximize its collections were driven by "a yet-heightened, self interested quest to maximize its compensation under a new, non-public agreement with the FDIC in July 1990; and in particular by bank officers' desires to collect up to one third (1/3) of their annual salaries in bonuses from the bank for accomplishing particularly large quantities of collections."³²² Based upon these facts, the court concluded that Perry Brothers established its duty of good faith and fair dealing claim.

319. 803 S.W.2d 443, 447 (Tex. App.—Fort Worth 1991, writ denied) ("The [Texas Supreme] Court has consistently held . . . that a duty of good faith is not imposed *in every contract*, but [rather,] only in special relationships marked by shared trust or an imbalance in bargaining power.") (emphasis added). *Id.*

320. *Id.*; cf. *FDIC v. Coleman*, 795 S.W.2d 706, 708-09 (Tex. 1990).

321. *Perry Brothers*, 854 F. Supp. at 1260.

322. *Id.*

3. Fraud

In *NCNB Texas National Bank v. Johnson*³²³ the Fifth Circuit ruled that state law fraud was barred by the *D'Oench, Duhme* doctrine. In *Johnson* a development corporation borrowed \$500,000 from a bank and one of the shareholders signed a guaranty which covered the \$500,000 note. This guaranty also contained a dragnet clause covering all other indebtedness "of any kind or character" of the corporation to the bank. The guaranty stated that it was to be "continuing, absolute, unconditional, and unlimited as to all indebtedness guaranteed."³²⁴ Two other shareholders had executed guaranties of \$1.8 million and all three shareholders had signed guaranties of a \$700,000 note. When the development corporation filed Chapter 11 bankruptcy, suit was brought to enforce the guaranties. The counterclaimant-appellant alleged, among other things, that Sam Houston Bank misrepresented that the notes guaranteed by the appellant would not be modified without his consent. However, the court found that the appellant's guaranty plainly waived all rights to "notice of extensions, renewals or rearrangements of [d]ebt, [notice] of release or substitution of collateral . . . and every other notice of every kind."³²⁵ On the face of the agreements, the specific terms of the guaranty controlled and no representation to the contrary was recorded. The court noted that there was nothing in the guaranty to indicate that it was limited to a single transaction. Therefore, the court ruled that the *D'Oench, Duhme* doctrine barred the appellant's fraud claim.³²⁶

4. Tying Act/Violations of Bank Holding Company Act

NCNB v. Johnson also involved the issue of whether Sam Houston Bank had violated the anti-tying provisions of the Bank Holding Company Act.³²⁷ The district court found that this counterclaim also was barred by the *D'Oench, Duhme* doctrine.³²⁸ The court noted that in order to prevail under the Bank Holding Company Act, Anderson must show (1) that the banking practice in question was unusual in the banking industry; (2) an anti-competitive tying arrangement existed; and (3) that Sam Houston Bank benefitted from the practice.³²⁹ The court noted that in order to survive summary judgment, the guarantor must present evidence sufficient to create a fact issue regarding whether the conditions

323. 11 F.3d 1260, 1269 (5th Cir. 1994).

324. *Id.* at 1263.

325. *Id.* at 1266.

326. *Id.* at 1269.

327. 11 F.3d 1260, at 1267; *see also* Bank Holding Company Act, 12 U.S.C. § 1972(1)(c) (1988).

328. The common law *D'Oench, Duhme* doctrine is designed to protect the FDIC's interest in assets it acquires as a receiver for failed banks. *See Johnson*, 11 F.3d at 1267 (citing *Beighley v. FDIC*, 868 F.2d 776, 783-84 (5th Cir. 1989)). Specifically, the *D'Oench, Duhme* doctrine bars defenses and claims by borrowers based on unrecorded agreements with the failed bank. *See Johnson*, 11 F.3d at 1267 (citations omitted).

329. *Id.* at 1268 (citing *Bieber v. State Bank of Terry*, 928 F.2d 328, 330 (9th Cir. 1991)).

placed on the loan were unusual in the banking industry.³³⁰ The court determined that the language of the note on which the guarantor relied was facially neutral and would not have put the FDIC on notice that Sam Houston Bank engaged in illegal tying.³³¹ The court determined that proof of tying would require evidence of terms or agreements outside of the face of the document at issue. Thus, Anderson's tying claim was barred by the *D'Oench, Duhme* doctrine.³³²

*Board of Governors of Federal Reserve System v. DLG Financial Corp.*³³³ involved a corporation, DLG Financial Corp. (DLG), engaged in the business of buying discounted promissory notes and reselling them for profit. In 1990, DLG entered into a letter agreement to purchase two promissory notes from NCNB Texas National Bank, N.A. which was acting on behalf of the FDIC. The two notes were executed by International Bancorporation, Inc. and were secured by a pledge of all of the outstanding common stock of International Bank, N.A. Pursuant to the security agreement, if the notes fell into default, the noteholder had the right to exercise all of the voting rights and corporate powers concerning the pledged stock without having to foreclose the note.³³⁴ At the time the notes were transferred to DLG, they were already in default. Shortly thereafter, DLG was informed that its purchase of the notes and concomitant acquisition of the voting rights of the bank stock violated the Bank Holding Company Act³³⁵ which generally prohibits an entity from becoming a bank holding company without obtaining prior approval from the Board of Governors of the Federal Reserve System. On appeal, the court noted that by the express terms of the security agreement, the noteholder could exercise all voting rights of the pledged stock upon default under the notes. Since DLG obtained the notes already in default, DLG immediately acquired the power to vote the stock and, therefore, ipso facto, became a bank holding company under the Bank Holding Company Act.³³⁶

DLG argued that even if it were a bank holding company, it was not required to obtain Board approval because DLG previously contracted for control of the bank stock in good faith, an exception to the requirement that approval be given by the Board. The court noted that the approval exception pertained to ownership or control of bank shares acquired and securing a debt *previously* contracted for in good faith.³³⁷ When DLG purchased the notes, they were already in default giving DLG the immediate power to vote the stock, thus the debt acquired was

330. *Id.*

331. *Id.*

332. *Id.*

333. 29 F.3d 993 (5th Cir. 1994).

334. *Id.* at 996.

335. 12 U.S.C. §§ 1841-1850 (1988 & Supp. III 1991).

336. *DLG Fin. Corp.*, 29 F.3d at 1003-04. A company becomes a bank holding company if, inter alia, it has the power to vote 25% or more of any class of voting security of a bank. 12 U.S.C. § 1841 (a)(2)(A) (1988 & Supp. III 1991).

337. *Id.* at 1004 (emphasis the court's).

not one DLG had previously contracted for in good faith and the approval exception did not apply.³³⁸ In making its decision, the court relied on the interpretations of the FDIC and the Office of the Comptroller of the Currency (OCC) with respect to an analogous exception under the Change in Bank Control Act of 1978.³³⁹ In one such interpretation, the OCC noted that in order for the good faith element of the exception to be satisfied, "a lender must either make or acquire the loan secured by bank stock in advance of any known default."³⁴⁰

5. Conversion

In holding that sufficient evidence existed to find that a bank converted the account of a depositor held for the benefit of third parties, the Texas Court of Appeals in *Mauriceville National Bank v. Zernial*³⁴¹ conducted an evidentiary review of the following five considerations in order to determine that an award of punitive damages was correct: (1) the nature of the wrong; (2) the character of the conduct involved; (3) the degree of culpability of the wrongdoer; (4) the situation and sensibilities of the parties concerned; and (5) the extent to which such conduct offends the public sense of justice and propriety.³⁴² The court followed the standard outlined in *Alamo National Bank v. Kraus*³⁴³ and developed in *Transportation Insurance Co. v. Moriel*.³⁴⁴ The court held that the bank knew or should have known that funds in the particular account were for the benefit of third parties, and that the bank had specific knowledge of the trust nature of the account when it improperly "Razooed"³⁴⁵ the balance of the account. The court described the term "Razoo" as a "real" word meaning "with influence of razzle-dazzle."³⁴⁶ In the words of the court, "'Razoo' was also used colloquially, meaning, 'grab all you can, as quick as you can.'"³⁴⁷ The court, considering the nature of the wrong, found that there was a conversion. The court further considered the character of the conduct involved and found that the bank knew that the third party subcontractors had rights to the funds in the account. The court also concluded that despite specific notice, the bank converted the funds and disregarded the rights of the subcontractors. And, after applying the evidence to the factors outlined in *Kraus*, the *Zernial* court held that there was sufficient evidence to show that the bank wantonly disregarded

338. *Id.*

339. Pub. L. No. 95-630, 92 Stat. 3683 (codified as amended in scattered sections of 12 U.S.C.).

340. *DLG Fin. Corp.*, 29 F.3d at 1004 (citing OCC Inter. Ltr. No. 451).

341. 880 S.W.2d 282 (Tex. App.—Beaumont 1994, writ granted), *rev'd*, 1995 WL 64162 (Tex. Feb. 16, 1995).

342. *Id.* at 289.

343. 616 S.W.2d 908 (Tex. 1981).

344. 879 S.W.2d 10 (Tex. 1994).

345. *Zernial*, 880 S.W.2d at 291 n.1.

346. *Id.* (citing WEBSTER'S NEW INTERNATIONAL DICTIONARY 2069 (2d ed. 1936)).

347. *Id.*

the rights of others.³⁴⁸ Therefore, the court concluded that the \$200,000 punitive damage award was not legally excessive.

In *Zernial*, the jury affirmatively found that the conversion of funds was done willfully, maliciously or with gross negligence. "Exemplary damages have long been recoverable for conversion accompanied by fraud or oppression, or by willfulness and malice."³⁴⁹ The *Zernial* court upheld the findings by the jury while exercising caution in light of the recent Texas Supreme Court decision requiring appellate courts not only to apply the guiding factors set forth in *Kraus*, but to definitively articulate an application of the evidence to the factors.³⁵⁰ Quoting *Ellis County State Bank v. Keever*³⁵¹ the court agreed that *Moriel* "should be applied to a pending case in which a party has preserved the complaint that the court of appeals failed to properly scrutinize a punitive damage award."³⁵² The court concluded that in situations where punitive damages have been awarded, "the new focus for reviewing courts is upon insuring that such awards, 'are not grossly out of proportion to the severity of the offense and have some understandable relationship to compensatory damages.'"³⁵³

In a suit brought by a corporation, its shareholder and other businesses against a bank for forcible entry, conversion and wrongful foreclosure, a Texas court denied a bank's motion for summary judgment in *Lighthouse Church of Cloverleaf v. Texas Bank*.³⁵⁴ The bank contended that it was entitled to a summary judgment as a matter of law because the appellants had no standing to sue because the only contractual relationship was between the bank and a defunct corporation. While the court held that the bank was not entitled to summary judgment as a matter of law, it also concluded that, relying upon TEX. TAX CODE ANN. section 171.252(1) (Vernon Supp. 1994), the corporation did not have standing to sue.³⁵⁵ In addressing the attack on the repossession of the real property, the court disagreed with the bank and concluded that the deed from the bank to the appellant was not void for lack of a grantee. The court further noted that even if the deed was void, that fact did not entitle the bank to forcibly enter the property.³⁵⁶ The court also concluded that the deed of trust and security agreement did not sanction the bank's actions. The court found that the security agreement allowed repossession of the personal property only and that the deed of trust expressly stated that the bank's remedy for non-vacation of the property was a lawsuit. The court affirmed that Texas law does not recognize "self-help repossession" of real

348. *Id.* at 291-92.

349. *Id.* at 289 (citations omitted).

350. *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994).

351. 888 S.W.2d 790, 799 (1994).

352. *Zernial*, 880 S.W.2d at 292.

353. *Id.* (citing *Moriel*, 879 S.W.2d at 28).

354. 889 S.W.2d 595 (Tex.App.—Houston [14th Dist] 1994, writ requested).

355. *Id.* at 600 (citing TEX. BUS. & COM. CODE ANN. § 36.25 (Vernon 1987); TEX. TAX CODE ANN. § 171.252(1) (Vernon Supp. 1994)).

356. *Id.* at 601.

estate.³⁵⁷ Therefore, because of the express language of the deed of trust and security agreement, the court denied the bank's motion for summary judgment.

In another conversion case, the bank fared better than in *Zernial* and in *Lighthouse*. In *Crutcher v. Continental National Bank*,³⁵⁸ the court refused to find the bank liable for conversion. The court found that the mere taking and recording of a security interest in personal property without exercising ownership or control over property other than the filing of a security interest cannot constitute conversion. Since the former bank customers did not have ownership, possession, or the right to immediate possession of the property covered by the unrecorded liens, the former customers could not maintain an action against the bank for conversion.

6. Lender Liability Under the Farm Credit Act

*Grant v. Farm Credit Bank of Texas*³⁵⁹ involved the question of whether the Farm Credit Act of 1971 and its amendment, the Agricultural Credit Act of 1987, provide a private cause of action.³⁶⁰ In 1983, Thomas A. Grant, III and two other individuals purchased 37,000 acres of land in Louisiana for about \$36 million. Grant borrowed approximately half of the purchase price from the Federal Land Bank of Jackson (FLBJ). In exchange, Grant gave FLBJ a mortgage on 15,000 acres to secure the debt. After a few years, Grant fell behind in mortgage payments and to avoid foreclosure, Grant filed a lawsuit in 1986 against FLBJ and others in which he asserted various lender liability claims.

In May of 1988, the Farm Credit Administration appointed REW Enterprises (REW) as the receiver for FLBJ. In 1990, the district court granted REW summary judgment for the amounts due on the loans and recognized the mortgage. REW then conveyed its interest in the notes and the collateral to the Farm Credit Bank of Texas (FCBT). Shortly thereafter, FCBT seized the mortgaged property, selling the property at a public auction in which FCBT purchased the land for \$14 million. When FCBT notified Grant in March 1992 that it intended to sell the property and that Grant had a right of first refusal, Grant offered to settle FCBT's claims against him by purchasing the property for \$16,900,000. When FCBT rejected this offer, Grant filed a lawsuit in Louisiana state court against FCBT, REW and others seeking damages and a declaration of his rights to the property. The case was removed to federal district court where the United States District Court for the Western District of Louisi-

357. *Id.* at 603.

358. 884 S.W.2d 884 (Tex. App.—El Paso 1994, writ denied).

359. 8 F.3d 295 (5th Cir. 1993).

360. Farm Credit Act of 1971, Pub. L. 92-181, 85 Stat. 583, as amended by Agricultural Credit Act of 1987, Pub. L. 99-509, 100 Stat. 1877 (codified at 12 U.S.C. §§ 2001-2279aa-14 (1988)).

ana granted the defendants' motions for failure to state a claim upon which relief could be granted and for summary judgment.³⁶¹

The Court of Appeals for the Fifth Circuit affirmed and held that borrowers do not possess a private cause of action under the Farm Credit Act of 1971 and its amendment, the Agricultural Credit Act of 1987. The Fifth Circuit noted that its holding followed other circuits' decisions which had previously addressed the issue.³⁶² Although the Fifth Circuit did not explain the rationale for the circuits' unanimous stance on the issue, the district court opinion stated that the courts had concluded that the legislative history and the comprehensive administrative remedial scheme of the Farm Credit Act and its amendment establish that Congress did not intend to confer a private right of action under such acts.³⁶³

F. DEPOSIT ACCOUNTS

1. Joint Accounts

In *Regency Financial Corp. v. Kidder, Peabody & Co.*³⁶⁴ one joint account holder brought suit against Kidder, Peabody & Co., Inc for its alleged unauthorized disbursement of funds from a joint account. The court reversed an earlier summary judgment granted in favor of the brokerage company. The real issue was whether Kidder Peabody had authority to disburse proceeds from the joint account to one joint owner of the account. The court determined that the answer depended upon the contractual arrangement between the brokerage company and the owners of the account.³⁶⁵ Relying upon *Leinert v. Sabine National Bank*,³⁶⁶ the court concluded that Kidder Peabody's liability for payment from the joint account depended upon whether the account was an "and" account or an "or" account. If the account had been an "and" account, the funds would have been joint property and two signatures would be required to draw a check or withdraw funds. If the account had been an "or" account, either party acting alone would have had the right or authority to draw checks or otherwise act concerning the account. The court held that a fact question existed and remanded to the trial court for further proceedings.³⁶⁷

361. 8 F.3d at 296.

362. *Id.* (citing *Saltzman v. Farm Credit Servs.*, 950 F.2d 466 (7th Cir. 1991); *Zajac v. Federal Land Bank*, 909 F.2d 1181 (8th Cir. 1990) (*en banc*); *Griffin v. Federal Land Bank*, 902 F.2d 22 (10th Cir. 1990); and *Harper v. Federal Land Bank*, 878 F.2d 1172 (9th Cir. 1989)).

363. *Grant v. Farm Credit Bank of Texas*, 841 F. Supp. 186, 189 (W.D. La. 1992).

364. 879 S.W.2d 178 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

365. *Id.* at 181.

366. 541 S.W.2d 872 (Tex. Civ. App.—Beaumont 1976, writ ref'd n.r.e.).

367. 879 S.W.2d at 184.

2. *Right of Survivorship*

In another Texas Court of Appeals case involving joint accounts, the court in *Banks v. Browning*³⁶⁸ followed the reasoning in *Stauffer v. Henderson*³⁶⁹ where the court held that the terms of joint account cards were clear and unambiguous, and clearly showed the husband and wife's intent to create joint accounts with the right of survivorship. Since there was no ambiguity on the face of the cards, no extrinsic evidence was admissible.³⁷⁰ As in *Stauffer*, the court in *Banks* held that the joint account cards were sufficient to create joint accounts with the right of survivorship.³⁷¹

G. SURETIES AND GUARANTORS

A number of cases during this Survey period addressed questions regarding a guarantor's liability. The Fifth Circuit predicted that the Texas Supreme Court would hold that guarantors could waive their right to a commercially reasonable default sale. The courts applied the *D'Oench, Duhme* doctrine in several instances to defeat guarantor's defenses to liability and also rejected application of the doctrine in at least one instance where the guarantor ultimately defeated liability.

1. *Comaker Liability*

In *FDIC v. Gilbert*³⁷² the Fifth Circuit reviewed a United States District Court for the Eastern District of Louisiana decision granting summary judgment to a successor to a failed bank. In *Gilbert*, the FDIC and the then current holder of the note asserted an action against a comaker to recover on a promissory note and guaranty. The Fifth Circuit held that a comaker's liability would not be discharged based on a post-execution alteration of the note's repayment provision that was initialed by the comaker, and that the comaker was not entitled to reduction in his obligation based on other comaker's settlements with the holder or on insolvency of the makers.³⁷³ Defendant Gilbert appealed the summary judgment entered against him in favor of the current holder of the note, Baton Rouge Bank and Trust Company. The *Gilbert* court affirmed the lower court's application of Louisiana law governing the effect of settlements reached with other makers on the note and the insolvency of another maker.

Gilbert's defense to the note was based on his assertion that the note was altered on its face, subsequent to its execution. He cited the 1975 version of the Louisiana revised statute section 10:3-407 (Louisiana's version of section 3-407 of the Uniform Commercial Code) which provides that "as against any person other than a subsequent holder in due

368. 873 S.W.2d 763 (Tex. App.—Fort Worth 1994, writ denied).

369. 801 S.W.2d 858 (Tex. 1990).

370. *Banks*, 873 S.W.2d at 765.

371. *Id.*

372. 9 F.3d 393 (5th Cir. 1993).

373. *Id.* at 397.

course. . . alteration by the holder [of an instrument] which is both fraudulent and material discharges any party whose contract is thereby changed unless that party assents or is precluded from asserting the defense. . . ."³⁷⁴ The Fifth Circuit rejected this defense because, among other reasons, the defense was barred by the federal *D'Oench, Duhme* and the holder in due course doctrines.³⁷⁵ These doctrines "bar the assertion of personal defenses to a note in cases where the FDIC has become the holder of the note."³⁷⁶ The court noted that Fifth Circuit precedent establishes that alteration of a document after execution, on its own, does not preclude the application of these doctrines.³⁷⁷ The court noted that handwritten or typewritten changes to a printed document made by the party or parties agreeing to the changes is a common practice in commercial and banking transactions.³⁷⁸ According to the Fifth Circuit, to initial such a change and then claim it as a defense to the note is a "classic example of circumstances that the *D'Oench, Duhme* doctrine was created to address, namely a 'scheme or arrangement whereby the banking authority on which [the FDIC] relied in ensuring the bank was or was likely to be misled.'"³⁷⁹ Accordingly, the Fifth Circuit held that Gilbert was therefore liable on the note.

The Fifth Circuit also addressed Gilbert's claim that the district court incorrectly applied Louisiana law when evaluating the effect of the settlements with comakers in the discharge in bankruptcy of the obligation of another comaker. The Fifth Circuit concluded that Gilbert was not entitled to a pro rata reduction in his obligation under the note based on the settlements or insolvency of the other makers.³⁸⁰ The court relied on Louisiana state law precedent which stated that the nonsettling guarantor was liable for the corporation's indebtedness up to the dollar limit set in the guaranty and that a bank's release of the settling guarantor did not affect the nonsettling guarantor's liability.³⁸¹ The Fifth Circuit also relied on its prior decision in *GATX Aircraft Corp. v. M/V Courtney Leigh*,³⁸² in which the court held that a guarantor was not entitled to an offset equal to the virile shares of settling and bankrupt guarantors.³⁸³ The court concluded by noting that it interpreted the language of the agreement in the present case "to provide that each of the four maker/guarantors is liable on the note for its full amount, and that the lender could settle with one

374. *Id.* at 394.

375. *Id.* at 395.

376. *Id.* at 395 n.2.

377. *Id.* at 395 n.3.

378. *Id.* at 395.

379. *Id.* (citing *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 460 (1942)); see 9 F.3d 395 n.4.

380. *Id.* at 396.

381. *Id.*; see also *First Nat'l Bank of Crowley v. Green Garden Processing Co.*, 387 So. 2d 1070 (La. 1980).

382. 768 F.2d 711 (5th Cir. 1985).

383. *Gilbert*, 9 F.3d at 396.

maker without losing its right to pursue another maker for the remaining balance on the note."³⁸⁴

2. Defenses

In *First City, Texas — Beaumont, N.A. v. Treece*³⁸⁵ the court held the guarantor liable on his guaranty despite several defenses raised by the defendant. Between May 6 and June 18, 1987, Farmer's Discount Supply, Inc. (Farmer's) executed and delivered three notes to First City National Bank of Beaumont (First City), with the total indebtedness at \$78,858. When the president and operating officer of Farmer's died, the remaining directors appointed the president's widow to continue operating the business, but never elected her to the board nor granted her specific authority to obligate Farmer's on any additional debt. The widow later refinanced Farmer's debt and obtained additional loans from First City without the knowledge of the board. On July 15, 1987, Farmers closed its business and surrendered the collateral to First City. After it had been reorganized with the assistance of the FDIC, First City filed suit against John H. Kennamer, Jr., a stockholder of Farmer's and one of the guarantors, seeking to recover the deficiency on the Farmer's notes by enforcing a provision of the guaranty which stated that the guarantor would be personally liable for Farmer's debt even if the debt was not properly authorized. The FDIC, as receiver for the failed First City, moved for summary judgment against Kennamer and the court held that, as to its prima facie case, summary judgment is proper because it proved that (i) the note and guaranty agreement were in existence and valid, (ii) the FDIC was the present holder of the note, (iii) the maker had defaulted, and (iv) the guarantor was liable under the guaranty agreement.³⁸⁶ Kennamer offered no evidence to contradict the FDIC's prima facie case, but did assert a number of affirmative defenses sounding in fraud in the inducement, fraud in the factum, duress and lack of authority. The FDIC argued that whatever Kennamer's affirmative defenses, they were barred as a matter of law by the federal holder in due course doctrine, the *D'Oench, Duhme* doctrine and 12 U.S.C. section 1823(e).

In response to the FDIC's first argument that the guarantors's defenses were barred by the federal holder in due course doctrine, the court held that the FDIC cannot be a holder in due course in this case for two reasons. First, a guaranty is a nonnegotiable instrument which is merely a contractual obligation, and as a result, the FDIC cannot be a holder in due course of guaranties acquired in a purchase and assumption transaction.³⁸⁷ The court stated that guaranties are not chameleons and they do not become negotiable simply because they have passed from a failed

384. *Id.* at 397.

385. 848 F. Supp. 727 (E.D. Tex. 1994).

386. *Id.* at 734.

387. *Id.* at 735.

institution to the FDIC.³⁸⁸ Second, the court agreed with Kennamer's assertion that the federal holder in due course status is available to the FDIC only when it acts in its corporate capacity, and found that in this case the FDIC was merely acting as a receiver.³⁸⁹

The court held, however, that Kennamer's defenses were based on unwritten, unrecorded agreements, and such defenses are barred by the common law *D'Oench, Duhme* doctrine and its statutory counterpart 12 U.S.C. section 1823(e).³⁹⁰ As previously discussed in this article, *D'Oench, Duhme* held that a person who has dealt with a failed institution may not rely on unwritten agreements with the bank as a defense to the enforcement of a facially valid obligation.³⁹¹ Furthermore, the court held that section 1823(e) was intended to supplement *D'Oench, Duhme*, not to replace or preempt it.³⁹² The two are not mutually exclusive, although they often lead to the same result. Thus, the FDIC may invoke the *D'Oench, Duhme* doctrine, section 1823(e) or both to bar defenses based on unwritten agreements.³⁹³

Kennamer also alleged that First City forged the maker's signature on the security agreement. Although fraud in the factum is an exception to the *D'Oench, Duhme* doctrine, the court held that because the guaranty agreement is not dependent on the presence of a valid security agreement, the defense of fraud in the factum would not discharge Kennamer's obligation to guarantee Farmer's debts.³⁹⁴

Finally, Kennamer argued that the alleged forged signature invalidated not only the security agreement, but also his obligation to guarantee the notes, based upon section 3.606(a)(2) of the Texas Business & Commerce Code.³⁹⁵ However, the court held that the guaranty agreement which Kennamer signed did not fall within Article 3 because Article 3 does not apply to continuing guaranties which merely guaranty overall indebtedness rather than a particular note. This is because a continuing guaranty is not an "instrument" as that term is used in Article 3 and therefore, the guarantor is not a "party to the instrument" as Kennamer argued under section 3.606. The rationale of this rule is premised on the difference between a guarantee of a specific note and a continuing guaranty. Since a continuing guaranty guarantees an overall indebtedness, a continuing guarantor is obliged to pay the debts of the defaulting principal whether

388. *Id.*

389. *Id.*

390. *Id.* at 736.

391. *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942).

392. *Treese*, 848 F. Supp. at 737.

393. *Id.*

394. *Id.* at 738.

395. Section 3.606 provides, in pertinent part, that "(a) [t]he holder discharges any party to the instrument to the extent that without such party's consent the holder . . . (2) unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse." TEX. BUS. & COM. CODE ANN. § 3.606(a)(2) (Vernon 1994).

those debts are secured by collateral or not.³⁹⁶ Accordingly, the court, having rejected all of the guarantor's affirmative defenses, granted the FDIC's motion for summary judgment and entered judgment in favor of the FDIC.³⁹⁷

As reported earlier, the court also enforced the guaranty in *NCNB Texas National Bank v. Johnson*.³⁹⁸ On June 28, 1985, Quest Development, Inc. (Quest) borrowed \$1,828,000 from the National Bank of Fort Sam Houston (Sam Houston Bank). Quest's three shareholders were Frank Corte, Ben Johnson and Fred Anderson. Only Corte and Johnson signed a guaranty for this Quest loan. On December 28, 1987, Quest borrowed \$519,000 from Sam Houston Bank and Anderson signed a guaranty covering the note as well as other indebtedness of "any kind and character" of Quest to Sam Houston Bank. The guaranty Anderson signed specified that it was to be "continuing, absolute, unconditional and unlimited as to all the indebtedness guaranteed."³⁹⁹ On August 9, 1985, Quest borrowed an additional \$700,000 from Sam Houston Bank and the bank obtained personal guaranties from all three shareholders. Sam Houston Bank subsequently became insolvent and the FDIC, as receiver, transferred the bank's assets, including the Quest notes and guaranties to NCNB Texas National Bank (NCNB) in late 1988. On August 7, 1990, Quest filed for reorganization under Chapter 11 of the United States Bankruptcy Code. The district court granted summary judgment against Anderson on the \$1.8 million note, and Anderson appealed contending that (i) he did not guaranty the \$1.8 million Quest note, (ii) Quest's reorganization proceeding barred any action against its guarantors, (iii) certain modifications made to the note during Quest's reorganization were improper, and (iv) dismissal of his counterclaim under the *D'Oench, Duhme* doctrine was in error.

The court, however, rejected Anderson's arguments and held that Anderson was liable under the express terms of the agreement he signed, which expressly covered "all other indebtedness of any kind and character", thereby encompassing Quest's \$1.8 million note to Sam Houston Bank. Citing *FDIC v. Cardinal Oil Well Servicing Co.*,⁴⁰⁰ the court stated that in the face of such explicit and unequivocal language, free of any ambiguity, it may not look to extraneous evidence of intent.⁴⁰¹

Anderson argued that the confirmed plan of reorganization barred the FDIC's suit against him, under principles of *res judicata* and accord and satisfaction, stating that there was no deficiency on the notes since the reorganization plan expressly provided that the Quest loans will be fully

396. *Treece*, 848 F. Supp. at 739 (citing *Union Planters Nat'l Bank of Memphis v. Markowitz*, 468 F. Supp. 529, 535 (W.D. Tenn. 1979)).

397. *Treece*, 848 F. Supp. at 744.

398. 11 F.3d 1260 (5th Cir. 1994).

399. *Id.* at 1263.

400. 837 F.2d 1369, 1371 (5th Cir. 1988).

401. *Johnson*, 11 F.3d at 1265.

repaid. Relying upon *United States v. Stribling Flying Service, Inc.*,⁴⁰² the court held that the discharge of a debtor in reorganization proceedings does not affect a guarantor's liability.⁴⁰³ Section 524(e) of the United States Bankruptcy Code provides that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity, for such debt."⁴⁰⁴ The court furthermore stated that Anderson's theory would defeat the purpose of loan guaranties; after all, a lender obtains guaranties specifically to provide an alternative source of repayment in the event that the primary obligor's debt is discharged in bankruptcy. In conclusion, the court stated that "[f]urther, there has been no accord and satisfaction, simply because there has been no accord. Reorganization proceedings are judicial, not contractual, even where a secured creditor voluntarily participates."⁴⁰⁵

Anderson also argued that modifications of the note made without his written consent constituted breach of the guaranty agreement and thus release him from liability. In response to such argument, the court held that since Anderson and the other guarantors had plainly waived "notice of extension, renewals or rearrangements of Debt, [notice] of release or substitution of collateral, . . . and every other notice of every kind",⁴⁰⁶ any modification of the note did not affect the continuing obligations of the guarantors where a guaranty's terms were plain and unambiguous.⁴⁰⁷

An important lesson was learned by the guarantor in *Bank One Texas v. Morrison*.⁴⁰⁸ Gary E. Morrison and others formed Triple M Drilling Company (Triple M) in January of 1984, and in 1985 Triple M obtained a \$200,000 line of credit from MBank Houston, N.A. (MBank). Morrison executed an unconditional personal guaranty in favor of MBank for that line of credit, as well as for any debt incurred after the issuance of the credit line, but the guaranty expressly provided that Morrison could unilaterally cancel at any time by giving written notice and thereby limit his obligation to those sums previously borrowed by Triple M. Morrison never sent such a notice to MBank; however, once the company began generating receivables, MBank released the guaranty and sent a package of loan documents to Morrison including the original \$200,000 note and a copy of the guaranty, conspicuously stamped "CANCELLED." When Morrison's assistant contacted the bank requesting the original guaranty, she was assured that the original was in MBank's "dead files" and was therefore effectively cancelled. Triple M subsequently obtained a second line of credit in the amount of \$500,000, which was renewed and increased to \$750,000. All loan applications related to this second line of

402. 734 F.2d 221, 223 (5th Cir. 1984) (citing 11 U.S.C. § 524(e) (1988)).

403. *Johnson*, 11 F.3d at 1266.

404. 11 U.S.C. § 524(e) (1988).

405. *Johnson*, 11 F.3d at 1266 (citing *R.I.D.C. Indus. Dev. Fund v. Snyder*, 539 F.2d 487, 492-94 (5th Cir. 1976), *cert. denied*, 429 U.S. 1095 (1977)).

406. *Id.*

407. *Id.*

408. 26 F.3d 544 (5th Cir. 1994).

credit expressly stated that there were no guarantors and that Morrison did not guarantee this line and would have no personal liability. Numerous additional MBank memoranda and official bank documents consistently reflected that such loan was not guaranteed. Bank One Texas National Association (Bank One), having acquired the \$750,000 note from the FDIC following MBank's insolvency, filed a lawsuit against Morrison asserting the continued validity of the guaranty and seeking to recover the balance of the \$750,000 note. The trial court entered judgment in favor of Bank One, disregarding the jury's finding that the guaranty was not intended to apply to the \$750,000 note, deeming that answer to be irrelevant in the face of what it considered to be an unambiguous guaranty contract.

On appeal, the court held that contract interpretation provisions are irrelevant where, as here, there is a dispute over whether the guaranty was even in existence as to the \$750,000 note. Therefore, a fact issue existed as to whether the parties agreed to cancel the guaranty — or at the very least modify the contract to exclude the obligation at issue. Moreover, the court stated that the indispensable, component loan documents reflected that the parties specifically agreed that the \$750,000 obligation was not guaranteed, presumably because the guaranty contract was either cancelled or modified to exclude that note.⁴⁰⁹ The court concluded that the jury properly determined that the parties did not intend the guaranty to cover the line of credit at issue and the trial court's disregard of this finding was in error. The court also rejected the application of the *D'Oench, Duhme* doctrine because even if the guaranty was in MBank's "active files" other documents which indisputably were contained in MBank's "active files" clearly reflected that the parties agreed that the guaranty did not apply to the \$750,000 obligation.⁴¹⁰ The lessons learned: guarantors should always insist upon the return of the original guaranty when it is cancelled by the lender and lenders should not attempt to enforce a guaranty contract which its files clearly indicate has been cancelled.

In *Sonne v. FDIC*,⁴¹¹ several guarantors attempted to avoid liability under their guaranties alleging that there was "no meeting of the minds" and that there had been a material alteration of the guaranty. Each guaranty provided that it guaranteed "the payment of that certain \$2,646,000 promissory note dated as of October 3, 1986."⁴¹² When the note was executed, in a hand written provision, the amount of the note was increased by \$300,000. The guaranty was not so amended. The court held that the guaranty contract was valid. The court reasoned that, although the language in the guaranty limited the guaranty to the specific note, the fact that the parties amended the amount of the note did not have the effect

409. *Id.* at 548.

410. *Id.* at 549.

411. 881 S.W.2d 789 (Tex. App.—Houston [14th Dist.] 1994).

412. *Id.* at 791.

of releasing the guarantors.⁴¹³ The court also considered it significant that the guaranty contained a dragnet clause. The court found that the guarantors had consented to the increased indebtedness.⁴¹⁴

3. Waiver of Commercially Reasonable Sale

In *Steinberg v. Cinema N' Drafthouse Systems, Inc.*⁴¹⁵ the Fifth Circuit predicted that the Texas Supreme Court would hold that guarantors could waive their right to a commercially reasonable default sale. In *Steinberg*, the maker and the guarantors of a secured note alleged that their liability under the note was discharged by the secured creditor's failure to give adequate notice of the sale of the collateral and failure to conduct the sale in a commercially reasonable manner.⁴¹⁶

The Fifth Circuit examined the possibility of a guarantor waiving the requirement of a commercially reasonable sale imposed by section 9-504 of the Texas Business and Commerce Code. Section 9-504(c) governs the disposition of collateral after a debtor's default and requires that "[e]very aspect of the disposition including the method, manner, time, place, and terms of the sale must be commercially reasonable."⁴¹⁷ The Fifth Circuit noted that, although the Texas Supreme Court had declined to rule on the issue, Texas appellate courts had held that, for purposes of section 9-504, "debtor" includes guarantors and, as a result, guarantors can assert section 9-504 defenses such as commercial reasonability in a deficiency action.⁴¹⁸ However, no Texas case had addressed the issue, before the Fifth Circuit in *Steinberg*, of whether a guarantor can waive his right to assert a commercial reasonability defense.⁴¹⁹ The Fifth Circuit concluded that it could determine how the Texas Supreme Court would rule on the issue based upon two lines of cases.⁴²⁰

The first line of cases concerns the timely notice defense under section 9-504. Section 9-504(c) requires that a debtor receive timely notice of the sale of collateral. Various Texas courts of appeals and one Fifth Circuit case had held that a guarantor cannot waive his right to timely notice.⁴²¹ The Texas cases based their holdings on section 9-501(c) of the Texas Business and Commerce Code which states that a debtor may not waive rights created by section 9-504(c). Although this line of cases appears to support the conclusion that, based on section 9-501(c), a guarantor can-

413. *Id.* at 792.

414. *Id.*

415. 28 F.3d 23 (5th Cir. 1994).

416. *Id.* at 24.

417. TEX. BUS. & COM. CODE ANN. § 9-504(c) (Vernon 1991).

418. *Steinberg*, 28 F.3d at 24-25.

419. *Id.* at 25.

420. *Id.* at 24-25.

421. *Id.* at 25; *FDIC v. Attayi*, 745 S.W.2d 939, 948 (Tex. App.—Houston [1st Dist.] 1988, no writ); *Carroll v. Gen. Elec. Credit Corp.*, 734 S.W.2d 153, 154 (Tex. App.—Houston [1st Dist.] 1987, no writ); *Hernandez v. Bexar County Nat'l Bank*, 710 S.W.2d 684, 687 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.); *Peck v. Mack Trucks, Inc.*, 704 S.W.2d 583, 586 (Tex. App.—Austin 1986, no writ).

not waive the right to a commercially reasonable sale because the right is a non-waivable right conferred by section 9-504, the Fifth Circuit's analysis in *Steinberg* led to a different result.

The second line of cases which the Fifth Circuit cited involves the "good faith" provision in section 1-203 of the Texas Business and Commerce Code. Section 1-203 requires parties to perform and enforce contracts and duties in good faith. According to the Fifth Circuit, two cases constitute the second line of cases: a Texas Supreme Court case, *FDIC v. Coleman*⁴²² and a Fifth Circuit case which applied *Coleman*'s holding, *Clay v. FDIC*.⁴²³ *Coleman* and *Clay* addressed whether a guarantor can waive certain claims which were based on section 1-203's good faith requirement. In *Coleman*, a guarantor alleged that section 1-203 required the FDIC to liquidate collateral shortly after default. In response to the guarantor's claims, the Texas Supreme Court held that, although the good faith requirement must normally be met, the guarantors had waived their good faith claim by not requiring the creditors to satisfy their debt from the collateral.⁴²⁴

Applying the two lines of cases to the issue before the court in *Steinberg*, the Fifth Circuit stated:

We are convinced that the Texas Supreme Court would follow the second line of cases. . . . [T]he requirement that a sale be made in "good faith" is inextricably intertwined with the requirement that a sale be "commercially reasonable. . . ." In both situations, the possibility of a court second-guessing a creditor's actions creates uncertainty and discourages loans.⁴²⁵

The Fifth Circuit also concluded that, unlike the Courts of Appeals in the first line of cases, the Texas Supreme Court would not apply section 9-501(c)'s prohibition against the waiver of section 9-504 rights to a guarantor's waiver of commercial reasonableness.⁴²⁶ The Fifth Circuit based this conclusion on the fact that, although Texas Business and Commerce Code section 1-102(c) prohibits the disclaimer of the obligation of good faith by agreement, *Coleman* and *Clay* did not apply this prohibition to a guarantor. In the Fifth Circuit's opinion, section 9-501 and section 1-102(c) are based upon the same rationales: both sections prohibit waiver in order to serve certain economic interests such as the preservation of collateral. According to the Fifth Circuit, a guarantor's involvement reduces the importance of preserving collateral and increases the importance of considerations such as allowing the guarantor to determine his best interest and facilitating the transaction.⁴²⁷

This decision raises an interesting issue. Courts have applied section 9-501(3) to guarantors because the definition of "debtor" in section 9-

422. 795 S.W.2d 706 (Tex. 1990).

423. 934 F.2d 69 (5th Cir. 1991).

424. *Coleman*, 795 S.W.2d at 710; *Steinberg*, 28 F.3d at 25.

425. *Steinberg*, 28 F.3d at 25.

426. *Id.*

427. *Id.* at 25-26.

105(1)(d) has been read to include "guarantors." If this is not the correct application of section 9-105(1)(d), then why do guarantors have the rights granted by section 9-504(3) in the first place?

In one final decision involving guarantor liability, the court in *Marshall v. Ford Motor Co.*⁴²⁸ determined that sales by a successor via merger were not covered by a guaranty contract because the guarantor could insist on strict construction of the guaranty and the guaranty did not run to successors.⁴²⁹

H. D'OENCH, DUHME DOCTRINE

*Lemaire v. FDIC*⁴³⁰ involved an appeal of a lender liability action against MBank Abilene for a breach of an oral loan promise. After the jury returned a verdict for the plaintiffs, the trial court rendered a judgment on the verdict against MBank for approximately \$69,000,000. MBank then appealed to the Texas Court of Appeals for the 14th District. The Texas Court of Appeals reversed and rendered a take nothing judgment on the breach of contract claim; it also reversed and remanded for retrial the fraud and tortious interference claims, and reversed and remanded for retrial one DTPA claim but reversed and remanded take nothing judgments on the remaining DTPA claims. The court also affirmed the trial court's award of attorney's fees to all plaintiffs. Therefore, the only portion of the appellant's judgment that remained intact after the Texas Court of Appeals decision was the attorney's fees award. The FDIC argued for the first time on appeal that the appellant's claims were barred by the doctrine of *D'Oench, Duhme & Company v. FDIC*⁴³¹ and that doctrine's codification in 12 U.S.C. section 1823. Citing *Union Federal Bank of Indianapolis v. Minyard*⁴³², the appellate court followed the principle that since " 'the FDIC had neither opportunity nor occasion to assert the *D'Oench* doctrine in the trial court,' we will ordinarily consider this argument on appeal."⁴³³

The appellants, relying upon *Thurman v. FDIC*,⁴³⁴ argued that when federal regulators are appointed after entry of judgment they are not allowed to assert *D'Oench, Duhme* for the first time on appeal.⁴³⁵ The court, however, stated that the appellant's reliance on *Thurman* was misplaced. The court distinguished this case from *Thurman* in that the FDIC was not seeking to enforce an asset that became void before the appointment of the FDIC as receiver. Instead, the FDIC was seeking to defend from appellant's attack. The court acknowledged that in *Thurman*, it refused to permit the FDIC to raise *D'Oench, Duhme* for the first time on

428. 878 S.W.2d 629 (Tex. App.—Dallas 1994, n.w.h.).

429. *Id.* at 631.

430. 20 F.3d 654 (5th Cir. 1994).

431. 315 U.S. 447 (1942).

432. 919 F.2d 335, 336 (5th Cir. 1990).

433. *Lemaire*, 20 F.3d at 656.

434. 889 F.2d 1441, 1447 (5th Cir. 1989).

435. *Lemaire*, 20 F.3d at 656.

appeal to reverse a judgment that rendered assets void,⁴³⁶ however, the court distinguished this case from *Thurman* and held that the FDIC is permitted to raise the doctrine of *D'Oench, Duhme* on appeal to defend against an attack on judgment.⁴³⁷ In applying the *D'Oench, Duhme* doctrine, the court concluded that the doctrine effectively barred all of appellants' lender liability claims.⁴³⁸ As a result of all of the claims being barred, the court denied the recovery of any attorneys' fees to appellant.⁴³⁹

The Fifth Circuit addressed the issue of whether the *D'Oench, Duhme* doctrine barred several counterclaims, including violation of anti-tying provisions of the Bank Holding Act and state law fraud in *NCNB Texas National Bank v. Johnson*, previously discussed.⁴⁴⁰ Relying upon the common law *D'Oench, Duhme* doctrine, which was designed to protect the FDIC's interests in the assets it acquires as the receiver for failed banks, the Court of Appeals held that the anti-tying claim and the fraud claim both were barred.⁴⁴¹ Relying upon *NCNB Texas National Bank v. King*,⁴⁴² the court stated that the *D'Oench, Duhme* doctrine bars defenses and claims by borrowers based on unrecorded agreements with a failed bank.⁴⁴³ In this case the court held that the *D'Oench, Duhme* doctrine also protected NCNB and the FDIC corporate entity as assignees of the FDIC receiver.⁴⁴⁴ Relying upon *Beighley v. FDIC*⁴⁴⁵ the Fifth Circuit held that the test for application of the *D'Oench, Duhme* doctrine is whether the borrower "lent himself to a scheme or arrangement" whereby banking authorities are likely to be misled.⁴⁴⁶

The Fifth Circuit, applying Louisiana law, affirmed its disapproval of the "innocent borrower" exception to the *D'Oench, Duhme* doctrine in *Dendinger v. First National Corporation*.⁴⁴⁷ The FDIC, as receiver of First National Corporation, was substituted as the defendant in two lawsuits brought against the bank prior to its insolvency. In the first lawsuit, note makers sued the bank alleging that the bank's misrepresentations had induced them to enter into the notes. The FDIC, while not disputing the note makers claims, argued that the claims were barred by the *D'Oench, Duhme* doctrine. The note makers disagreed and argued that the doctrine was inapplicable because the notes were void and therefore, the FDIC could not take title to a void note. The note makers also as-

436. *Id.*

437. *Id.*

438. *Id.* at 657.

439. *Id.*

440. *Johnson*, 11 F.3d at 1267-69.

441. *Id.* at 1267.

442. 964 F.2d 1468, 1470 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 2305 (1992).

443. 11 F.3d at 1268.

444. *Johnson*, 11 F.3d at 1268.

445. 868 F.2d 776, 783-84 (5th Cir. 1989).

446. *Johnson*, 11 F.3d at 1268; *see also Beighley*, 868 F.2d at 784.

447. 16 F.3d 99 (5th Cir. 1994).

serted that they were "innocent borrowers," and as such were entitled to the exception to the *D'Oench, Duhme* doctrine.⁴⁴⁸

The court affirmed the district court's grant of summary judgment to the FDIC.⁴⁴⁹ The court found that any oral misrepresentation by the bank constituted an unwritten "agreement" which did not bind the FDIC under the *D'Oench, Duhme* doctrine.⁴⁵⁰ The court rejected the customers' claim to the "innocent borrower" exception, noting that the exception had been recently disapproved by the Fifth Circuit in *FDIC v. Payne*.⁴⁵¹ The court also rejected the customer's claim that the notes were void because the bank had fraudulently induced them to execute the promissory notes.⁴⁵² The court concluded that the notes were merely voidable, not void.⁴⁵³ Therefore, the FDIC took valid title to the notes. The court disavowed any inference in *FDIC v. McClanahan*⁴⁵⁴ that malfeasance was necessary in order for the *D'Oench, Duhme* doctrine to apply. The court concluded that the weight of authority in the Fifth Circuit "mitigates against an 'innocent borrower's' defense."⁴⁵⁵

In June 1994 the Fifth Circuit held that the *D'Oench, Duhme* doctrine barred liability of a failed bank and its subsidiaries for breach of fiduciary duty, fraud, misrepresentation and declaratory judgment. In *Robinowitz v. Gibraltar Savings*⁴⁵⁶ the appellant asserted that the *D'Oench, Duhme* doctrine applies only when a party is attempting to use an unrecorded agreement as a defense to collection efforts by a receiver of a debt or obligation. The court concluded that this argument was without merit. In *Robinowitz*, the Fifth Circuit affirmed that the *D'Oench, Duhme* doctrine applies in a case "with an affirmative claim, against FDIC-Receiver, with no note whose terms are subject to a secret protocol."⁴⁵⁷ The appellant in *Robinowitz* further argued that no cases have held that *D'Oench, Duhme* bars claims for breach of fiduciary duty where the fiduciary relationship has been established. The appellant argued that a fiduciary relationship in this case had been established because of certain partnership agreements entered into between the appellant and the defendant. The court rejected this argument in that claimant's claims were not based upon any partnership agreement but were based on oral misrepresentations during settlement negotiations.⁴⁵⁸

448. *Id.* at 102.

449. *Id.* at 103-04.

450. *Id.* at 102.

451. 973 F.2d 403, 407 (5th Cir. 1992).

452. 16 F.3d at 102.

453. *Id.*

454. 795 F.2d 512, 516 (5th Cir. 1986). *See also* Bell and Murphy & Assocs., Inc. v. Interfirst Bank Gateway, N.A., 894 F.2d 750, 753-54 (5th Cir.), *cert. denied*, 498 U.S. 895 (1990); Beighley v. FDIC, 868 F.2d 776, 784 (5th Cir. 1989).

455. *Dedinger*, 16 F.3d at 102.

456. 23 F.3d 951 (5th Cir. 1994).

457. *Id.* at 955; *see also* Bowen v. FDIC, 915 F.2d 1013, 1015 (5th Cir. 1990); Beighley v. FDIC, 868 F.2d 776, 783-84 (5th Cir. 1989).

458. *Id.*

For the first time the Fifth Circuit was asked, in *Robinowitz*, whether subsidiaries of protected institutions may assert defenses available under *D'Oench, Duhme*.⁴⁵⁹ The Fifth Circuit concluded that, as the First, Eighth and Eleventh Circuit had previously concluded, the *D'Oench, Duhme* defense is available to wholly-owned subsidiaries of an insured institution.⁴⁶⁰ The court reasoned that "[f]ederal regulators have to 'rely on a financial institution's records and its assets, such as wholly-owned subsidiaries, to determine solvency for regulatory purposes.'"⁴⁶¹ "They must be able to examine the records of the subsidiary, as well as the parent, especially since the subsidiary may constitute a major asset of the parent. Such reliance is necessary to enable the federal regulators to persuade solvent banks to assume the accounts of the failed institutions."⁴⁶² The court concluded that the district court was correct in extending the *D'Oench, Duhme* doctrine defense to the subsidiary in this case.⁴⁶³

Robinowitz also argued that since the RTC had knowledge of the side agreement or secret promise, then *D'Oench, Duhme* did not apply.⁴⁶⁴ Robinowitz asserted that the RTC knew about his claim at least two years before the RTC took over Gibraltar Savings. Relying upon *Langley v. FDIC*,⁴⁶⁵ the Fifth Circuit followed the rulings of the Texas Supreme Court that knowledge of the misrepresentation by the FDIC prior to its acquisition of the note is not relevant to whether section 1823(e) applies. The key factor in the application of the *D'Oench, Duhme* doctrine continues to be whether the borrower "lent himself to a scheme or arrangement whereby banking authorities are likely to be misled."⁴⁶⁶

Robinowitz also argued that the real estate partnership transactions at issue were outside the traditional banking function and therefore not covered by the *D'Oench, Duhme* doctrine. He relied on the recent Fifth Circuit decision in *Alexandria Associates, Ltd. v. Mitchell Co.*⁴⁶⁷ The court rejected Robinowitz's argument and distinguished *Alexandria* from this case on the basis that although the lender had a proprietary interest in the

459. *Id.* at 956. See *Alexandria Assoc. v. Mitchell*, 2 F.3d 598, 601 n.10 (5th Cir. 1993) (choosing not to address issue).

460. *Id.* See *Sweeney v. RTC*, 16 F.3d 1 (1st Cir. 1994) (*D'Oench, Duhme* extends to the financial interests of any wholly owned subsidiary of a failed institution); *Oliver v. RTC*, 955 F.2d 583, 585-86 (8th Cir. 1992) ("*D'Oench* doctrine extends broadly to cover any secret agreement adversely affecting the value of a financial interest that has come within the RTC's control as receiver of a failed financial institution" including the financial interests of wholly-owned subsidiaries); *Victor Hotel Corp. v. FCA Mortgage Corp.*, 928 F.2d 1077 (11th Cir. 1991).

461. *Id.* (citing *Victor Hotel*, 928 F.2d at 1083).

462. *Id.*

463. *Id.*

464. *Id.*

465. 484 U.S. 86, 94-95 (1987). See also *Bell & Murphy v. Interfirst*, 894 F.2d 750, 753 (5th Cir.), *cert. denied*, 498 U.S. 895 (1990).

466. *Robinowitz*, 23 F.3d at 956-57; *Bowen v. FDIC*, 915 F.2d 1013, 1015 (5th Cir. 1990) (quoting *D'Oench*); see also *McMillan v. MBank Fort Worth, N.A.*, 4 F.3d 362, 368 (5th Cir. 1993).

467. 2 F.3d 598 (5th Cir. 1993) (Fifth Circuit declined to apply *D'Oench, Duhme* to the commercial sale of partnership interests in a real estate development venture by a third generation subsidiary of a failed institution).

real estate at issue, its primary relationship with Robinowitz was as a lender.⁴⁶⁸ Unlike the parent bank in *Alexandria*, which did not make any loans on the project, Gibraltar Savings had made substantial loans to the project which was the subject of their dispute. The court concluded that *D'Oench, Duhme* did apply to bar Robinowitz's claim.⁴⁶⁹

In *First City Texas-Beaumont, N.A. v. Treece*,⁴⁷⁰ discussed previously, the district court affirmed that section 1823(e) was intended to supplement *D'Oench, Duhme*, not to replace or preempt it.⁴⁷¹ The court further stated that section 1823(e) and *D'Oench, Duhme* are not mutually exclusive, although they often lead to the same result.⁴⁷² Thus, the FDIC was permitted to invoke the *D'Oench, Duhme* doctrine, section 1823(e) or both to bar defenses based on unwritten agreements.⁴⁷³ In response to Kennamer's affirmative defenses the district court held that each of them was barred by both the *D'Oench, Duhme* doctrine and section 1823(e), and the FDIC was entitled to judgment on these issues. The court rejected Kennamer's assertions that section 1823(e) and the *D'Oench, Duhme* doctrine could not operate as defenses to the lack of authority, fraudulent inducement or duress affirmative defenses.⁴⁷⁴ The court, in rejecting these contentions, held that fraud in the inducement is barred by *D'Oench, Duhme* and section 1823(e) to the same extent as other unrecorded agreements.⁴⁷⁵ The court also held that because of *D'Oench, Duhme* and section 1823(e), Kennamer could not rely upon Treece's lack of authority to avoid his obligations under his guaranty agreement.⁴⁷⁶ While acknowledging that some courts have held that defenses based on economic duress fall outside the *D'Oench, Duhme* doctrine and section 1823(e), the court rejected this minority view and held that duress is barred by *D'Oench, Duhme* and section 1823(e).⁴⁷⁷ The majority of courts, including one case affirmed by the Fifth Circuit, have held that economic duress is barred to the same extent as other personal defenses.⁴⁷⁸

Kennamer also attempted to characterize First City's conduct as fraud in the factum. The court agreed that fraud in the factum is an exception

468. *Robinowitz*, 23 F.3d at 957.

469. *Id.*

470. 848 F. Supp. 727 (E.D. Tex. 1994).

471. *Id.* at 737; see also *FDIC v. McClanahan*, 795 F.2d 512, 514 n.1 (5th Cir. 1986) ("[i]t has not been suggested that the enactment of § 1823(e) . . . preempted the common law rule of *D'Oench, Duhme*."); *FDIC v. Hoover-Morris Enter.*, 642 F.2d 785, 787 (5th Cir. 1981) (stating that both § 1823(e) and *D'Oench, Duhme* are available to the FDIC).

472. *Treece*, 848 F. Supp. at 737.

473. *Id.*

474. *Id.*

475. *Id.*

476. *Id.* at 737.

477. *Id.* at 738. Supporting the minority position, see, e.g., *RTC v. Ruggiero*, 756 F. Supp. 1092 (N.D. Ill. 1991).

478. *Treece*, 848 F. Supp. at 738; see also *FDIC v. Gettysburg Corp.*, 760 F. Supp. 115 (S.D. Tex. 1990), *aff'd without opinion*, *United Bank v. Gettysburg Corp.*, 952 F.2d 400 (5th Cir. 1992); *Desmond v. FDIC*, 798 F. Supp. 829 (D. Mass. 1989); *FSLIC v. Maio*, 736 F. Supp. 1039 (N.D. Cal. 1989).

to the *D'Oench, Duhme* doctrine.⁴⁷⁹ The court rejected Kennamer's argument, however, stating that this defense was still "Duhmed" for two reasons.⁴⁸⁰ There was simply no evidence that the instrument in question was a forgery and, more importantly, even if the security agreement was a forgery, it would not relieve Kennamer's obligation under his guaranty agreement. Nothing in the guaranty agreement discharged Kennamer's obligation if the security agreement was in some way defective.⁴⁸¹

On January 24, 1994 the United States Supreme Court denied review in three unpublished federal appeals court rulings including the U.S. Court of Appeals for the Fifth Circuit decision in *Fennell v. Federal Deposit Insurance Corp.*⁴⁸² In *Fennell*, the Fifth Circuit rejected claims by borrowers of a failed bank that they were not liable on several promissory notes. In a suit by the FDIC against the borrowers to recover the outstanding amounts, the borrowers claimed they and the bank had modified the loan agreement. The Fifth Circuit agreed with the FDIC's argument that *D'Oench, Duhme* barred the borrowers defense based on an unwritten agreement with the lender.

I. MISREPRESENTATION BY BANK

*Roberts v. United New Mexico Bank at Roswell*⁴⁸³ involved two brothers, Donald and Joe Roberts, who owned an Oregon-based plant research company that grew coriander and other spices. The Roberts brothers contacted United New Mexico Bank at Roswell and inquired about the availability of certain property owned by the bank in the Dell City, Texas area. Two bank employees told Joe Roberts that the farm consisted of "very good land [with] very good water" and provided the Roberts brothers with a written appraisal of the farm prepared for the bank which described the farm as being "highly productive" with "good" quality well-water.⁴⁸⁴ The Roberts brothers eventually decided to lease part of the farm and attempted to grow three coriander crops. The coriander plants, however, died before maturity each time and after the last crop died, the Roberts brothers sued the bank alleging that the salt content of the soil and the well-water caused the crops to fail. Evidence at trial established that the three wells on the leased land contained between 3000 and 4000 parts per million (ppm) of salt, as contrasted with "good" wells in the Dell City area which, on average, contained only 1700 ppm of salt and "average" wells contained between 2500 and 2700 ppm. The trial court jury found that the statements made by the bank as to the land's produc-

479. 848 F. Supp. at 738; *see also* *McLemore v. Landry*, 898 F.2d 996 (5th Cir. 1990), *cert. denied*, 498 U.S. 966, 111 S. Ct. 428, 112 L.Ed. 2d 412, *Kilpatrick v. Riddle*, 907 F.2d 1523, 1527, n.6.

480. 848 F. Supp. at 738.

481. *Id.*

482. 114 S. Ct. 926 (1994). *See also* *Maxwell v. First National Bank of Maryland*, 114 S. Ct. 920 (1994); *Gracey v. Day*, 114 S. Ct. 924 (1994).

483. 14 F.3d 1076 (5th Cir. 1994).

484. *Id.* at 1077.

tivity and quality of the water supply constituted both fraudulent and negligent misrepresentations and awarded the Roberts brothers their out-of-pocket costs. On appeal the Fifth Circuit rejected the Bank's argument that the statements were merely opinions and found that the statements made about the water quality constituted actionable statements of fact about the present condition of the land.⁴⁸⁵

Under Texas law a plaintiff may recover for fraud upon establishing that: (1) a material representation was made; (2) it was false when made; (3) the speaker knew it was false, or made it recklessly without knowledge of its truth and as a positive assertion; (4) the speaker made it with the intent that it should be acted upon; and (5) the party acted in reliance and suffered injury as a result.⁴⁸⁶

The bank further argued that even if it did make any representations as to the farm's soil and water quality, those representations were true statements as to the farm's *average* water and soil quality.⁴⁸⁷ The court rejected this argument noting that it was within the province of the jury to find that the bank's representations were designed to create a substantially false impression which is actionable under Texas law.⁴⁸⁸ The bank also asserted that there was no reliance by the Roberts brothers as a result of their being coriander experts. The court, however, concluded that where the misrepresentation went to the nature of the land and its water and not to any matter specifically related to coriander, the reliance was not barred as a matter of law simply because one of the Roberts brothers had substantial experience with the production of coriander.⁴⁸⁹

The bank also argued that the purchasers were aware of facts that should have put them on "reasonable inquiry" as to the condition of the property and its ground water.⁴⁹⁰ The court considered that "[i]n Texas, a plaintiff's 'failure to inspect or to investigate will not defeat an action in fraud [because t]he defrauded party is entitled to rely on the fraudulent parties representations.'" ⁴⁹¹ The court did note, however, that "'knowledge of facts that would lead a reasonably prudent person to conduct further inquiry to clarify a misimpression or reveal a misrepresentation can be deemed equivalent to knowledge of the truth.'" ⁴⁹² Relying upon

485. *Id.* at 1079. See *Commonwealth Mortgage Corp. v. First Nationwide Bank*, 873 F.2d 859, 865 (5th Cir. 1989); *Gibraltar Sav. v. L.D. Brinkman Corp.*, 860 F.2d 1275, 1301 (5th Cir. 1988), *cert. denied*, 490 U.S. 1091 (1989).

486. *Id.* at 1078. See also *Beijing Metals & Minerals Import/Export Corp. v. American Business Ctr., Inc.*, 993 F.2d 1178, 1185 (5th Cir. 1993); *Boggan v. Data Sys. Network Corp.*, 969 F.2d 149, 151-52 (5th Cir. 1992).

487. *Id.* at 1079.

488. *Id.* (citing *State Nat'l Bank v. Farah Mfg. Co.*, 678 S.W.2d 661, 681 (Tex. App.—El Paso 1984, writ dismissed by agreement of the parties); *Commonwealth Mortgage*, 873 F.2d at 865; *Blanton v. Sherman Compress Co.*, 256 S.W.2d 884, 887 (Tex. Civ. App.—Dallas 1953, no writ)).

489. *Id.* at 1080.

490. *Id.*

491. *Id.* (citing *Kerrville HRH, Inc. v. City of Kerrville*, 803 S.W.2d 377, 385 (Tex. App.—San Antonio 1990, writ denied)).

492. *Id.* at 1080 (citing *Gibraltar*, 860 F.2d at 1303).

Holmes v. P.K. Pipe and Tubing, Inc.,⁴⁹³ the court held that this duty of inquiry “‘extends only to those matters that are fairly suggested by facts that are actually known, rather than circumstances that merely arouse suspicion in the mind of a reasonably prudent person.’” Viewing the evidence in that light, and with all reasonable inferences most favorable to the Roberts, the record evidence indicated that “the Roberts did not possess knowledge of facts sufficient to lead a reasonably prudent person to conduct further inquiry.”⁴⁹⁴

That bank also asserted that because the Roberts had undertaken their own investigation regarding the leased property, they were barred as a matter of law from alleging any reliance upon the bank’s representations. The court rejected this argument because such an assertion was too broad. The rule applied by the court was “‘. . . that one cannot recover for fraudulent representations when he knows the representation is false, or when he has *relied solely* on his own investigation rather than on the representations of the other party.’”⁴⁹⁵ After reviewing the record the court found that the evidence presented at trial supported the jury’s verdict that the Roberts relied on the bank’s misrepresentations and not solely on their inspection of the property.⁴⁹⁶ The court also rejected the bank’s final argument that the Roberts failed to present evidence that the coriander crop failed as a result of the water problem.⁴⁹⁷

In *Dendinger v. First National Corporation*,⁴⁹⁸ previously discussed, Duane Dendinger, and other named plaintiffs, executed promissory notes payable to or held by First National Bank of Covington, Louisiana (FNB), for the purpose of purchasing shares of stock. The plaintiffs filed suit against FNB seeking rescission and money damages under federal and state law for such notes. After FNB was declared insolvent, the FDIC, as receiver for FNB, was substituted as the party-in-interest to defend all claims asserted against FNB. The FDIC filed counterclaims against many of the plaintiffs to recover the amounts due on their notes. The plaintiffs alleged that their obligations on the notes were not enforceable due to material misrepresentations by FNB that prompted their execution of the notes and purchase of the stock. On appeal from a summary judgment granted to the FDIC, the FDIC did not dispute the factual allegations made by appellants regarding the circumstances surrounding the execution of the promissory notes. Rather, the FDIC argued that despite any alleged illegality attendant to the execution of the notes, appellants did not have a defense to FDIC recovery under the doctrine set forth in *D’Oench, Duhme & Co. v. FDIC*,⁴⁹⁹ and that doctrine’s

493. 856 S.W.2d 530, 543 (Tex. App.—Houston [1st Dist.] 1993); see also *Lang v. Lee*, 773 S.W.2d 158, 163 (Tex. App.—Dallas 1989, no writ).

494. *Roberts*, 14 F.3d at 1080.

495. *Id.* at 1081. See also *Bernstein v. Portland Sav. & Loan Ass’n*, 850 S.W.2d 694, 713 (Tex. App.—Corpus Christi 1993, writ denied).

496. *Id.*

497. *Id.* at 1081-82.

498. 16 F.3d 99 (5th Cir. 1994).

499. 315 U.S. 447 (1942).

codification in 12 U.S.C. section 1823(e). The court held that appellants were barred by the *D'Oench, Duhme* doctrine from asserting any of their defenses against the FDIC and, citing their earlier decision in *FDIC v. Payne*,⁵⁰⁰ stated that the "wholly innocent borrower" exception to the *D'Oench, Duhme* doctrine was disapproved.⁵⁰¹ The court specifically refused to follow the Ninth Circuit's decision in *FDIC v. Meo*,⁵⁰² which allowed a good faith borrower to assert the defense of failure of consideration against the FDIC because he was "a completely innocent party."⁵⁰³ The court further held that the appellants' assertion that FNB fraudulently induced them to execute the promissory notes was a defense that made the notes merely voidable, and therefore title to the notes properly passed to the FDIC (the FDIC does not take title to void obligations).⁵⁰⁴ Furthermore, the court held that the principles it announced in *Kilpatrick v. Riddle*⁵⁰⁵ controlled this case. In *Kilpatrick*, the court concluded that (1) an oral misrepresentation by a lender to a borrower, whether in violation of federal securities law or not, constituted an unwritten "agreement" that did not bind the FDIC under the *D'Oench, Duhme* doctrine, and (2) a voidable interest was transferable whether or not the FDIC knew of the misrepresentation or fraud which produced the voidability.⁵⁰⁶

In another previously cited case, *Robinowitz v. Gibraltar Savings*,⁵⁰⁷ the Fifth Circuit held that Robinowitz's claim of the bank's oral misrepresentation was barred by the *D'Oench, Duhme* doctrine.⁵⁰⁸ In *Robinowitz*, Daniel Robinowitz, in 1983, approached Gibraltar Savings for financing and ultimately entered into several partnerships with subsidiaries of Gibraltar Savings for the purpose of developing the Galleria project, a multi-use development in Metairie, Louisiana. By 1986, serious disputes had developed between the parties, and eventually Robinowitz agreed to sell his interests in the project for \$3.5 million and also entered into a Settlement and Mutual Release agreement with Gibraltar Savings and its related subsidiaries. Robinowitz later sued Gibraltar Savings for breach of fiduciary duty, fraud, misrepresentation and declaratory judgment for allegedly fraudulently inducing him to sign the release and misrepresenting their true plans regarding the Galleria project in order to induce him to sell his interest in the project for a price well below the real value. In 1988, the trial court granted defendant's motion for summary judgment. However, the Texas Court of Appeals reversed and remanded for trial. Then, on October 30, 1989, the RTC was appointed receiver for Gibraltar Savings and removed the state court action to federal district

500. 973 F.2d 403, 407 (5th Cir. 1992).

501. *Dendinger*, 16 F.3d at 102.

502. 505 F.2d 790 (9th Cir. 1974).

503. *Dendinger*, 16 F.3d at 102.

504. *Id.* at 101.

505. 907 F.2d 1523 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 954 (1991).

506. *Dendinger*, 16 F.3d at 102.

507. 23 F.3d at 951 (5th Cir. 1994).

508. *Id.* at 955-56.

court. The RTC subsequently filed a motion for summary judgment on the grounds that Robinowitz' claims were barred by the *D'Oench, Duhme* doctrine and related statutes. The district court granted defendant's motion, holding that because Gibraltar Savings' misrepresentations did not appear in the Settlement and Mutual Release agreement or on any document on file with Gibraltar Savings, Robinowitz had "lent himself to a scheme or arrangement whereby banking authorities are likely to be misled."⁵⁰⁹ Robinowitz appealed to the Fifth Circuit. Robinowitz asserted several arguments as to why *D'Oench, Duhme* should not apply to this case, including the argument that the doctrine did not apply to bar claims for breach of fiduciary duty. The court, citing *Langley v. FDIC*,⁵¹⁰ held that Robinowitz's claim is analogous to one for fraudulent inducement which is barred by *D'Oench, Duhme*.⁵¹¹ As previously discussed, the Supreme Court in *Langley* held that an oral misrepresentation regarding the nature of investment property was sufficient to constitute an "agreement" within the meaning of section 1823 and that even if the misrepresentation was fraudulent, section 1823 still barred a claim based on such misrepresentation unless it met the recording requirements. The court held that Robinowitz' claim that an oral misrepresentation fraudulently induced him to enter the settlement agreement, like the *Langley*'s claim that the bank's oral misrepresentation regarding the property induced them to borrow funds, was also barred by *D'Oench, Duhme*.⁵¹²

J. FEDERAL HOLDER IN DUE COURSE DOCTRINE

The federal holder in due course doctrine, adopted in *FDIC v. Payen*,⁵¹³ allows the FDIC and RTC, as receivers for failed financial institutions to acquire holder in due course status under federal common law even though they cannot meet the technical requirements under state law. During the Survey period, two different courts applied the doctrine and reached, what appear to be, irreconcilable results.

In the first case, the FDIC asserted the holder in due course doctrine to defeat defenses raised by the guarantors.⁵¹⁴ This lawsuit began as a simple suit to enforce guaranty agreements against several defendants to collect the deficiency from a series of notes. Subsequent to filing suit, the plaintiff bank went into receivership, one defendant declared bankruptcy, another failed to answer, another was dismissed, and the case was eventually removed to federal court. John H. Kennamer, Jr., the remaining defendant, asserted affirmative defenses sounding in fraud, duress and lack of authority against the FDIC. The FDIC argued that "it is a 'holder' of both the notes and the guaranty agreement and therefore, because Kennamer's defenses are personal defenses, they are barred by the federal

509. *Id.* at 954.

510. 484 U.S. 86 (1987).

511. *Robinowitz*, 23 F.3d at 955.

512. *Id.*

513. 973 F.2d 403, 407 (5th Cir. 1992).

514. *First City, Texas—Beaumont, N.A. v. Treece*, 848 F. Supp. 727 (E.D. Tex. 1994).

holder in due course doctrine."⁵¹⁵ Kennamer disagreed and argued that the FDIC was not a "holder" because the guaranty agreement was not a negotiable instrument. Therefore, he argued, the FDIC was subject to both real and personal defenses against enforcement of the guaranty agreement. The United States District Court for the Eastern District of Texas court held that "[t]he FDIC cannot be a holder in due course not only because the guaranty agreement is non-negotiable, but also because the FDIC is acting in its capacity as receiver in this action, rather than in its corporate capacity."⁵¹⁶ Relying upon *Gunter v. Hutcheson*,⁵¹⁷ the court further held:

The FDIC is permitted to avail itself of the federal holder in due course doctrine when it acts in its corporate capacity pursuant to a purchase and assumption transaction. . . . In essence, the doctrine provides the FDIC with 'a complete defense to state and common law fraud claims on a note acquired by the FDIC in the execution of a purchase and assumption transaction . . . ' . . . The FDIC must take the instrument for value, in good faith and without actual knowledge of the alleged fraud at the time it enters into the purchase and assumption transaction. . . . The FDIC may become a holder in due course even in situations where it acquires the notes on guaranty after litigation involving them has already begun.⁵¹⁸

The court agreed with Kennamer's argument that the guaranty agreement was not negotiable and therefore, the FDIC could not be a holder in due course under federal common law. Because of this non-negotiability, the court held that the FDIC cannot be a holder in due course of guaranties acquired in their purchase and assumption transactions.⁵¹⁹ The court followed the principle that federal holder in due course status is available to the FDIC only when it acts in its corporate capacity.⁵²⁰ The court held that it was undisputed that the FDIC was acting in its capacity as receiver for the collecting bank in this action. Because the FDIC was acting in its capacity as receiver, rather than in its corporate

515. *Id.* at 735.

516. *Id.*

517. 674 F.2d 862 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982). In a note to the *Trecee* decision the court determined that there was some question as to whether, and to what extent, *Gunter* had been adopted by the Fifth Circuit. *Trecee*, 848 F. Supp. at 735 n.4. The court cited *FDIC v. Whitlock*, 785 F.2d 1335, 1339 n. 8 (5th Cir. 1986) (questioning the wisdom of *Gunter* and its application to the case). *But see* *FSLIC v. Murray*, 853 F.2d 1251 (5th Cir. 1988) (granting the FSLIC rights of a holder in due course for negotiable instruments acquired in a purchase and assumption transaction, but without explicitly adopting *Gunter*). Despite this uncertainty, the court noted that *Gunter* has been followed by several district courts. *See* *Sunbelt Sav. FSB v. Amercorp Realty Corp.*, 730 F. Supp. 741 (N.D. Tex. 1990).

518. *Trecee*, 848 F. Supp. at 735 (citations omitted).

519. *Id.* (citing *Sunbelt Sav. v. Montross*, 923 F.2d 353, 357 (5th Cir. 1991); *FDIC v. Payne*, 973 F.2d 403 (5th Cir. 1992)).

520. *Id.* at 736; *see also* *Montross*, 923 F.2d at 353; *FSLIC v. Murray*, 853 F.2d 1251, 1256 (5th Cir. 1988); *FDIC v. Byrne*, 736 F. Supp. 727, 730 (N.D. Tex. 1990) (the federal holder in due course doctrine "does not protect . . . one who assumes [the failed institution's] liabilities . . .").

capacity, federal holder in due course status was not available to bar the defendant's affirmative defenses.⁵²¹

In the second case, however, the Houston Court of Appeals reached a different conclusion when the RTC asserted the federal holder in due course doctrine to defeat a lack of notice defense. In *Burns v. Resolution Trust Corp.*,⁵²² the court, in reviewing the grant of a motion for judgment notwithstanding the verdict, held that all claims of lack of notice, including the breach of contract claim, were barred by the federal holder in due course doctrine. The court rejected the appellant's argument that the federal holder in due course doctrine did not apply because the assumption agreement and loan modification agreement in question were not negotiable instruments.⁵²³ The court concluded that the notes underlying the assumption and modification agreements satisfied the requirements for a negotiable instrument according to the laws of the states of Texas and Colorado.⁵²⁴ The court rejected the appellant's contention that the subsequent agreements pertaining to the obligation to pay taxes on the property rendered the agreements non-negotiable because they no longer contained an obligation to pay a sum certain.⁵²⁵ The court also affirmed its holding in *NCNB Texas National Bank v. Campise*⁵²⁶ where the same court previously rejected a lack of notice defense in a deficiency suit by applying the federal holder in due course doctrine. In *Campise*, the court determined that the borrower's claim that he failed to receive notice of the sale of collateral was a personal defense, barred by the federal holder in due course doctrine.⁵²⁷ The court concluded that its decision in *Campise* applied in this case and held that Burns' claims were barred by the federal holder in due course doctrine.⁵²⁸ The opinion in *Burns* does not include a discussion of the *Treece* decision.

The results in *Treece*, as it applies to the FDIC, and in *Burns*, as it applies to the RTC, appear to be irreconcilable. The Fifth Circuit, however, in *FDIC v. Trans Pacific Industries, Inc.*⁵²⁹ may have resolved the issue when it held that the holder in due course doctrine did not defeat the chairman of the board's agency defense because the FDIC did not acquire the promissory notes as part of a purchase and assumption.⁵³⁰ In view of the Fifth Circuit's ruling in *Trans Pacific*, it is not likely that the ruling in *Burns* will withstand appeal.

521. *Id.*

522. 880 S.W.2d 149, 154 (Tex. App.—Houston [14th Dist.] 1994, n.w.h.).

523. *Id.* at 153.

524. *Id.* (citing TEX. BUS. & COM. CODE ANN. § 3.104(a) (Vernon 1968); COLO. REV. STAT. ANN. § 4-3-104(1) (West 1989)).

525. *Burns*, 880 S.W.2d at 153.

526. 788 S.W.2d 115, 118-19 (Tex. App.—Houston [14th Dist.] 1990, writ denied).

527. *Id.* at 154 (citing *Campise*, 788 S.W.2d at 118-19 (add'l citation omitted)).

528. *Id.*

529. 14 F.3d 10 (5th Cir. 1994).

530. *Id.* at 12-13.

K. SANCTIONS

In an action by a buyer of bank stock brought against the bank president and the FDIC, the Fifth Circuit held that the bank president disproved as a matter of law at least one essential element of the buyer's causes of action.⁵³¹ The court, in determining whether the district court had abused its discretion, concluded that the district court's finding that the buyer's suit was wholly frivolous and should not have been brought was sufficient to explain why the award of the bank president attorney's fees was the least severe sanction adequate to serve the purposes of Rule 11.⁵³² The court held that the district court properly granted summary judgment in favor of the bank president because, by the buyer's own admission, there was no agreement between himself and the bank president, and they never discussed the purchase of the bank stock, meaning that there could be no agreement whatsoever between the two parties.⁵³³ Additionally, the buyer failed to prove that he relied upon any representation, communication or statement by the bank president when he purchased the bank stock, meaning the buyer could not prove his cause of action for common law or securities fraud. Additionally, the court ruled that the buyer could not prove that the bank president's conduct constituted grounds for rescission pursuant to section 33 of the Texas Securities Act.⁵³⁴ Lastly, the buyer failed to prove his claim for negligent misrepresentation because reliance is an element for such cause of action.⁵³⁵ With respect to the Rule 11 sanctions, the court held that the district court's order adequately met the requirements for appellate review set out in *Akin v. Q-L Investments, Inc.*⁵³⁶ Such requirements are as follows:

- (i) enter specific factual findings;
- (ii) indicate in the record all the factors it considered in choosing the attorney's fee award as a sanction;
- (iii) state in the record which alternative sanctions, if any, it also considered; and
- (iv) explain why the sanction it imposed was the least severe sanction adequate to serve the purposes of Rule 11.⁵³⁷

The court stated the following relevant policy concerns underlying Rule 11: "[o]n the one hand, Rule 11 sanctions are designed to deter frivolous lawsuits. Sanctions also insure, to a large degree, that victims of frivolous lawsuits do not pay the expensive legal fees associated with defending such suits. . . . [o]n the other hand, Rule 11 only authorizes 'reasonable' fees, not necessarily actual fees."⁵³⁸ Therefore, the *Granader* court held

531. *Granader v. McBee*, 23 F.3d 120, 122 (5th Cir. 1994).

532. *Id.* at 122-24.

533. *Id.*

534. *Id.* at 123.

535. *Id.*

536. 959 F.2d 521, 534-35 (5th Cir. 1992).

537. *Id.*

538. *Granader*, 23 F.3d at 124 (citing *Thomas v. Capital Sec. Servs., Inc.*, 836 F.2d 866, 879 (5th Cir. 1988) (en banc)).

that the district court did not abuse its discretion in awarding Rule 11 sanctions against the plaintiff.

When drafting affidavits for clients, attorneys should keep in mind the holding in *Resolution Trust Corp. v. Bright*.⁵³⁹ The Fifth Circuit held that attorneys could not be sanctioned for preparing a draft affidavit that included statements not previously discussed with the affiant, because the statements were not shown to be knowingly false and the affiant was warned to consider them carefully.⁵⁴⁰ In *Bright*, counsel to the RTC attempted to persuade the officer that the additions to her statements were supported by the facts. The officer, however, did not agree. The district court sanctioned the attorneys for "tampering with" or attempting to "manufacture" evidence. The Fifth Circuit reversed based on the lack of bad faith which is required for the district court to impose sanctions.⁵⁴¹

A federal appeals court recently reinstated a suit against former directors of a failed bank stating that the trial judge went too far in dismissing the case to punish lawyers for the FDIC.⁵⁴² The FDIC claimed that seven former directors of Capital National Bank of Fort Worth, Texas wrongfully approved twenty-one loans that resulted in more than \$2.8 million in losses to the bank. The trial judge dismissed the FDIC's claims against five of the directors as a sanction for an FDIC lawyer's failure to abide by an earlier order that directed the FDIC to respond to interrogatories. While acknowledging that the FDIC's actions were sanctionable, the Fifth Circuit relied upon *Coane v. Ferrara Pan Candy Co.*⁵⁴³ and concluded that ". . . taking all circumstances of this case into account, we conclude that the FDIC's conduct did not exhibit the degree of delay or contumacy that justifies the dismissal of its claims."⁵⁴⁴

L. MISCELLANEOUS CASES

I. Statute of Limitations and Adverse Domination

a. Adverse Domination

The U.S. Supreme Court declined to review a Fifth Circuit decision applying Texas law of adverse domination.⁵⁴⁵ In *FDIC v. Dawson*⁵⁴⁶ the FDIC, as receiver for a failed bank, brought an action against former directors and officers of the bank alleging that the bank had incurred substantial losses as a result of their conduct. The United States District Court for the Southern District of Texas granted summary judgment for the directors and officers based on the fact that the claims lapsed before the FDIC was appointed receiver. On appeal, the Fifth Circuit held that:

539. 6 F.3d 336 (5th Cir. 1993).

540. *Id.* at 342.

541. *Id.*

542. *FDIC v. Conner*, 20 F.3d 1376, 1383 (5th Cir. 1994).

543. 898 F.2d 1030, 1032 (5th Cir. 1990).

544. *Conner*, 20 F.3d at 1381.

545. *FDIC v. Dawson*, 114 S. Ct. 2673 (1994).

546. 4 F.3d 1303 (5th Cir. 1993).

- (i) state law governed the claim that the statute of limitations was tolled by the adverse domination doctrine,⁵⁴⁷
- (ii) the FDIC had to show only that the majority of the board members were wrongdoers during the period it sought tolling for the adverse domination doctrine to apply,⁵⁴⁸
- (iii) the majority of the directors did not have to be named as defendants for the doctrine to apply,⁵⁴⁹ and
- (iv) the directors had to be more than negligent for the doctrine to apply.⁵⁵⁰

The FDIC presented two arguments for reversal: first, it argued that the statute of limitations was tolled during the tenure of the corporate wrongdoers under the doctrine of adverse domination; and, second, it argued that the district court erred in applying the tort statute of limitations to its claim based on the director's oath of office instead of the longer statute of limitations for breach of contract actions. With respect to whether the district court applied the correct statute of limitations to the FDIC's claims, the Fifth Circuit pointed out that FIRREA has been interpreted "not to revive stale state law claims acquired by the FDIC."⁵⁵¹ One of the cases the *Dawson* court relied upon in making this assertion was *FDIC v. Shrader & York*.⁵⁵² The Fifth Circuit pointed to *Shrader & York's* holding that "a legal malpractice claim brought by the FDIC was time-barred because the Texas statute of limitations had expired before the FDIC was appointed receiver."⁵⁵³ According to the Fifth Circuit, the district court applied the correct analysis to the FDIC's claims, as it first decided whether the claims had expired under Texas law prior to the FDIC being appointed receiver.⁵⁵⁴ With respect to whether the two-year statute of limitations for tort or the four-year limitations period for a breach of contract claim should apply, the Fifth Circuit stated that "there is no substantial question regarding this issue; the law in this circuit is long-settled that claims based upon an oath of office sound in tort."⁵⁵⁵ For this proposition, the court relied upon *McNair v. Burt*.⁵⁵⁶

With respect to the adverse domination issue, the court addressed several preliminary issues. First, the court applied the de novo standard of review.⁵⁵⁷ Next, the court addressed whether to apply federal or state law with respect to the FDIC's assertion of the adverse domination doctrine. The Fifth Circuit refused to follow *Farmers & Merchants National Bank v. Bryan*,⁵⁵⁸ which held that when the FDIC brings a claim against

547. *Id.* at 1309.

548. *Id.* at 1313.

549. *Id.* at 1311.

550. *Id.*

551. *Id.* at 1306-07.

552. 991 F.2d 216 (5th Cir. 1993).

553. *Dawson*, 4 F.3d at 1307.

554. *Id.*

555. *Id.* at 1307 (citation omitted).

556. 68 F.2d 814, 816 (5th Cir. 1934).

557. *Dawson*, 4 F.3d at 1308.

558. 902 F.2d 1520, 1522 (10th Cir. 1990).

the directors of a failed bank, the trial court should "borrow" the appropriate state statute of limitations and apply it to the FDIC's claims.⁵⁵⁹ The *Bryan* court also held that the issue of equitable tolling was governed by federal law, despite the borrowing of the state statute of limitations.⁵⁶⁰ Therefore, the *Bryan* court adopted the adverse domination doctrine as part of the federal common law of the Tenth Circuit and then applied it to the FDIC's claims.⁵⁶¹ The *Dawson* court stated that the *Bryan* court "misread the current law regarding the proper source of tolling rules for federal courts that borrow a state statute of limitations."⁵⁶²

After determining that Texas law governs the application of the adverse domination doctrine in this case, the court next addressed the doctrine itself. Specifically, the court focused on three questions:

- (i) How completely must the wrongdoers dominate their corporation in order to trigger adverse domination tolling?
- (ii) Must a plaintiff relying on the adverse domination doctrine sue all allegedly culpable directors?
- (iii) How culpable must a director's conduct be before he will be considered a "wrongdoer" within the meaning of the adverse domination doctrine?⁵⁶³

The court compared the "complete domination" test, under which the plaintiff seeking to toll the statute under adverse domination must show "full, complete and exclusive control in the directors or officers charged," to the "majority test" which provides that the plaintiff need not show that the wrongdoers completely dominated the corporation, but rather must show only that a majority of the board members were wrongdoers during the period the plaintiff seeks to toll the statute.⁵⁶⁴ Relying on *FDIC v. House*⁵⁶⁵ and *Allen v. Wilkerson*,⁵⁶⁶ the court followed the "majority" version of the adverse domination doctrine.⁵⁶⁷

With respect to whether a plaintiff seeking to toll the statute of limitations under the adverse domination doctrine must sue all allegedly culpable directors, the Fifth Circuit again followed the *Allen* decision. *Allen* demonstrated that "a plaintiff may sue only a minority of the board and still assert adverse domination to toll the statute of limitations under Texas law."⁵⁶⁸ In applying the *Allen* decision, the court noted that the district court incorrectly assumed the adverse domination doctrine could not apply since the FDIC sued less than the majority of the board of directors.⁵⁶⁹

559. *Id.* at 1522.

560. *Id.* at 1522-23.

561. *Dawson*, 4 F.3d at 1308-1309.

562. *Id.* at 1309.

563. *Id.*

564. *Id.* at 1309-10 (citations omitted).

565. 736 F. Supp. 1437 (S.D. Tex. 1990).

566. 396 S.W.2d 493 (Tex. Civ. App.—Austin 1965, writ ref'd n.r.e.).

567. *Dawson*, 4 F.3d at 1310.

568. *Id.* (citing *Allen*, 396 S.W.2d at 500-01).

569. *Id.* at 1311.

The Fifth Circuit noted that Texas case law provides little guidance on the issue of whether Texas law allows the plaintiff to establish the adverse domination doctrine by proving that a majority of a corporation's directors were merely negligent. The court noted that "no Texas case comes to light in which the adverse domination doctrine has been invoked based on the mere negligence of a majority of a corporation's directors."⁵⁷⁰ As a result, the Fifth Circuit looked to the law of other jurisdictions in order to predict how a Texas court would rule on this issue. The Fifth Circuit stated that it did not believe Texas courts would extend the adverse domination doctrine to cases where the wrongdoing by the majority of the board amounts to mere negligence.⁵⁷¹ As a result, after surveying several states' laws, the Fifth Circuit held that under Texas law, a corporate plaintiff cannot "toll the statute of limitations under the doctrine of adverse domination unless it shows that a majority of its directors was more than negligent for the desired tolling period."⁵⁷² In light of these findings, the Fifth Circuit affirmed the district court's summary judgment findings for the defendants.⁵⁷³

b. Statute of Limitations

In *Ketcham v. First National Bank of New Boston, Texas*,⁵⁷⁴ reported earlier in this Survey article, one issue raised by Ketcham in her appeal from the district court's take-nothing summary judgment was whether a two-year or four-year statute of limitations applied to her claims against the bank.⁵⁷⁵ It was agreed by both sides that the date on which the relevant transactions occurred was on or about December 16, 1986. Suit was filed May 8, 1990. Thus, if the two-year limitation period applied, then Ketcham's suit would be barred. Ketcham's allegations, the court concluded, sounded in fraud and therefore a four-year limitations period was applicable under Texas law.⁵⁷⁶ Ketcham's suit, therefore, was not time-barred.

The court in *Resolution Trust Corp. v. Acton*⁵⁷⁷ held, in light of *Dawson*, that it should reverse its own earlier ruling applying the three-year federal statute of limitations to alleged tortious acts by the directors and apply the two-year statute of limitations period instead.⁵⁷⁸ In reaching this conclusion, the *Acton* court noted that the state statute was not tolled by the extension of the doctrine of adverse domination to cases in which the wrongdoing by a majority of the board amounts to mere negligence rather than gross negligence.⁵⁷⁹

570. *Id.*

571. *Id.* at 1312.

572. *Id.* at 1312-13.

573. *Id.* at 1313.

574. 875 S.W.2d 753 (Tex. App.—Texarkana 1994, n.w.h.).

575. *Id.* at 755.

576. *Id.* at 755; see also TEX. CIV. PRAC. & REM. CODE, ANN. § 16.051 (Vernon 1986).

577. 844 F. Supp. 307 (N.D. Tex. 1994).

578. *Id.* at 317.

579. *Id.*

Similarly, in *FDIC v. Benson*,⁵⁸⁰ the defendants contended that their claims were time-barred before the plaintiff, the FDIC, took over the insolvent bank; therefore, the FDIC as an assignee was unable to assert its claims of negligence, gross negligence, negligence per se and breach of duties of obedience, care and loyalty. The FDIC alleged that limitations had not expired because the statute should have been tolled by the equitable doctrine of adverse domination.⁵⁸¹ The *Benson* court applied the two year statute of limitations under Texas Civil Practice and Remedies Code Annotated section 16.003 (Vernon 1986) to each of the FDIC's claims.⁵⁸² If the claims would have been time-barred at the time the FDIC Receiver acquired the claims, the claims cannot be revived by the acquisition.⁵⁸³ The threshold issue was whether the statute of limitations period had expired before the FDIC, as receiver, was appointed and took over the failed bank.⁵⁸⁴ In addressing this issue, the court, again relying upon *Dawson*, followed the Texas rule that the tort statute of limitations begins to run when the tort is committed unless there has been fraudulent concealment or unless a statute exists to the contrary.⁵⁸⁵ The *Benson* court followed *Dawson* and affirmed that Texas does recognize the adverse domination doctrine for purposes of equitable tolling of limitations. Relying upon *Dawson*, the court held that the adverse domination doctrine did not apply to toll the statute of limitations on the negligence claim.⁵⁸⁶ With regard to the claims other than negligence, the issue became whether the FDIC was able to show that the majority of the board of directors was more than negligent in failing to supervise the loans and was actively involved in ultra vires conduct or fraudulent concealment of wrongdoing, so as to avoid the business judgment rule. The court concluded that the business judgment rule precluded the FDIC's simple negligence claims that were not already barred by limitations.⁵⁸⁷ With respect to the allegations of self-interest, knowing participation in wrongdoing, fraud, concealment, abdication, and violations of statutes and regulations, although the FDIC had failed to submit proof to raise a genuine issue of material fact to preclude summary judgment, the court denied the defendants' motion for summary judgment at least until the expiration of the discovery deadline of June 11, 1994.⁵⁸⁸

A Fifth Circuit decision involved a suit filed by the RTC against three former directors in *RTC v. Seale*,⁵⁸⁹ which alleged that loans were made

580. 867 F. Supp. 512 (S.D. Tex. 1994).

581. *Id.* at 519.

582. *Id.* at 518.

583. *Id.* (citing *Guaranty Trust Co. v. United States*, 304 U.S. 126 (1938)).

584. *Id.* at 519 (citing, *FDIC v. Shrader & York*, 991 F.2d 216, 220-27 (5th Cir. 1993), *cert. denied*, 114 S. Ct. 2704 (1994); *FDIC v. Howse*, 736 F. Supp. 1437, 1440 (S.D. Tex. 1990)).

585. *Benson*, 867 F. Supp. at 519 (citing *Dawson*, 4 F.3d at 1312).

586. *Id.*

587. *Id.* at 521.

588. *Id.* at 524-25.

589. 13 F.3d 850 (5th Cir. 1994).

involving regulatory violations and grossly negligent investments. The trial court held that the state statute of limitations barred the suit. The RTC appealed, arguing that FIRREA revived claims barred by state statute of limitations, that the general federal statute of limitations applied instead, and that the state statute of limitations was tolled because of adverse domination. The court rejected the arguments of the RTC and held that the suit was barred by the state statute of limitations because FIRREA could not revive claims that had already lapsed prior to the passage of FIRREA.⁵⁹⁰ The court also ruled that the RTC failed to meet its burden of proof in asserting adverse domination. Therefore, the state statute of limitations was not tolled. In response to the rulings in *Dawson* and *Seale*, the FDIC and the RTC asked the legislators to pass legislation to assure enough time to litigate against former directors and officers of failed financial institutions. On September 29, 1994, Congress approved legislation amending the Bank Holding Company Act of 1956, the Revised Statutes of the United States, and the Federal Deposit Insurance Act.⁵⁹¹ Section 201(a) of the new legislation provides:

Section 11(d)(14) of the Federal Deposit Insurance Act (12 U.S.C. 1821 (d)(14)) is amended by adding at the end the following new subparagraph:

(C) REVIVAL OF EXPIRED STATE CAUSES OF ACTION.—

(i) IN GENERAL.—In the case of any tort claim described in clause (ii) for which the statute of limitations applicable under State law with respect to such claim has expired not more than 5 years before the appointment of the Corporation as conservator or receiver, the Corporation may bring an action as conservator or receiver on such claim without regard to the expiration of the statute of limitations applicable under State law.

(ii) CLAIMS DESCRIBED.—A tort claim referred to in clause (i) is a claim arising from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to the institution.

A similar law was passed in section 201 (b) as it relates to section 21A(b)(14) of the Federal Home Loan Bank Act.⁵⁹²

2. Subject Matter Jurisdiction

In *Carney v. Resolution Trust Corp.*⁵⁹³ Carney and Fisher, after being sued in Texas state court by the RTC, countersued the RTC in federal court and pursuant to their first amended petition, sought (1) a declaratory judgment as to matters in controversy in the state court case; (2) injunctive relief for denial of due process; (3) monetary damages for intentional infliction of emotional distress; and (4) injunctive relief and

590. *Id.* at 853.

591. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338.

592. *Id.* (amending 12 U.S.C. 1441a(b)(14) (Supp. V 1993)).

593. 19 F.3d 950 (5th Cir. 1994).

monetary relief for tortious interference with prospective contractual relations.⁵⁹⁴ The RTC moved to dismiss Carney and Fisher's claims on the following grounds: (1) lack of subject matter jurisdiction; (2) failure to state a claim for which relief could be granted; and (3) pendency of a state court action which would resolve all issues between the parties.⁵⁹⁵ The district court determined that it lacked subject matter jurisdiction over Carney and Fisher's claims for monetary damages because FIRREA precluded assertion of such claims against the RTC until Carney and Fisher had exhausted their administrative remedies.⁵⁹⁶ The district court therefore dismissed Carney and Fisher's claims for monetary judgment. The district court dismissed Carney and Fisher's claims for injunctive relief pursuant to Federal Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim for which relief could be granted.⁵⁹⁷

On appeal, Carney and Fisher alleged that the district court erred in determining that it did not have subject matter jurisdiction over their claims for monetary damages.⁵⁹⁸ After concluding that, under a relation back theory, Carney and Fisher filed their claims for monetary damages before the RTC was appointed receiver, the *Carney* court addressed the issue of whether a claim for monetary damages filed prior to the RTC's appointment as receiver is subject to FIRREA's jurisdictional bar, i.e., that courts do not have jurisdiction over suits for monetary damages until the plaintiffs have exhausted their administrative remedies.

Following the case law from other circuits on the issue, the court determined that courts continue to have subject matter jurisdiction over claims for monetary damages when such claims are filed before the RTC is named as receiver.⁵⁹⁹ The court further concluded, as other circuits had done, that a claimant could not simultaneously pursue its judicial remedies and administrative remedies under FIRREA and concluded that FIRREA creates a "scheme under which courts will retain jurisdiction over pending lawsuits—suspending, rather than dismissing, the suits—subject to a stay of proceedings as may be appropriate to permit exhaustion of the administrative review process as it pertains to the underlying claims."⁶⁰⁰

With respect to injunctive relief, the court followed its reasoning in *Ward v. Resolution Trust Corp.*⁶⁰¹ and determined that if Carney and Fisher were attempting to enjoin the RTC from exercising one of its authorized powers or functions, then section 1821(j) of FIRREA would de-

594. *Id.* at 953.

595. *Id.*

596. *Id.*

597. *Id.*

598. *Id.* at 954.

599. *Id.* at 955; (citing *Brady Dev. Co. v. RTC*, 14 F.3d 998, 1003 (4th Cir. 1994); *Marquis v. FDIC*, 965 F.2d 1148, 1152-53 (1st Cir. 1992); *Rosa v. RTC.*, 938 F.2d 383, 392 (3d Cir.), *cert. denied*, 112 S. Ct. 582 (1991)).

600. *Id.* at 956; (citing *Marquis*, 965 F.2d at 1154); *see also* *Guidry v. RTC*, 790 F.Supp. 651, 653 (E.D. La. 1992); *In re FDIC*, 762 F. Supp. 1002, 1004 (D. Mass. 1991).

601. 996 F.2d 99, 102-04 (5th Cir. 1993).

prive the district court of subject matter jurisdiction.⁶⁰² Relying upon *Ward*, the court concluded that only if the RTC were engaging in activity outside its statutory authority would the district court have jurisdiction.⁶⁰³ In their petition, Carney and Fisher sued to enjoin the RTC from (1) making statements that Carney and Fisher converted funds or were liable for the conduct of one of the corporate defendants and (2) from engaging them in the state court action.⁶⁰⁴ The RTC argued that such relief would prevent it from exercising its statutory authority to "collect obligations and money due" and to "preserve and conserve the assets and property of" a failed financial institution.⁶⁰⁵ The court agreed that the RTC was acting within its statutory authority and held that the district court did not have subject matter jurisdiction over Carney and Fisher's claims for injunctive relief.⁶⁰⁶

Regarding the district court's jurisdiction over Carney and Fisher's claims for declaratory relief, the court noted that Carney and Fisher requested a declaratory judgment that, inter alia, the claims and actions of the RTC were claims for which Carney and Fisher had no individual liability.⁶⁰⁷ The court stated it was clear that Carney and Fisher were attempting to enjoin the RTC from including them in the state court lawsuit under the guise of a declaratory judgment.⁶⁰⁸ Therefore, the same reasoning applicable to Carney and Fisher's request for injunctive relief was equally applicable to Carney and Fisher's request for a declaratory judgment.⁶⁰⁹ Based on the foregoing, the court concluded that the district court did not have subject matter jurisdiction over Carney and Fisher's claim for a declaratory judgment.

The Fifth Circuit followed its ruling in *Carney* in *Whatley v. Resolution Trust Corporation*⁶¹⁰ when it held that because subject matter jurisdiction is tested as of the time of the filing of the complaint, district courts presiding over actions properly filed prior to the appointment of a receiver continue to be vested with jurisdiction.⁶¹¹ The court explained that the situation differs when the receiver is appointed before the filing of an action against a failed financial institution. The court stated that this circuit and others addressing the issue have interpreted section 1821 (d) of FIRREA to mean that "a separate scheme exists for the disposition of lawsuits filed pre-receivership."⁶¹² The court concluded that claims based

602. *Carney*, 19 F.3d at 956.

603. *Id.*

604. *Id.*

605. *Id.*; see also 12 U.S.C. § 1821(d)(2)(B)(ii) and (iv) (Supp. I 1989).

606. *Id.* at 956-57.

607. *Id.* at 958.

608. *Id.*

609. *Id.*

610. 32 F.3d 905 (5th Cir. 1994).

611. *Id.* at 907.

612. *Id.* at 908.

on valid federal jurisdiction when filed, may be affected only through the stay provision detailed in paragraph 12 (A)(ii) of section 1821(d).⁶¹³

The court, however, took exception with the lack of notice provided to the claimants by the RTC. The court stated that

[t]here is an added odious dimension when the receiver, with full knowledge of the pending lawsuit, foregoes a request for a stay and waits until the time for the administrative claims process has expired to appear in court requesting dismissal because of the plaintiffs' supposed failure to exhaust administrative remedies. In the eyes of the claimant—especially one who receives no actual notice of the administrative process—his lawsuit is awaiting disposition: the receiver, having intervened and been substituted as party defendant, ostensibly joins him in awaiting a hearing on the merits. In reality, however, the receiver lies in ambush, awaiting expiration of the administrative deadline so that it may dispose of the claim without consideration of its merits. We neither find nor assign any such intent to Congress in its enactment of FIRREA.⁶¹⁴

The court, therefore, held that “with regard to actions filed before the receivership, the receiver may opt either for the judicial route, by allowing the action to continue, or it may choose the administrative process, by moving for a stay within 90 days of its appointment.”⁶¹⁵

Judge Duhé concurred with the majority and added that the RTC's failure to mail notice was also dispositive because (1) the receiver lacked the authority to determine the claim under section 1821 (d)(3)(A), and (2) the Due Process Clause required that notice be mailed to a claimant known to the receiver by virtue of his having filed suit against the institution before the appointment of the receiver.⁶¹⁶ Judge Duhé considered that for such a claimant, publication of notice was “constitutionally infirm.”⁶¹⁷

In a decision rendered by the Fifth Circuit two weeks following the *Whatley* decision, the court followed its own decision in *Whatley*. The court held that “where the receiver fails to give notice of any other claims procedure, it must consider any pending law suits [sic] in the administrative process or forego the administrative process and proceed with the law suit.”⁶¹⁸ The court was also persuaded by the claimant's argument that the failure to provide them notice by mail violated their right to due process.⁶¹⁹

613. *Id.*

614. *Id.*

615. *Id.* at 910. Since the RTC did not timely move for a stay, it was deemed by the court to have chosen to proceed with the pending litigation.

616. *Id.* at 910-11.

617. *Id.* at 911.

618. *Greater Slidell Auto Auction, Inc. v. American Bank & Trust Co. of Baton Rouge, La.*, 32 F.3d 939, 941 (5th Cir. 1994).

619. *Id.* at 941.

3. *Applicable Interest Rate on Note of Failed Institution*

In *FDIC v. Massingill*⁶²⁰ the Fifth Circuit was asked to determine whether the FDIC had properly applied the prime rate of the bank which had acquired promissory notes providing for an unascertainable interest rate of a defunct bank. The two promissory notes were payable to the order of Moncor Bank, N.A. (Moncor), located in Hobbs, New Mexico. According to the terms of the first note in the amount of \$360,000, the interest rate was to be a "variable rate equal to 1/2% per year above Bank's Base Lending Rate. Bank's Base Lending Rate is the rate set from time to time by Bank, below which loans will not usually be made."⁶²¹ Massingill and the other note makers defaulted on both notes. The second defaulted note was eventually renewed with the unpaid principal balance bearing interest at the annual rate of interest equal to two percent above Moncor's Base Lending Rate. On August 30, 1985, Moncor Bank was declared insolvent and the FDIC was appointed as receiver. United Bank of Lee County, New Mexico (United Bank) acquired both notes from the FDIC. In determining the amounts of the installment payments owed with regard to the two notes, United Bank substituted its prime rate of interest for Moncor's Base Lending Rate. Shortly thereafter, the FDIC reacquired the notes and continued to rely upon the prime rate of United Bank in order to compute the accruing interest. After default had occurred on both notes, the FDIC filed suit against Massingill for the outstanding balances due upon both notes. The trial court awarded the FDIC the outstanding principal remaining upon both notes, interest calculated in accordance with the prime rate of United Bank, and attorneys' fees.⁶²²

On appeal, the Fifth Circuit held that since the parties to the notes agreed upon an applicable rate of interest, article 5069-1.03 of Texas Revised Civil Statutes Annotated (which provides for interest at a rate of six percent per annum when no specific rate of interest is agreed upon by the parties) does not apply, but unfortunately, due to the unanticipated failure of Moncor, the rate agreed upon between the parties could no longer be applied.⁶²³ Citing *FDIC v. Blanton*,⁶²⁴ the court stated that Texas law provides that a specific prematurity interest rate continues after maturity when the contract is silent as to postmaturity interest.⁶²⁵ Since no provision for postmaturity interest appeared upon the face of the notes, the court must determine whether the prematurity rate is ascertainable and, if so, must utilize that rate.⁶²⁶ The court then compared Moncor's "Base Lending Rate" against "prime rate", which is defined in Black's Law dictionary as "the most favorable interest rates charged by a commercial

620. 24 F.3d 768 (5th Cir. 1994).

621. *Id.* at 771.

622. *Id.* at 773.

623. *Id.* at 780.

624. 918 F.2d 524, 532 (5th Cir. 1990).

625. *Massingill*, 24 F.3d at 780.

626. *Id.*

bank on short-term loans to its best (i.e., most credit worthy customers),⁶²⁷ and concluded that if there is any difference between the two rates, such difference would reasonably render the base rate higher than the prime.⁶²⁸ Therefore, the court decided that, in this case, use of United Bank's prime rate by the FDIC is a permissible, reasonable alternative which, if it does differ from Moncor's Base Lending Rate, more likely than not errs in favor of Massingill.⁶²⁹

4. *Federal v. State Statute of Limitations*

While the trend has been developing in Texas, as well as other jurisdictions,⁶³⁰ to permit the use of the federal statute of limitations, some federal district courts have not been following this trend. The court in *Wamco III, Ltd. v. First Piedmont Mortgage*,⁶³¹ in discussing the similar role of the RTC, failed to follow the reasoning of *Bledsoe*. Also, in *Farm Credit Bank v. Firemans Fund Ins.*⁶³² the court failed to apply *Bledsoe* to a situation where a bargained for contractual statute of limitations was in conflict with the federal six-year statute of limitations.

The issue of whether an assignee from the FDIC or RTC can use the six-year federal statute of limitation in actions to collect on instruments purchased from the agencies rather than be limited to the shorter limitations periods permitted by state law may finally have been settled in

627. BLACK'S LAW DICTIONARY 813 (6th ed. 1990).

628. *Massingill*, 24 F.3d at 780.

629. *Id.* at 781.

630. See John Krahmer, *Trend Emerging For Use Of Federal Limitations Period*, TEX. BANK LAW., Apr. 1994, wherein Krahmer indicates that the trend is emerging to permit assignees to use the federal statute of limitations. According to Krahmer,

. . . decisions in Florida, Kansas and Texas seem[s] to indicate a trend has emerged to permit an assignee of such paper to use the federal limitations period instead of being restricted to shorter time periods. In *Cadle Company II, Inc. v. Stamm*, —So.2d—, 1994 WL 30317, 19 Fla L. Weekly D295 (Fla. App. 1 Dist., Feb 07, 1994) (Opinion not yet released for publication), the Florida Court of Appeals (1st Dist) held that an assignee from the FDIC could utilize the six-year limitations period allowed under 12 U.S.C. sec. 1821 (d)(14). In *Cadle Company II, Inc. v. Lewis*, 254 Kan. 158, 684 P.2d 718 (Kan., Dec. 1993), the Supreme Court of Kansas reached the same result and reversed the Kansas Court of Appeals which had concluded the state limitations period controlled. . . .

Id.

Krahmer's analysis concluded that in all of these decisions, the courts attempted to bolster the value of the assets sold by the FDIC by preserving claims that would otherwise be lost by shorter limitation periods, by emphasizing public policy goals of protecting an assignee with a longer limitations period.

These decisions seem to leave *Tivoli Ventures, Inc. v. Tallman*, 852 P.2d 1310 (Colo. App., Oct. 22, 1992), *cert. granted*, as a lonely outpost adopting a state limitations period instead of the federal period. If the case law trend is any indication, it seems likely the Colorado Supreme Court will overrule that decision at the same time in the (possibly near) future.

Id. Krahmer appears to have been correct as to his prediction of how the Colorado Supreme Court would treat *Tivoli*. *Tivoli* was reversed by *Tivoli Ventures, Inc. v. Bumann*, 870 P.2d 1244 (Colo. 1994).

631. 856 F. Supp. 1076, 1085 (E.D. Va. 1994).

632. 822 F. Supp. 1251, 1257 (W.D. La. 1993).

Weatherly v. Federal Debt Management, Inc.,⁶³³ where the United States Supreme Court denied review of the Texas Supreme Court decision permitting the use of the federal statute of limitations.

In two recent cases, consolidated on appeal to the Texas Supreme Court, the court held that the six-year limitations period set forth in 12 U.S.C. section 1821(d)(14) applies to actions brought by purchasers of assets from the FDIC to recover on those purchased assets.⁶³⁴ In addition, the court held that the limitations period applies retroactively to claims in existence on August 9, 1989.⁶³⁵ The cases were consolidated to resolve a conflict among appeals courts.

In *Weatherly*, the Court of Appeals for the Fifth District of Texas held the state's four-year statute of limitations applied. In *Thweatt*, the Austin Court of Appeals held that the six-year limitation period set forth in 12 U.S.C. section 1821 (d)(14) applied.⁶³⁶ In both *Thweatt* and *Weatherly*, purchasers who acquired assets of failed banks from the FDIC sued the borrowers to collect on delinquent promissory notes. On appeal to the Texas Supreme Court, the defendants argued the six-year limitations period of FIRREA applied only to actions brought by the FDIC, and not those brought by the FDIC's successors in interest. The defendants further argued that the statute of limitations does not apply retroactively to claims arising before FIRREA's enactment in 1989.

Relying upon the Fifth Circuit ruling in *FDIC v. Bledsoe*,⁶³⁷ the Texas Supreme Court, in a unanimous decision, ruled that the FDIC's successors in interest are entitled to the same benefits under the common law maxim that "[a]n assignee stands in the shoes of his assignor."⁶³⁸ The court stated that "[i]f the FDIC's statute of limitations did not enure to the benefit of its transferees, the market value of notes and other assets in the hands of FDIC would be diminished, thus hindering this statutory purpose."⁶³⁹ With regard to the issue of retroactive application of the statute, the court determined that the limitations period applies retroactively to causes of action in existence when FIRREA was passed.⁶⁴⁰

Although the *Weatherly* court chose the federal statute of limitations, an expired state statute of limitations will not be revived by application of the federal six-year statute of limitations.

633. 883 S.W.2d 171 (Tex. 1994).

634. *Jackson v. Thweatt*, 883 S.W.2d 171 (Tex. 1994); *Federal Debt. Mgmt. v. Weatherly*, 883 S.W.2d at 171.

635. *Id.* at 178.

636. *Thweatt*, 888 S.W.2d 735, 728 (Tex. App.—Austin 1992).

637. 989 F.2d 805, 810 (5th Cir. 1993).

638. *Thweatt*, 883 S.W.2d at 174.

639. *Id.*

640. *Id.* at 177.

5. Security Interests

a. Life Insurance

In *First American Bank & Trust v. Texas Life Insurance Company*⁶⁴¹ the bank's loan was secured by an assignment of a life insurance policy. Pursuant to the terms of the loan documents, the debtor remained obligated to pay the insurance premiums due on the policy. The bank requested that the insurance company notify the bank prior to termination of the policy. Despite notice from the insurance company to the insured the premiums were not paid and the policy was terminated. After the accidental death of the insured, the bank filed suit against the insurance company claiming that it was not notified of the termination of the policy, and it was entitled to the proceeds thereof. The court, applying Louisiana law, rejected the bank's argument that it was entitled to notice stating that the language of the applicable statute required notice only be sent to "the person whose life is insured *or* the assignee of the policy."⁶⁴² Since the insurance company had complied with the provisions of the statute, it was not liable to the bank.⁶⁴³ The bank also alleged breach of contract by the insurance company. Relying on a prior contract, the bank claimed that the insurance company was required to notify the bank of the termination of the policy. The court held that at most this would afford the bank a one year extension of coverage.⁶⁴⁴ The claim, however, was not made until three years after the policy had expired. Therefore, the court concluded that the insurance company was not liable to the bank.

b. Mobile Homes

A tough lesson was learned by a party, who thought they were secured, when one Texas court has recently addressed the proper method of perfecting a security interest in a mobile home in *Giese v. NCNB Forney Banking Center*.⁶⁴⁵ As a general rule, a security interest in a mobile home is perfected by notation on the certificate of title pursuant to the provisions of Texas' Manufactured Housing Standards Act.⁶⁴⁶ As in *Giese*, when the mobile home is affixed to real estate, questions concerning whether real estate or certificate of title provisions control the proper method of perfection. In *Giese*, Purchaser A purchased and received a "clean" certificate of title to a mobile home. Purchaser A affixed the mobile home to real estate and added various improvements. Purchaser A later sold the mobile home and financed the sale herself. To secure her loan, she filed a deed of trust and financing statement in the county real estate records. She also delivered a "clean" certificate of title to Purchaser B. Purchaser B subsequently borrowed money from the bank and

641. 10 F.3d 332 (5th Cir. 1994).

642. *Id.* at 336 (emphasis in original).

643. *Id.* at 337.

644. *Id.* at 337-38.

645. 881 S.W.2d 776 (Tex. App.—Dallas 1994).

646. TEX. REV. CIV. STAT. ANN. art. 5221f (Vernon 1987 & Supp. 1995).

used the mobile home as collateral. The bank noted its security interest in the mobile home on the certificate of title. Following a default by Purchaser B, the bank foreclosed on the mobile home asserting a priority interest therein.

The court held that as long as a certificate of title on the mobile home was outstanding, perfection of a lien in the mobile home by filing in the real estate records was ineffective.⁶⁴⁷ The court determined that the proper method to perfect a security interest in a mobile home when a certificate of title exists is by notation thereon, regardless of whether the mobile home is affixed to realty.⁶⁴⁸ Recording in the real property records is the proper method of perfection only after the certificate of title has been surrendered and canceled by the issuing authority. Since the bank was the only party which had properly perfected, its liens had priority.

c. Annuity Contracts

Annuities and the rights of the annuitants are being offered more often as collateral security. Some lenders are confused about how to perfect because no one is sure how an annuity contract should be categorized under the Article 9 of the Uniform Commercial Code. In *In re Newman*⁶⁴⁹ the court concluded that a provision in the annuity contract negating any liability of the insurance company to an assignee until the insurance company had received notice of the assignment precluded delivery of the contract (coupled with an indorsement or assignment) as an effective transfer of rights under the Texas Business and Commerce Code definitions.⁶⁵⁰ Possession of the certificate alone did not convey the right to receive payments.⁶⁵¹ The Fifth Circuit in *Newman* also held that annuity contracts are not instruments under Article 9.⁶⁵² Since annuities did not fit into any other category, the court concluded that they must be "general intangibles".⁶⁵³ Interestingly, the court did not consider the possibility that an annuity is excluded from Article 9 as an interest in "insurance" under section 9-104(g).

Subsequent to *Newman*, the United States Supreme Court, reversing and remanding a Fifth Circuit decision, answered the question of whether annuities are properly classified as "investments," or "insurance," at least for purposes of the National Bank Act.⁶⁵⁴ On August 8, 1989, Nations-Bank of North Carolina, a national bank, sought permission from the Comptroller of the Currency to sell fixed and variable annuity contracts

647. *Id.* at 781.

648. *Id.*

649. 993 F.2d 90 (5th Cir. 1993).

650. *Id.* at 95.

651. *Id.*

652. *Id.* at 94.

653. *Id.* at 94-95.

654. Nations Bank of N.C., N.A. v. Variable Annuity Life Ins. Co., 115 S. Ct. 810 (1995)(the opinion consolidates two cases—NationsBank of N.C., N.A. v. Variable Life Ins. Co. and Ludwig v. Variable Life Ins. Co.).

through its wholly-owned subsidiary NationsBank Securities. NationsBank proposed to sell the annuity contracts as an agent for various life insurance companies in cities with more than 5000 inhabitants. On March 21, 1990, the Comptroller of the Currency issued an opinion letter approving NationsBank's proposed sale of annuities, finding that the sale of annuities was within the power of the National Bank Act.⁶⁵⁵ The Comptroller reasoned that "[a]s part of their traditional role as financial intermediaries, banks have broad powers to buy and sell financial investment instruments as agents for customers. . . [and] [a]lthough annuities have historically been a product of insurance companies, they are primarily financial investments."⁶⁵⁶ The Comptroller concluded that the authority to broker annuities was within "the business of banking" under 12 U.S.C. section 24, subdivision seventh. Challenging the Comptroller's approval of NationsBank's proposed sale of annuities, the Variable Life Insurance Company (VALIC) filed a lawsuit in the Southern District of Texas seeking declaratory and injunctive relief.⁶⁵⁷

Valic argued that NationsBank's proposed sale of annuities violates 12 U.S.C. section 92, which prohibits national banks from selling insurance products in towns with a population larger than 5000.⁶⁵⁸ The Comptroller and NationsBank argued that NationsBank could sell annuity contracts in towns with populations greater than 5000 because annuity contracts are not "insurance" within the meaning of 12 U.S.C. section 92, but are allowable as "incidental" financial products under 12 U.S.C. section 24(7). The district court affirmed the Comptroller's approval of the proposed annuities sale⁶⁵⁹ and VALIC appealed to the Fifth Circuit.⁶⁶⁰

655. *Variable Annuity Life Insurance Co. v. Clarke*, 998 F.2d 1295, 1297 (5th Cir. 1994) *reh'g denied*, *Variable Annuity Life Ins. Co. v. Clarke*, 13 F.3d 833 (5th Cir. 1994); *cert. granted*, *Ludwig v. Variable Annuity Life Ins. Co.*, 114 S. Ct. 2161 (1994); *rev'd and remanded*, *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

656. *Id.* at 1297.

657. *Variable Annuity Life Ins. Co. v. Clarke*, 786 F. Supp. 639 (S.D. Tex. 1991); *rev'd by Variable Annuity Life Ins. Co. v. Clark*, 998 F.2d 1295 (5th Cir. 1994), *reh'g denied*, *Variable Annuity Life Ins. Co. v. Clarke*, 13 F. 3d 833 (5th Cir. 1994); *cert. granted*, *Ludwig v. Variable Annuity Life Ins. Co.*, 114 S. Ct. 2161 (1994).

658. Section 92 provides in relevant part that:

[N]ational banks, located and doing business in any place the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which such bank is located to do business in such state, by soliciting and selling insurance and collecting premiums on policies issued by such company. . . .

Act of Sept. 7, 1916, ch. 461, 39 Stat. 753 (codified at 12 U.S.C. § 92 (1926)). The 1952 edition of the U.S.C. omitted this provision and added a note explaining that Congress had repealed it in 1918. 12 U.S.C. § 92 note (1952). Although successive editions of the U.S.C. have all carried over the same note, both Congress and the courts have on occasion acted as if section 92 has remained in force. *See United States Nat'l Bank of Oregon v. Independent Ins. Agents of America, Inc.*, 113 S. Ct. 2173, 2176 (1993).

659. *Variable Annuity Life Ins. Co. v. Clarke*, 786 F. Supp. 639 (1991).

660. *Variable Annuity Life Ins. Co. v. Clarke*, 998 F.2d 1295 (1993).

Two statutory provisions are at the heart of the dispute. Section 24, subdivision seventh of the National Bank Act permits national banks to engage in the business of banking and "all such incidental powers as shall be necessary."⁶⁶¹ Section 92 of the same Act allows national banks located and doing business in small towns to act as agents in the sale of life insurance.⁶⁶²

The case really involved three main issues:

- (i) whether annuities are insurance products for the purposes of the National Bank Act;
- (ii) whether section 92 of the National Bank Act acts as a limitation on national banks' insurance powers (as the Fifth and Second Circuits have held), or whether it is an additional grant of power; and
- (iii) whether annuities sales are incidental to the business of banking under 12 U.S.C. 24, subdivision seventh.

Relying upon its prior ruling in *Saxon v. Georgia Association of Independent Insurance Agents*,⁶⁶³ the Second Circuit's ruling in *American Land Title Association v. Clarke*,⁶⁶⁴ and legislative history,⁶⁶⁵ the Fifth Circuit and held that both fixed and variable annuity products are "insurance", at least for bank regulatory purposes, and that national banks can sell annuities only under their "small town" insurance powers enumerated under the National Bank Act.⁶⁶⁶ The court also stated that annuities have historically been insurance products, and not investment vehicles as the Office of the Comptroller of the Currency had concluded.⁶⁶⁷ The Fifth Circuit later denied a motion to rehear the case.

Four judges dissented from the Fifth Circuit decision for reasons that the panel had not accorded due deference to the Comptroller's reasonable statutory interpretations.⁶⁶⁸ The United States Supreme Court granted certiorari⁶⁶⁹ and held that "[t]he Comptroller's conclusion that brokerage of annuities is an 'incidental powe[r]. . . necessary to carry on the business'"⁶⁷⁰ was a reasonable statutory interpretation. The court deferred to "the Comptroller's reasonable determination that 12 U.S.C. section 92 is not implicated because annuities are not insurance within the meaning of that section. Accordingly, the judgment of the Court of Appeals of the Fifth Circuit [was] reversed."⁶⁷¹ The Supreme Court agreed

661. 12 U.S.C. § 24 (1988).

662. See *supra* note 658.

663. 399 F.2d 1010, 1012 (5th Cir. 1968) (reversing the Comptroller's ruling that national banks have the authority to act as agent in the issuance of insurance regardless of the size of the city in which they are operating).

664. 968 F.2d 150 (2nd Cir.), *cert. denied*, 113 S. Ct. 2959 (1993) (reversing Comptroller's directive allowing national banks to act as agents for title insurance companies in cities with a population over 5000).

665. *VALIC*, 998 F.2d at 1299.

666. *Id.* at 1300.

667. *Id.* at 1300-01.

668. *Variable Annuity Life Ins. Co. v. Clark[e]*, 13 F.3d 833, 837-838 (CA5 1994).

669. 114 S. Ct. 2161 (1994).

670. *NationsBank of North Carolina, N.A., v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 817 (1995).

671. *Id.*

with the Comptroller's construction of the section 24, subdivision seventh authorization of "incidental powers . . . necessary to carry on the business of banking."⁶⁷² The Court also considered the second sentence of section 24, subdivision seventh as presupposing that banks had authority not circumscribed by the five specifically listed activities.⁶⁷³ In reaching its conclusion, the Court found that

modern annuities, though more sophisticated than the standard savings bank deposits of old, answer essentially the same need. By providing customers with the opportunity to invest in one or more annuity options, banks are essentially offering financial investment instruments of the kind congressional authorization permits them to broker. Hence, the Comptroller reasonably typed the permission NationsBank sought as an "incidental powe[r]. . . necessary to carry on the business of banking".⁶⁷⁴

By accepting the Comptroller's view that, for purposes of the National Bank Act, annuities are properly classified as investments, not insurance, the Court did not reach the question urged by VALIC of whether section 92, by negative implication, precludes national banks located in places more populous than 5000 from selling insurance.⁶⁷⁵ The Court also determined that it was reasonable for the Comptroller to classify fixed and variable annuities together, despite the fact that fixed annuities more closely resemble insurance.⁶⁷⁶

As a result of the United States Supreme Court decision in VALIC, the Fifth Circuit, on March 21, 1995 vacated its mandate and remanded to the district court for entry of judgment in favor of the Comptroller of the Currency and NationsBank of North Carolina.⁶⁷⁷

The question still remains whether annuities, for purposes of Article 9 of the Texas Business and Commerce Code, will be classified as insurance or general intangibles. The United States Supreme Court, in VALIC, did not address this issue or discuss *Newman*. The court, however, did acknowledge that ". . . a characterization fitting in certain contexts may be suitable in others."⁶⁷⁸ Due to the uncertainty regarding the proper way to perfect a security interest in an annuity contract, lenders would be wise to take possession of the annuity contract, file a UCC-1 covering the annuity as a general intangible and otherwise comply with the requirements of state law and perfect in the same manner as one perfects an assignment of a cash surrender life insurance policy—by notifying the insurance company of the security interest.

The outcome of this case will have far reaching implications for both the banking and insurance industries. Despite the final decision of the

672. *Id.* at 814.

673. *Id.* at 814.

674. *Id.* at 815.

675. *Id.*

676. *Id.* at 817.

677. 1995 U.S. App. LEXIS 5744 (5th Cir. Mar. 21, 1995).

678. *Id.* at 816.

courts, the battle over the sale of insurance and insurance-like products will continue for some time.

6. *Consumer Credit Code*

In *Allied Finance Company v. Rodriguez*⁶⁷⁹ the Texas Court of Appeals held that a retail installment contract clause containing an insurance notice was not conspicuous and therefore was in violation of the Consumer Credit Code and the Deceptive Trade Practices Act. The clause in question, entitled "Insurance Notice and Agreement," provided that the insurance obligation on the security for the loan could be satisfied by the borrowers' pre-existing insurance policies. Unaware of the terms of this provision, the borrowers obtained additional insurance which they alleged caused them to be delinquent in their loan payment. The court found that the contract terms regarding the insurance requirement was not conspicuous because it was not written in a manner such that a reasonable person in the borrowers' position ought to have noticed it. Even though the title might have been conspicuous, the lender was also required to make the individual clauses within the section conspicuous so the borrowers would be aware that their existing insurance could be used to satisfy the insurance requirement.⁶⁸⁰ As a result of this ruling, banks should review their consumer loan contracts to ascertain whether they are in compliance with this ruling.

7. *Commercial Paper*

In *FDIC v. Trans Pacific Industries, Inc.*,⁶⁸¹ discussed earlier, the Fifth Circuit had occasion to apply the provisions of section 3.403(2)(b) of the Texas Business and Commerce Code to the interpretation of a promissory note. In *Trans Pacific*, W. K. Robbins, Jr., chairman of the board of Trans Pacific Industries, Inc. (Trans Pacific), executed two promissory notes payable to the bank. These promissory notes were preprinted forms which contained a block on the top left corner listing "Borrower(s) name(s) and addresses" and three signature blocks; each signature line bore the designation "Borrower." Trans Pacific was the only borrower identified in the name and address block in both notes. The names Trans Pacific Industries, Inc. and W. K. Robbins, Jr. were typed in two of the three signature blocks on each note. The trial court was asked to determine whether Robbins had any liability on the notes after default occurred. The court granted summary judgment for the lender against Trans Pacific and Robbins.

On appeal, the Fifth Circuit reversed, applying section 3.403(b)(2) of the Texas Business and Commerce Code.⁶⁸² The court explained that

679. 869 S.W.2d 567 (Tex. App.—Corpus Christi 1993, no writ).

680. *Id.* at 571.

681. 14 F.3d 10 (5th Cir. 1994).

682. Section 3.403(b) provides as follows:

(b) An authorized representative who signs his own name to an instrument

even though no specific language announced that Robbins signed the notes in a representative capacity, that capacity was clear from the faces of the instruments and in the context of business expectations.⁶⁸³ First, Trans Pacific was the only entity listed in each borrower identification block. Secondly, a corporation is normally bound with the signature of an officer authorized by the corporation to sign on its behalf. And third, lenders commonly require a personal guaranty from an individual corporate officer of a closely held corporation before lending its funds. When they do, the officer must sign the instrument twice as maker: once on behalf of a corporation and once for himself.⁶⁸⁴ Taking all of these facts into account, the court reasoned that any noteholder would easily recognize that he had signed exclusively on the corporation's behalf.

8. *Consumer Credit Reports*

The San Antonio Court of Appeals of Texas recently refused to find a bank liable for mere negligent reporting to credit reporting bureaus because the bank was qualifiedly privileged to report information to credit reporting bureaus.⁶⁸⁵ The court further held that since no evidence of malice was found in the bank's actions, the privilege was maintained.⁶⁸⁶ In a case of first impression in the federal circuit, the Fifth Circuit held that the Fair Credit Reporting Act allows a department store to obtain a customer's credit history before deciding whether to accept his check in payment for a purchase.⁶⁸⁷

9. *Ship Mortgage Act Does Not Preempt DTPA Claims*

In *Ocean Transport, Inc. v. Greycas, Inc.*⁶⁸⁸ the Corpus Christi Court of Appeals answered the question of whether the Ship Mortgage Act⁶⁸⁹ preempts state deceptive trade practices act claims surrounding the structure and closing of a loan. The debtor in *Ocean Transport*, along with three guarantors, borrowed funds for the purchase of two ocean-going barges. The loan was secured by a preferred ship mortgage on each of the barges. After the debtor defaulted, the barges were sold by the se-

(1) is personally obligated if the instrument neither names the person represented nor shows that the representative signed in a representative capacity;

(2) except as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented but does show that the representative signed in a representative capacity.

TEX. BUS. & COM. CODE § 3.403(b)(2) (Vernon 1994).

683. *Trans Pacific*, 14 F.3d at 12.

684. *Id.*

685. *Lomas Bank USA v. Flatow*, 880 S.W.2d 52 (Tex.App.—San Antonio 1994, writ denied).

686. *Id.* at 53.

687. *Estiverne v. Sak's Fifth Ave.*, 9 F.3d 1171 (5th Cir. 1993).

688. 878 S.W.2d 256 (Tex. App.—Corpus Christi 1994, writ denied).

689. 46 U.S.C. §§ 911-984 (1975) (recodified at 46 U.S.C. §§ 31301-31307 (1988)).

cured party at a foreclosure sale pursuant to the Ship Mortgage Act. The creditor then sued the guarantors for the deficiency. Recognizing that state and federal courts have concurrent jurisdiction under section 954 of the Ship Mortgage Act for in personam actions to recover deficiencies,⁶⁹⁰ the guarantors argued that the state four-year limitations period had run. The court agreed that the state four-year statute of limitations applied. The court concluded, however, that two of the three guarantors failed to prove the limitations period had run with respect to the claims against them.⁶⁹¹

10. Trust Provisions

In *In re Shurley*⁶⁹² a debtor exchanged some property for a beneficial interest in a trust which contained both spendthrift and discretionary provisions. The debtor then attempted to exclude the property from the bankruptcy estate. The Bankruptcy Court for the Western District of Texas held that the debtor's contribution to the trust defeated the trust's spendthrift and discretionary provisions as to the debtor's interest.⁶⁹³ The court reasoned that a debtor ought not be able to tie up his own property in such a way that he can still enjoy it but can prevent his creditors from reaching it.⁶⁹⁴ The court further held that the amount the creditors could reach was the maximum amount which the trustee could distribute for the debtor's benefit and was not limited to the total amount of the debtor's contribution to the trust.⁶⁹⁵ The court also stated that the beneficial interest was not an inheritance under section 541 (a)(5) of the Bankruptcy Code despite the pour-over provisions of the two wills since the trust was created inter vivos.⁶⁹⁶

11. Imputation of Knowledge

In *O'Melveny & Meyers v. FDIC*⁶⁹⁷ the Supreme Court was asked to address the question of whether a law firm sued for malpractice by the FDIC, as receiver of a failed savings and loan, can assert state law defenses against the federal agency. In *O'Melveny*, the FDIC, as receiver for a failed savings and loan, sued the former counsel of the savings and loan for legal malpractice and breach of fiduciary duty stemming from such counsel's advice and services rendered with respect to public offerings. The United States District Court for the Central District of California granted the law firm's summary judgment motion based on the fact that the FDIC stood in the shoes of the savings and loan to whom the wrongdoing of the insiders was attributed so as to preclude any claims

690. *Ocean Transport*, 878 S.W.2d at 266.

691. *Id.* at 268.

692. 171 B.R. 769 (Bankr. W.D. Tex. 1994).

693. *Id.* at 781-82.

694. *Id.*

695. *Id.* at 784-86.

696. *Id.* at 787.

697. 114 S. Ct. 2048 (1994).

against the law firm.⁶⁹⁸ The Court of Appeals for the Ninth Circuit reversed and remanded holding that the officers inequitable conduct, even if attributed to the savings and loan, was not imputed to the FDIC so as to preclude a legal malpractice action.⁶⁹⁹ Justice Scalia's opinion for the Supreme Court of the United States held that:

- (1) California law rather than federal law, governs imputation of corporate officers' knowledge of fraud to the corporation asserting the cause of action created by state law;
- (2) California law, rather than federal law, applied to whether knowledge of fraudulent conduct by the savings and loan officers could be imputed to the FDIC suing its receiver; and
- (3) even if FIRREA was inapplicable to the instant receivership which began prior to the effective date of FIRREA, the judicial creation of a special federal rule of imputation with respect to the FDIC would not be justified without any significant conflict with federal policy or interest in use of state law.⁷⁰⁰

The central issue in *O'Melveny* was whether "in a suit by the Federal Deposit Insurance Corporation as a receiver of a federally insured bank, it is a federal law or rather a state law rule of decision that governs the tort liability of attorneys who provided services to the bank."⁷⁰¹ The *O'Melveny* Court stated that "there is no federal general common law," and recognized that the "remote possibility that corporations may go into federal receivership is no conceivable basis for adopting a special federal common law rule divesting states of authority over the entire law of imputation."⁷⁰² The Court concluded that California law rather than federal law governs imputation of knowledge to corporate victims of alleged negligence, regardless of whether California chooses to follow the "majority rule."⁷⁰³

The next issue addressed by the *O'Melveny* Court was whether "the California rule of decision was to be applied to the issue of imputation or displaced, and if it is applied it is of only theoretical interest whether the basis for that application is California's own sovereign power or federal adoption of California's disposition."⁷⁰⁴ The Court stated that in answering this question it would not contradict an explicit federal statutory provision, nor would it adopt a court made rule to supplement a federal statutory regulation which is comprehensive and detailed.⁷⁰⁵ The Court concluded that "matters left unaddressed in such a scheme are presumably left subject to the disposition provided by state law."⁷⁰⁶ The Court noted that "uniformity of law might facilitate the FDIC's nation-wide liti-

698. *Id.*

699. 969 F.2d 744 (9th Cir. 1992).

700. *Id.* at 2054.

701. *Id.* at 2051.

702. *Id.* at 2053 (citations omitted).

703. *Id.*

704. *Id.* at 2053-54.

705. *Id.*

706. *Id.* at 2054.

gation of these suits, eliminating state-by-state research and reducing uncertainty — but if the avoidance of those ordinary consequences qualified as an identifiable federal interest, we would be awash in ‘federal common law’ rules.”⁷⁰⁷ The Court further noted that the respondent failed to identify a specific conflict between some federal policy or interest and the use of state law.⁷⁰⁸ The Court concluded that “this is not one of those extraordinary cases in which the judicial creation of a federal rule of decision is warranted.”⁷⁰⁹ The Court left it to the Ninth Circuit to resolve what California law provides, as the parties were in agreement that if state law does govern it would be that of California.⁷¹⁰

12. Setoff

In *FDIC v. Perry Brothers, Inc.*⁷¹¹ the Federal District Court ruled that a depositor has a right to “contemporaneous notice” of a bank setoff action. While the court recognized that giving proper notice of a bank’s intention to exercise its right of setoff would impair the effectiveness of legitimate banking setoffs, it also believed that giving a post-setoff notice, even one day after the setoff is exercised, exposes the depositor to risks of additional harm from dishonored checks. After balancing the interests of the banks against the interests of the depositors, the court held that at least contemporaneous notice is required.⁷¹² Nothing in the opinion indicated that written notice would be required.

*In re Appel*⁷¹³ focused on a bank’s common law right of setoff. In this case, Thomas Appel, was a debtor of Citizen State Bank, but he also maintained four deposit accounts with the bank. Appel filed for Chapter 7 bankruptcy and shortly thereafter his bankruptcy trustee contacted the bank and requested that it turn over the amounts in the four deposit accounts. In compliance with the request, the bank prepared four cashier’s checks but, prior to the bank’s delivery of the checks to the trustee, the bank’s attorney advised the bank of its right of setoff and that such right was dependent upon the bank’s possession of the funds. The bank thereupon refused to deliver the checks to the trustee and filed a Motion for Relief from Stay which would allow it to execute its right of setoff.

In its analysis, the court noted that a payee of a cashier’s check has no interest in the check until it is delivered.⁷¹⁴ Thus, the court determined that since the bank never delivered actual possession of the cashier’s check to the trustee, the mutuality of debt between the bank and Appel

707. *Id.* at 2055 (citation omitted).

708. *Id.*

709. *Id.* at 2056.

710. *Id.*

711. 854 F. Supp. 1248 (E.D. Tex. 1994).

712. *Id.* at 1269.

713. 166 B.R. 624 (Bankr. S.D. Tex. 1994).

714. *Id.* at 625.

still existed and thus the bank's common law right to setoff was not extinguished.⁷¹⁵

At issue in *Soto v. First Gibraltar Bank*⁷¹⁶ was whether a bank may offset funds in a common non-testamentary trust account against a debt the settlor-trustee owes the bank. In *Soto*, Lorenzo and Nora Soto opened a trust account for their daughter of which they were the trustees. Mr. and Mrs. Soto had the right, acting together, to revoke the trust and withdraw the funds. When Lorenzo Soto's account at the bank became overdrawn, the bank applied the money in the trust account to offset Mr. Soto's overdraft. Nora Soto then sued the bank on theories of deceptive trade practices, breach of bailment and conversion.⁷¹⁷ The sole issue on appeal was whether a bank may offset revocable trust funds against a debt of its depositor, who is the trust's settlor.

The trust created by the Sotos was a revocable inter vivos trust also known as a tentative or "Trotten" trust after the famous New York case.⁷¹⁸ Unable to find any Texas case law on point, the court looked to outside authorities, all of which indicated that revocable savings account trusts are subject to the claims of the settlor-trustee's creditors.⁷¹⁹ The court also looked to the Restatement Second of Trusts section 58 which states that the creditors of a person who makes a savings deposit upon a tentative trust can reach that person's interest since he has such extensive power over the deposit as to justify treating him as in substance the unrestricted owner of the deposit.⁷²⁰

The court reiterated the established rule that banks have a common law right to offset and apply a depositor's general deposit to an indebtedness the depositor owes the bank on another account.⁷²¹ The court also noted that banks may not offset trust account funds in which the true owner is not the depositor.⁷²² The court noted that when a bank has actual or constructive knowledge that funds are held in trust for another, who is the true owner, it may not seize and retain the funds held in trust in order to offset a debt of the depositor.⁷²³ The court stated, however, that *National Indemnity Co. v. Spring Branch State Bank*⁷²⁴ and related cases, contemplated trust accounts in which the true owner was the beneficiary and not a tentative trust in which the true owner was the settlor-trustee. The court noted that the Sotos' desire to accumulate funds for their daughter's education did not make the account a deposit for a specific, special purpose, rather, it was general funds owned by the Sotos and

715. *Id.* at 625-26.

716. 868 S.W.2d 400 (Tex. App.—San Antonio 1993, writ ref'd).

717. *Id.* at 401.

718. *Id.* at 402.

719. *Id.* (citations omitted).

720. *Id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 58, cmt. d (1959)).

721. *Id.* First Nat'l Bank v. Winkler, 139 Tex. 131, 161 S.W.2d 1053, 1056 (1942).

722. *Id.*; see also Nat'l Indem. Co. v. Spring Branch State Bank, 162 Tex. 521, 348 S.W.2d 528, 529 (1961).

723. *Id.* at 403.

724. 162 Tex. 521, 348 S.W.2d 528, 529 (1961).

available to the Sotos' creditors.⁷²⁵ Based on the foregoing, the court held the tentative trust account to be subject to the bank's right to offset such funds against other debts of the settlor-trustees.⁷²⁶ *Soto* makes clear that its holding does not "denigrate tentative trusts," as its decision "has nothing to do with the rights of beneficiaries or creditors after the settlor has died."⁷²⁷ Rather, the court acknowledged the reality that "the owner of the funds in a tentative trust is the settlor/trustee as long as he lives, not the beneficiary."⁷²⁸

In *Boyd v. American Bank of Commerce at Wolfforth*⁷²⁹ Kay Boyd executed two promissory notes payable to American Bank of Commerce, the payments of which were secured by her checking account at the Bank and by her car.⁷³⁰ Both notes were due and payable upon demand, but if no demand was made, the notes would become due on January 6, 1992. Each note contained an identical provision stating that the bank had the right of setoff in the event of Boyd's default under the notes. In September 1991, a bank officer was told by Boyd that she would pay off the notes. When Boyd had not done so by October 7, 1991, the bank exercised its right of setoff against Boyd's checking account.⁷³¹ Boyd thereupon sued the bank for wrongful setoff.

The court analyzed the language of the notes which provided for setoff only in the event of a default by Boyd.⁷³² The court determined that, according to the terms of the note, the bank could not exercise its right of setoff unless the debt had matured or Boyd was insolvent.⁷³³ In seeking summary judgment, the bank had relied upon Boyd's waiver of demand, as provided for in the notes, as a predicate to exercising its setoff. The court noted that the language of the notes clearly manifested the intention that Boyd's default must occur before the bank was authorized to offset her account without a demand for payment of the notes.⁷³⁴ Thus, Boyd's waiver of demand did not negate a default as a condition precedent to the bank's right of setoff without a demand for payment.⁷³⁵ Since there was no default and no demand for payment, the bank's offset was wrongful.⁷³⁶ The bank attempted to argue on appeal that its contractual remedies were available because the notes matured when the bank officer believed the prospect of payment was impaired. Since the bank did not move for summary judgment on that ground, summary judgment could

725. *Id.* at 403.

726. *Id.* at 404.

727. *Id.* at 403.

728. *Id.*

729. 872 S.W.2d 29 (Tex. App.—Amarillo 1994, writ *dism'd* by *agr.*).

730. *Id.* at 30.

731. *Id.* at 31.

732. *Id.* at 30.

733. *Id.* at 32.

734. 872 S.W.2d at 32.

735. *Id.*

736. *Id.*

not be upheld on appeal on a ground not addressed in the motion for summary judgment.⁷³⁷

II. LEGISLATION

A. HOME EQUITY LENDING

In response to the Fifth Circuit decision in *First Gibraltar, FSB v. Morales*,⁷³⁸ Congressman Henry V. Gonzales of San Antonio proposed an amendment to the pending interstate banking and branching legislation⁷³⁹ which had the effect of overturning the *First Gibraltar* ruling. On September 29, 1994, Congress passed the legislation having the effect of nullifying the regulation issued by the Office of Thrift Supervision.⁷⁴⁰ Public Law 103-328, title I, section 102(b)(4)(D) provides in relevant part:

(f) STATE HOMESTEAD PROVISIONS.—No provision of this Act or any other provision of law administered by the Director shall be construed as superseding any homestead provision of any State constitution, including any implementing State statute, in effect on the date of enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, or any subsequent amendment to such a State constitutional or statutory provision in effect on such date, that exempts the homestead of any person from foreclosure, or forced sale, for the payment of all debts, other than a purchase money obligation relating to the homestead, taxes due on the homestead, or an obligation arising from the work and material used in constructing improvements on the homestead.

The amendment has the effect of overruling the federal pre-emption of a state law in Texas that prohibits lenders from making certain home equity loans. Specifically, the amendment overturned the Fifth Circuit decision in *Morales*. In *Morales*, the Fifth Circuit held that federal law preempts the Texas homestead law to the extent that Texas law prohibits certain types of home equity lending by federal savings associations and finance companies.⁷⁴¹

B. FEDERAL STATUTE OF LIMITATIONS

In addition to the home equity amendment to the interstate branching bill, an amendment was passed which resulted in the federal statute of limitations pre-empting state statute of limitations for gross and intentional misconduct. In response to the ruling in *FDIC v. Dawson*,⁷⁴² the FDIC and the RTC asked the legislators to pass legislation to assure enough time to litigate against former directors and officers of failed financial institutions. On September 29, 1994 Congress approved legisla-

737. *Id.* at 32 (citations omitted).

738. 19 F.3d 1032 (5th Cir. 1994).

739. H.R. 3841, 103d Cong., 2d Sess. (1994).

740. Pub. L. No. 103-328, § 102, 108 Stat. 2338 (1994).

741. *Morales*, 19 F.3d at 1039-1053.

742. 4 F.3d 1303 (5th Cir. 1993).

tion amending the Bank Holding Company Act of 1956, the Revised Statutes of the United States, and the Federal Deposit Insurance Act.⁷⁴³ Section 201(a) of the new legislation provides:

Section 11(d)(14) of the Federal Deposit Insurance Act (12 U.S.C. 1821 (d)(14)) is amended by adding at the end the following new subparagraph:

(C) REVIVAL OR EXPIRED STATE CAUSES OR ACTION.—

(i) IN GENERAL.—In the case of any tort claim described in clause (ii) for which the statute of limitations applicable under State law with respect to any such claim has expired not more than 5 years before the appointment of the Corporation as conservator or receiver, the Corporation may bring an action as conservator or receiver on such claim without regard to the expiration of the statute of limitations applicable under State law.

(ii) CLAIMS DESCRIBED.—A tort claim referred to in clause (i) is a claim arising from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to the institution.

A similar law was passed in section 201(b) as it relates to section 21A(b)(14) of the Federal Home Loan Bank Act.⁷⁴⁴

C. *DEPRIZIO* REFORM

On October 12, 1994, Congress passed the Bankruptcy Reform Act of 1994.⁷⁴⁵ One of the significant provisions of this bill overturned the infamous *Deprizio* case⁷⁴⁶ and its progeny, which expanded preference exposure from ninety days to one year for secured creditors in which the loan is guaranteed by a corporate insider. The Act amends section 550 so that an avoidable transfer to a non-insider lender, made in the extended preference period, is not recoverable from the lender, notwithstanding that an insider guarantor may have benefitted. The legislative history that accompanied the bill made it clear the congressional determination to clarify that non-insider transferees should not be subject to the preference provisions beyond the ninety-day period.⁷⁴⁷

743. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994; Pub. L. No. 103-328, § 201, 108 Stat. 2338 (1994).

744. 12 U.S.C. 1441a(b)(14) (1988).

745. Pub. L. No. 103-394, 108 Stat. 4106 (1994).

746. *Levit v. Ingersoll Rand Fin. Corp. (In re V.N. Deprizio Constr. Co.)*, 874 F.2d 1186 (7th Cir. 1989).

747. *Artha Management Inc. v. Lehigh Sav. Bank*, 174 B.R. 671 (Bankr. S.D.N.Y. 1994).