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Terry W. Wright

W. Alan Wright

Scott G. Night

ARTICLES

ALAMO LUMBER AND TEXAS USURY LAW: PLAYING WITH FIRE IN THE USURY FOREST

TERRY W. CONNER*
W. ALAN WRIGHT**
SCOTT G. NIGHT***

* B.A., 1972; J.D., 1975, University of Texas. Terry W. Conner is a partner in the Corporate Finance Section of Haynes and Boone, Dallas, Texas.

** B.A., 1978; M.P.A., 1982; J.D., 1982, University of Texas. W. Alan Wright is a partner in the Commercial Litigation Section of Haynes and Boone, Dallas, Texas.

*** B.B.A., University of Texas, 1983; J.D., Southern Methodist University, 1989. Scott G. Night is an associate in the Corporate Finance Section of Haynes and Boone, Dallas, Texas.

"Unto a foreigner thou mayest lend upon interest, but upon thy brother thou shalt not lend upon interest."[1]

I. INTRODUCTION

When a lender lends money, he expects compensation from the borrower for such loan. If the lender is in the business of lending money, then he will attempt to maximize profits (or, in these difficult lending times, minimize losses) by exacting as much compensation as the mar-

1. *Deuteronomy*, 23:21.

ket will bear. While lenders universally wrestle with the marketing and economic aspects of their business, Texas lenders and their lawyers must also look for legal restraints on the amount of compensation that the lenders may seek from their borrowers. In Texas, a lender "who contracts for, charges or receives interest . . ." in excess of that allowed by law may be subject to harsh usury penalties.[2] It might appear to be a simple matter for a lender to comply with the usury laws by setting the rate of interest on a loan below the rate allowed by statute.[3] Texas usury statutes, however, broadly define "interest" as any compensation for the use, forbearance or detention of money.[4]

As a result of the broad definition of interest, usury problems often arise when lenders charge borrowers a separate charge or fee that, although not called interest by the parties, a court will deem to be interest.[5] In addition, even if the loan documents do not provide for excessive interest, the facts surrounding a loan may be such that the court will deem that the lender has contracted for, charged or received usurious interest.[6] Because of the breadth and complexity of

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2. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (Vernon 1987). In general, a lender who contracts for, charges or receives usurious interest must forfeit to the borrower three times the amount of usurious interest contracted for, charged or received plus reasonable attorneys fees. *Id.* at art. 5069-1.06(1). If a lender contracts for, charges or receives interest greater than double the amount of interest allowed by law, then the lender must also forfeit as an added penalty all principal and interest on the loan, together with reasonable attorneys fees. *Id.* at art. 5069-1.06(2). In addition to statutory penalties, a borrower may recover from a lender, under the common law, all of the interest paid and cancellation of interest not yet paid. Danziger v. San Jacinto Sav. Ass'n, 732 S.W.2d 300, 304 (Tex. 1987).

3. In general, a lender and his borrower may agree to a maximum rate of interest of 10%. TEX. REV. CIV. STAT. ANN. art. 5069-1.02 (Vernon 1987). There are, however, numerous exceptions to this general rule. For example, where the parties do not agree to a stated rate of interest, the maximum rate is 6%. *Id.* at art. 5069-1.03. In addition, the parties to a written contract may agree to a rate of interest not to exceed a ceiling based upon 26-week treasury bills. *Id.* at art. 5069-1.04(a)(1). The ceiling under this provision is currently 18%.

4. *Id.* at 5069-1.01(a). The Texas usury statutes provide that interest is "the compensation allowed by law for the use or forbearance or detention of money . . . ." *Id.*

5. For example, a service charge on past due invoices is interest. Flato Elec. Supply Co. v. Grant, 620 S.W.2d 915, 917 (Tex. Civ. App.—Corpus Christi 1981, writ ref'd n.r.e.). Similarly, late charges are interest. Dixon v. Brooks, 678 S.W.2d 728, 731 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.). Generally, regardless of what the amount is termed, if it is "in fact compensation for the use, forbearance or detention of money [it] is, by definition, interest." Gonzales County Sav. & Loan Ass'n v. Freeman, 534 S.W.2d 903, 906 (Tex. 1976).

6. *See, e.g.*, Jim Walter Homes, Inc. v. Schuenemann, 668 S.W.2d 324 (Tex. 1984). The Texas Supreme Court in *Schuenemann* held that where an acceleration clause in an installment note provided that upon default all of the remainder of the installments would become due and payable, the note called for the collection of unearned interest. *Id.* at 329. As a result,

the Texas usury statutes and the overwhelming number of judicial interpretations of these statutes, Texas usury law continues to produce surprising twists and turns that create significant risks for lenders making loans in Texas.[7]

One Texas Supreme Court case has created a recurring nightmare for lenders who have not fully analyzed the terms of a proposed transaction. In *Alamo Lumber Co. v. Gold,*[8] the Texas Supreme Court held that where a lender, as a condition to a loan, requires the borrower to assume the obligation of a third party, the amount of the third party's debt is interest on the borrower's loan.[9] The following is a simple example of how this problem can arise. Borrower approaches Lender for a relatively routine loan. During the approval process, Lender discovers that Borrower's brother has defaulted on a loan to Lender. Lender tells Borrower that it will make the new loan if Borrower will assume his brother's debt, which Borrower was not previously obligated to pay, and Borrower agrees. Under these facts, a Texas court would probably hold that the amount of the brother's debt is interest on Borrower's loan. If the amount of such debt, together with the stated rate of interest on Borrower's loan, exceeds the applicable interest rate ceiling, then Lender will have contracted for usurious interest.[10]

While the previous example illustrates the principle enunciated by the court in *Alamo Lumber*, it does not begin to manifest the realm of possible situations in which a court may apply *Alamo Lumber* and hold that a loan is usurious. For example, suppose that Lender has

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the lender, despite never attempting to accelerate the obligations, had contracted for interest in excess of the amount allowed by Texas law. *Id.*

7. For example, in *Hardwick v. Austin Gallery of Oriental Rugs, Inc.*, 779 S.W.2d 438, 443-44 (Tex. App.—Austin 1989, writ denied), a Texas court suggested that a lender commits usury under Texas law if the amount of interest charged or received exceeds the amount of interest contracted for by the parties, even if the amount charged or received does not exceed the applicable usury ceiling. In addition, the Texas Supreme Court has held that a lender commits usury if it charges or receives interest during a contractually free interest period. Steves Sash & Door Co. v. Ceco Corp., 751 S.W.2d 473, 475-76 (Tex. 1988).

8. 661 S.W.2d 926 (Tex. 1984), *aff'g*, 623 S.W.2d 453 (Tex. App.—Beaumont 1981).

9. *Id.* at 928.

10. It is often difficult to compute an effective rate of interest contracted for, charged, or received on a loan in order to compare that rate to the maximum rate allowed by Texas law. Accordingly, the appropriate way to determine whether usury has occurred is to compute the dollar amount of interest that a lender could contract for, charge, or receive on a particular loan and compare that amount with the amount of interest actually contracted for, charged, or received on the loan. Nevels v. Harris, 102 S.W.2d 1046, 1049 (Tex. 1937).

made a loan to X Company, a corporation, secured by all of X Company's assets. In addition, Lender has made a loan to Shareholder, X Company's sole shareholder, secured by oil and gas properties. Shareholder is not currently liable for X Company's obligations to Lender. Both loans have matured and although Lender is willing to renew the loans, Lender is concerned about X Company's declining profits and cash flow. Lender informs Shareholder that it will renew his loan on the condition that he execute a guaranty of the obligations of X Company. Has Lender required Shareholder, as a condition to the renewal and extension of his loan, to "assume" the debts of a third party? And, if so, should this assumption constitute "interest" on Shareholder's loans, even if Shareholder's ultimate payment of the assumed debt either increases X Company's net worth, for the benefit of Shareholder, or provides Shareholder with an enforceable claim against X Company?

Alternatively, suppose that Lender is concerned about the value of its collateral on the loan to Shareholder. Lender informs X Company that it will renew its loan on the condition that X Company grant Lender a lien in X Company's assets in order to secure Shareholder's debt to Lender. Is X Company "assuming" Shareholder's debt as a condition to the renewal of its loan? This article will discuss the potential problems of requiring a borrower to pay, assume, guarantee or secure the obligations of another.

II. HOLDING IN *ALAMO LUMBER CO. V. GOLD*[11]

A. *Facts and Holding*

The facts producing the holding in *Alamo Lumber* are not particularly complicated. The First National Bank of Pleasanton (the Bank) made a loan to Addie Gold secured by a lien on real property located in Bexar County, Texas.[12] The proceeds of this note went to Mrs. Gold's son, Stetson Reed.[13] Mrs. Gold subsequently defaulted on this note and the Bank posted the property for a foreclosure sale.[14] At the same time, Mr. Reed had open account obligations to Alamo Lumber

11. 661 S.W.2d 926 (Tex. 1984), *aff'g*, 623 S.W.2d 453 (Tex. App.—Beaumont 1981).

12. *Alamo Lumber Co.*, 623 S.W.2d at 454.

13. *Id.*

14. *Id.*

Company (the Company) for his purchases of building materials.[15] The Company agreed, at the request of Mr. Reed, to purchase Mrs. Gold's obligations to the Bank under the condition that Mrs. Gold execute and deliver to the Company a note evidencing the open account obligations of Mr. Reed.[16]

Mrs. Gold subsequently sued the Company under Texas usury law alleging that the Company's requirement that she assume her son's debt made her loan usurious.[17] The jury found that the Company required Mrs. Gold to assume her son's indebtedness to the Company as a condition to the Company's purchase and extension of Mrs. Gold's debt to the Bank.[18] The jury also found, however, that the Company did not intend to charge or contract for usurious interest.[19] As a result, the trial court held in favor of the Company. The court of appeals, however, reversed and rendered in favor of Mrs. Gold and the Texas Supreme Court affirmed.[20] The basic holding in *Alamo Lumber* is that where a lender, as a condition to the making of a loan, requires the borrower to assume a third party's debt (as opposed to a preexisting debt of the borrower), the amount of the third party's debt is interest to be included in the computation of the amount of interest on the loan.[21] The court concluded that the Company's requirement that Mrs. Gold assume her son's obligations to the Company, which she was not previously obligated to pay, as a condition to the loan to Mrs. Gold, made the amount of her son's obligations to the Company interest on her loan.[22]

B. *Historical Precedents*

The court in *Alamo Lumber* approved the holdings in *Laid Rite,*

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15. *Id.* Mrs. Gold was not, at that time, liable to the Company for the open account obligations. *Id.*

16. *Id.*

17. *Alamo Lumber Co.*, 623 S.W.2d at 455.

18. *Id.*

19. *Id.* The jury also found that Mr. Reed was Mrs. Gold's agent in arranging the transaction and that the Company justifiably relied upon Mr. Reed in acquiring the Bank's note and accepting the new note. *Id.*

20. Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 927 (Tex. 1984).

21. *Id.* at 928. See *infra* notes 120-27 and accompanying text for a discussion of whether the rule in *Alamo Lumber* applies to a lender's requirement of a guaranty or a collateral pledge as a condition to a loan, or a renewal of an existing loan.

22. *Id.*

Inc. v. Texas Indus., Inc.[23] and *Stephens v. First Bank & Trust*,[24] which followed the holdings of courts in other states. In *Laid Rite*, the court relied upon the rule that where a lender as condition of a loan requires the borrower to assume the debt of another, the amount of the assumed debt will be considered interest in determining whether the loan is usurious.[25] Since a different legal entity, but a subsidiary of the original lender, made the new loan to the borrower, the court remanded the case to the trial court to determine whether to treat the new lender as the alter ego of the original lender.[26] The court in *Stephens* adopted the rule followed by the court in *Laid Rite*. The court, however, held that the lender in *Stephens* required that someone pay an existing loan, but not that the borrower had to pay the existing loan.[27]

Although the rule of *Alamo Lumber* and *Laid Rite* may have been based upon decisions from other states, the essential concept depends upon the broad definition of "interest" under Texas law.[28] Since any compensation for the use, forbearance or detention of money will constitute interest, it is not difficult to conclude that a borrower's assumption of another debtor's obligations to a lender will, in many cases, be the functional equivalent of the borrower's agreement to pay additional compensation or interest to the Lender.

C. *Dissenting Opinion*

The dissent in *Alamo Lumber* disagreed with the majority holding, arguing that the majority did not give the appropriate consideration to the issue of intent. Justice Barrow, citing cases in other states involving assumption of indebtedness, would hold that the transaction

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23. 512 S.W.2d 384 (Tex. Civ. App.—FortWorth 1974, no writ).

24. 540 S.W.2d 572 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.).

25. Laid Rite, Inc. v. Texas Indus., Inc., 512 S.W.2d 384, 389 (Tex. Civ. App.—Fort Worth 1974, no writ). The court cited several cases from other states, including *Vee Bee Serv. Co. v. Household Fin. Corp.*, 51 N.Y.S.2d 590 (N.Y. Sup. Ct. 1944), *aff'd*, 55 N.Y.S.2d 570 (N.Y. 1945); *Curtiss Nat'l Bank v. Solomon*, 243 So. 2d 475 (Fla.Dist. Ct. App. 1971); and *Ferdon v. Zarriello Bros., Inc.*, 208 A.2d 186 (N.J. Super. Ct. Law Div. 1965).

26. *Laid Rite*, 512 S.W.2d at 389. The court noted that in the cases in the other states, the borrower assumed or paid obligations of the third party to the same lender making the loan to the borrower. *Id.* See *infra* notes 60-90 and accompanying text for a discussion of whether the new loan and the loan assumed must be from the same lender.

27. Stephens v. First Bank Trust, 540 S.W.2d 572, 574 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.).

28. See *supra* note 4 and accompanying text for a definition of "interest" under Texas law.

is not usurious in the absence of wrongful intent on the part of the lender.[29] In cases where the note is not usurious on its face, the dissent would require a showing of wrongful intent on the part of the lender to exact usurious interest.[30] Furthermore, because of the general principle that the usury statutes are penal in nature and should be strictly construed, the dissent would not hold that the Company acted wrongfully.[31]

In addition, Justice Barrow stated that the courts in *Laid Rite* and *Stephens*, as well as the majority in *Alamo Lumber*, misstated the rule announced in the cases they relied upon.[32] The dissent stated that the rule is that the indebtedness assumed is interest " 'unless the borrower receives something of benefit for the additional assumption or payment, aside from the use of the money loaned.' "[33] The dissent stated that additional consideration is a critical factor in determining if a transaction is usurious because "the rule [stated by the majority] is inapplicable if the borrower fairly may be said to have received some consideration in addition to the money lent."[34] The dissent also cited the traditional Texas rule that "[a] lender may, without violating the usury law, make an extra charge for any distinctly separate and additional consideration other than the simple lending of money."[35]

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29. Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 929-30 (Tex. 1984) (Barrow, J., dissenting). The majority, rejecting the dissent's intent theory, held that the only intent required is the intent to make the bargain that was made. *Id.* at 928. There are a few cases in other states requiring usurious intent in order to hold that the assumption of indebtedness is interest. Schreiber v. Thistle, Inc., 437 N.Y.S.2d 596 (N.Y. Sup. Ct. 1981); *see also* McCullough v. Snow, 432 P.2d 811 (N.M. 1967). Texas courts appear to be bound to the principle that only intent to make the bargain made is necessary. *See Alamo Lumber Co.*, 661 S.W.2d at 928; Ballin v. Poston Home Care Center Co., 749 S.W.2d 164, 169 (Tex. App.—San Antonio 1988, writ denied).

30. *Alamo Lumber Co.*, 661 S.W.2d at 929 (Barrow, J., dissenting). The dissent distinguished *Cochran v. American Sav. & Loan Ass'n*, 586 S.W.2d 849 (Tex. 1979), which held that intent in usury cases means intent to make the bargain made, rather than intent to charge a usurious rate of interest. *Cochran*, 586 S.W.2d at 850. Justice Barrow noted that in *Cochran*, the note was usurious on its face, thus obviating the need to go behind the face of the documents to prove usury. *Alamo Lumber Co.*, 661 S.W.2d at 929 (citing Walker v. Temple Trust Co., 124 Tex. 575, 577-78, 80 S.W.2d 935, 936 (1935)).

31. *Alamo Lumber Co.*, 661 S.W.2d at 930 (Barrow, J., dissenting).

32. *Id.* at 931 (Barrow, J., dissenting).

33. *Id.* (Barrow, J., dissenting) (citing Vee Bee Serv. Co. v. Household Fin. Corp., 51 N.Y.S.2d 590, 602 (N.Y. Sup. Ct. 1944), *aff'd*, 55 N.Y.S.2d 570 (N.Y. 1945)). See *infra* notes 37-59 and accompanying text for a discussion of independent consideration.

34. *Alamo Lumber Co.*, 661 S.W.2d at 931 (Barrow, J., dissenting).

35. *Id.* (Barrow, J., dissenting). The court cited *Greever v. Persky*, which held that a lender may charge a separate fee for any distinctly separate and additional consideration other

D. *Distinguishing the Rule in* Alamo Lumber *from Other Situations*

In a variety of situations, a lender may require one party to assume, co-make, guarantee or secure the debts of a second party, in order to induce the lender to extend credit to the second party. If the party required to co-make, assume, guarantee or secure such indebtedness is not itself receiving an extension of credit from the lender, then there is no underlying loan transaction upon which the co-making, assumption, guarantee or security could constitute usurious "interest." Assume, however, that the party providing the additional support to the lender is itself a borrower from the lender, but is not receiving any new funds or other credit extension from the lender, and is not receiving a renewal, extension or modification of its loan at the time that the additional support for the second party's loan is provided to the lender. In such a case, *Alamo Lumber* would not apply because a critical factor in determining whether an *Alamo Lumber* usury violation has occurred is whether the party providing the additional support is required to do so as a condition to receiving a new loan or other credit extension from the lender.

In addition, a lender does not violate the principle enunciated in *Alamo Lumber* if a lender, as a condition to making a loan, or renewing, extending or modifying an existing loan, requires a borrower to pay, assume, guarantee or provide additional collateral for the borrower's *own* debts. The Texas Supreme Court in *Alamo Lumber* specifically excluded such transactions from the general rule.[36] Therefore, a lender may require that a borrower, as a condition to the extension of a new loan or a renewal of an existing loan, provide additional collateral for the borrower's own indebtedness to the lender.

As previously stated, a lender may, without violating the principles of *Alamo Lumber*, require that a third party execute a guaranty with respect to a loan. In some situations, a lender may simultaneously make separate loans to related borrowers. For example, a lender may make simultaneous loans to commonly controlled corporations. If the lender were making a loan to just one of the corporations, then the

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than the simple lending of money. Greever v. Persky, 140 Tex. 64, 68, 165 S.W.2d 709, 712 (1942). See *infra* notes 53-59 and accompanying text for a discussion of how Texas courts analyze separate charges and fees.

36. *Alamo Lumber Co.*, 661 S.W.2d at 928; *see also* In re Casbeer, 793 F.2d 1436, 1446-47 (5th Cir. 1986).

lender would have required that, as part of its credit analysis, the other corporation guarantee or collateralize the loan to the borrowing corporation. In the case of simultaneous loans, the lender may require that each corporation cross-guarantee or cross-collateralize the other corporation's loan. The borrowers in such a situation may be able to show that the transaction on its face is a violation of the rule in *Alamo Lumber*, because it will appear as though the lender required each borrower, as a condition to receiving a loan, to guarantee or collateralize the other borrower's loan.

Since the loans, when viewed independently, should not be usurious, the simultaneous cross-guarantees or cross-collateralizations also should not be usurious. The lender in such a situation should make it clear in the documentation that its credit policies required the guaranties for each borrower. Some lenders in this situation may be reluctant to close the loans simultaneously and will delay the closing of a second loan to avoid the appearance of an *Alamo Lumber* situation.

III. PRACTICAL CONSIDERATIONS IN APPLYING *ALAMO LUMBER*

A. *Independent Consideration*

1. Generally

In many cases, the determination of whether an assumption of indebtedness is interest may depend upon the court's willingness to consider whether the borrower received independent consideration for his assumption of the third party debt. Unfortunately, whether a Texas court would consider independent consideration to be a part of the *Alamo Lumber* test, or at least an exception to the general rule stated therein, is subject to question. The dissent in *Alamo Lumber* placed a great deal of emphasis on independent consideration while the majority did not discuss this aspect of the test in *Alamo Lumber*. One might assume that the dissent discussed independent consideration with the majority and that the majority rejected it. The majority, however, may have concluded that there was no independent consideration from Alamo Lumber to Mrs. Gold and, therefore, chose not to discuss independent consideration.[37]

To demonstrate the importance of independent consideration, con-

37. The dissent argued that the Company gave independent consideration to Mrs. Gold by allowing her to avoid the Bank's foreclosure sale of the property. *Alamo Lumber Co.*, 661 S.W.2d at 932 (Barrow, J., dissenting). Justice Barrow stated that the agreement to forbear

sider the following example of a fairly typical transaction. Some time ago Lender made a loan to Developer, evidenced by a promissory note in the amount of $2,000,000 and secured by real property in Texas. Developer intended to build a strip shopping center, but was unable to obtain construction financing due to his inability to prelease sufficient square footage prior to construction. Developer is in eminent danger of defaulting on the loan from Lender and has been actively marketing the property. Investor is willing to purchase the property from Developer, and Lender, after determining that Investor is a good credit risk, is willing to allow Investor to assume the existing note and extend the maturity date thereof. This simple set of facts would not present an *Alamo Lumber* problem since Lender is not requiring Investor to assume Developer's debt as a condition precedent to a new loan to Investor.

Now assume that Investor needs additional funds to hold and develop the property and Lender is willing to make a new loan of $300,000 for such purposes. Investor could now argue that Lender, as a condition to making the new loan of $300,000, required Investor to assume the $2,000,000 debt of Developer. As a result, Investor would argue: (i) the $2,000,000 old loan was interest on the $300,000 new loan; (ii) Lender has contracted for more than twice the amount of interest allowed by applicable law; and (iii) the statutory penalties include forfeiture of the $300,000 principal amount of the new loan and three times the amount of usurious interest contracted for by the parties.[38]

The facts and potential result seem exaggerated and harsh, yet they are not that dissimilar from those in *Alamo Lumber*. The difference is that under these facts, Investor has received independent consideration for his assumption of Developer's debt to Lender, by receiving a conveyance of the property. In addition, Lender consented to the conveyance of the property to Investor, which consent Lender could have, in most cases, withheld. If Developer conveyed the property to Investor without Lender's consent, then Lender typically could accelerate the debt and pursue its remedies against Developer and the property. Finally, although it is not consideration running directly to Investor, Lender will have given consideration by releasing Developer

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from foreclosing is good consideration and that the consideration need not flow between the contracting parties as long as there is a benefit and detriment on both sides. *Id.*

38. TEX. REV. CIV. STAT. ANN. art. 5069-1.06(1),(2) (Vernon 1987).

from liability under the note.[39]

If the evaluation of additional "interest" is tied either to the benefit received by the Lender or the detriment accepted by Investor as a result of the assumption, then other facts may become relevant. For example, if Lender can clearly demonstrate that the value of the property exceeds the amount of the indebtedness assumed, then (arguably) Lender has not received a direct economic benefit from the assumption. Investor (while required to undertake personal liability on the debt assumed) will not suffer direct economic loss as a result of assuming, or even paying, the debt that burdens Investor's property. Under these facts, there should be no usury violation; however, the case law in Texas on independent consideration is unclear.

2. Case Law on Independent Consideration

No Texas court has explicitly rejected an independent consideration exception to the *Alamo Lumber* rule. In *Laid Rite*, the Fort Worth Court of Appeals stated the rule that the assumption of the third party's debt must be a condition of a loan *and consideration for making it*.[40] One can read the court's requirement that the assumption of the indebtedness must be "consideration for making" the loan as an indication that there is an independent consideration exception to the general rule. That is, if the assumption was in consideration of something other than the loan, then the assumed debt is not considered to be interest.[41]

In the only other Texas case to discuss independent consideration in the context of an assumption of indebtedness, Main Bank of Houston required Shearn Moody, as a condition to maintaining Moody's

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39. *Cf.* Harrison v. Arrendale, 147 S.E.2d 356, 360 (Ga. Ct. App. 1966). A more appealing, yet less formal, argument is that the substance of this transaction is that Lender is making a new loan to Investor of $2,300,000, the proceeds of which are used by Investor to purchase and hold the property. The only reason that Investor is assuming the promissory note executed by Developer is so that Lender can continue its liens in the property created several years ago, maintaining lien priority over potential intervening lienholders.

40. Laid Rite, Inc. v. Texas Indus., Inc., 512 S.W.2d 384, 389 (Tex. Civ. App.—Fort Worth 1974, no writ). The court stated that:

> There are many cases that hold that where a lender, as a condition of a loan *and as a consideration for making it*, requires the borrower to assume or pay in whole or in part, the debt that another owes to this same lender; that the amount of the assumed or paid-off debt will be considered as interest in determining whether or not a loan is usurious. *Id.* (emphasis added) (citations omitted).

41. *See* Note, *Usury: Texas Courts Take Interest[;]* Alamo Lumber v. Gold, 36 BAYLOR L. REV. 919, 938-39 (1984).

clearinghouse relationship with Main Bank, to guarantee payment of a judgment Main Bank had against Moody's cousin.[42] The trial court instructed the jury that:

> Where a lender, as a condition of a loan and as consideration for making it, requires the borrower to assume or pay in whole or in part the debt that another owes to this same lender, the amount of the assumed or paid-off debt is considered as interest *unless the borrower also receives consideration for such action.*[43]

The court of appeals affirmed the jury's finding in favor of Main Bank, stating that Main Bank, in relinquishing its right to terminate the clearinghouse arrangement, gave valuable consideration in exchange for Moody's guaranty of the third party debt.[44]

The courts in *Laid Rite*, *Stephens* and *Alamo Lumber* each cited several cases in other states in holding that the assumption of indebtedness as a condition to a new loan may be interest. In many of these cases, the court included an independent consideration exception to the general rule. For example, a New York Supreme Court stated that

> Where a borrower is required, as a condition of the loan, to assume or pay, in whole or in part, the debt of another, in addition to legal interest, the transaction is usurious, unless the borrower receives something of benefit for the additional assumption or payment, aside from the use of the money loaned.[45]

In addition, the New Jersey Superior Court stated that "the exacted assumption of another's debt makes the loan to a new borrower usurious unless the exaction is supported by consideration other than the money newly loaned."[46]

In addition to these cases, other cases in other states have recognized independent consideration as part of the test of whether an assumption of indebtedness was usurious. In *Harrison v. Arrendale*,[47] the court held that the release of the original obligor from liability under the assumed indebtedness constituted additional consideration

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42. Moody v. Main Bank of Houston, 667 S.W.2d 613, 615-616 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.).

43. *Id.* at 618 (emphasis added). The court did not discuss the apparent dichotomy between the majority and the dissent in *Alamo Lumber*.

44. *Id.* at 618-19.

45. Vee Bee Serv. Co. v. Household Fin. Corp., 51 N.Y.S.2d 590, 602 (N.Y. Sup. Ct. 1944) (citations omitted), *aff'd*, 55 N.Y.S.2d 570 (N.Y. 1945).

46. Ferdon v. Zarriello Bros., Inc., 208 A.2d 186, 189 (N.J. Super. Ct. Law Div. 1965).

47. 147 S.E.2d 356 (Ga. Ct. App. 1966).

to the borrower.[48] The court stated that if there is good and valuable consideration beyond the mere use of money not interposed as a devise to exact usurious interest, then any excess paid or charged is not usurious.[49] In *McCullough v. Snow*,[50] the court stated that:

> Where the evidence discloses that a borrower is required to guarantee a loan to a third person in order to get a loan himself or get his loan renewed or extended, this is usurious unless, because of the facts surrounding the transaction, there is some intimate business connection as distinguished from kinship, between the loan being renewed and extended and the indebtedness being assumed, and *a present consideration* as well as absence of intention to exact a usurious return.[51]

The court in *McCullough* examined case law in several states in determining the above stated rule.[52]

3. Additional Authorities

There are many cases in Texas involving separate charges or fees a lender imposes on its borrowers where the courts have included independent consideration as part of the test of whether such charge is interest. The traditional rule in Texas as stated in *Greever v. Persky* is that "a lender may, without violating the usury law, make an extra charge for any distinctly separate and additional consideration other than the simple lending of the money."[53] Under this rule, Texas courts have held that a variety of charges imposed by a lender on a borrower are not interest because there was separate consideration for such charges.[54] For example, a bona fide commitment fee is not inter-

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48. *Id.* at 360.

49. *Id.*

50. 432 P.2d 811 (N.M. 1967).

51. *Id.* at 815. There are cases which hold that the assumption of indebtedness, by itself, is usurious. *See generally* Annotation, *Usury: Effect of Borrower's Agreement to Pay, Guarantee, or Secure Some Other Debt Owed to or by Lender*, 31 A.L.R.3d 763, 785-90 (1970). There are also cases where the court, as in *McCullough*, required that additional factors, such as usurious intent, insolvency of the third party obligor, or the distressed financial position of the borrower, are relevant in determining whether the assumption requirement was usurious. *Id.* at 790-807.

52. *McCullough*, 432 P.2d at 815.

53. Greever v. Persky, 165 S.W.2d 709, 712 (Tex. 1942) (citing Nevels v. Harris, 129 Tex. 190, 196, 102 S.W.2d 1046, 1049 (Tex. 1937)).

54. For a summary of cases holding that separate charges or fees were not interest see Texas Commerce Bank - Arlington v. Goldring, 665 S.W.2d 103, 104-06 (Tex. 1984) (Spears, J., concurring).

est.[55] Also, a lender's charge for a third party inspection of the collateral for the loan is not interest.[56]

This line of cases is substantial support for the proposition that the requirement of an assumption of indebtedness in an *Alamo Lumber* situation is not interest if there is independent consideration for the assumption. In *Goldring*, the Texas Supreme Court held that a requirement that the borrower reimburse the lender for attorneys' fees rendered in connection with the loan was not usurious.[57] In dissent, Justice Robertson stated that the holding in *Goldring* was inconsistent with the holding in *Alamo Lumber*.[58] Justice Robertson stated that the attorneys' fees were the independent debt of the bank and that the bank required the borrower to assume such indebtedness as a condition precedent to the extension of the underlying loan.[59] Although Justice Robertson would hold that independent consideration is not part of the test under both *Alamo Lumber* and the *Greever v. Persky* lines of cases, he acknowledges that there is no difference between separate charges or fees imposed by the lender and the assumption of indebtedness.

Therefore, the assumption of indebtedness is no different than a separate charge made upon the borrower by the lender. If such assumption is in consideration for the extension of a new loan (or renewal of an existing loan), then the amount of the assumed indebtedness is interest. If, however, there is some independent consideration for the assumption of indebtedness, then such amount is not interest. In addition, the concept of independent consideration is consistent with the basic definition of interest under Texas law. That is, if interest is compensation for the use, forbearance or detention of money, and if a borrower assumes indebtedness in exchange for some other consideration, such as a conveyance of property, then the assumption is not interest.

4. Conclusions About Independent Consideration

The only argument that a Texas court would not recognize in-

55. Gonzales County Sav. & Loan Ass'n v. Freeman, 534 S.W.2d 903, 906 (Tex. 1976); Stedman v. Georgetown Sav. & Loan Ass'n, 595 S.W.2d 486, 488 (Tex. 1979).

56. Morris v. Miglicco, 468 S.W.2d 517, 519 (Tex. Civ. App.— Houston [14th Dist.] 1971, writ ref'd n.r.e.).

57. *Goldring*, 665 S.W.2d at 104.

58. *Id.* at 106 (Robertson, J., dissenting).

59. *Id.*

dependent consideration as an exception to the general rule regarding the assumption of indebtedness as a condition to making or renewing a loan is that the Texas Supreme Court in *Alamo Lumber* did not discuss independent consideration while the dissent discussed independent consideration in depth. On the other hand, the cases cited in *Laid Rite* and *Alamo Lumber* recognized that the assumption of indebtedness is not interest if there is separate and distinct consideration for the assumption apart from the loan. In addition, the language of the test stated by the court in *Laid Rite* indicates that the assumption must be consideration for the making of the loan in order for the assumption to be interest. Furthermore, the assumption of indebtedness is no different from a separate charge or fee imposed by the lender upon the borrower. The traditional rule in Texas is that such separate charges or fees are not interest if there is separate and distinct consideration for such charge. Finally, although there are some cases which do not discuss independent consideration in the context of the assumption of indebtedness, there are no cases that wholly reject independent consideration as being a part of the test for determining whether a transaction is usurious.

5. What is Independent Consideration?

The existence of independent consideration in a particular transaction may be apparent from its facts. For example, in the example previously given, the independent consideration is the conveyance of the property to the new borrower, as well as the additional consideration of the lender's release of the original obligor and the consent to the transfer of the property. In other situations, however, the existence of independent consideration may depend upon an analysis of the economics of the transaction. For example, consider a situation described in the introduction of this article, where a lender requires a shareholder to guarantee or secure an obligation of his corporation as a condition to the making or renewal of a loan to the shareholder. Assuming that the shareholder owns one hundred percent (100%) of the outstanding stock of the corporation, then the shareholder's payments to the lender of the corporation's indebtedness may result in a corresponding economic benefit to the shareholder. If the corporation is solvent, then the value of the corporation, as well as the shareholder's equity in the corporation, will increase as a result of the repayment of the existing indebtedness. In addition, the corporation may provide to the shareholder a note or other evidence of his contribution to the

corporation by payment of its indebtedness. The conclusion that the shareholder's payment creates an economic benefit to the shareholder, however, is diminished if the corporation is insolvent, and remains insolvent, after the shareholder's payment.

It should also be noted that the decisions by the courts in *Laid Rite* and *Moody* did not explicitly require that the "independent consideration" be equal to, or the equivalent of, the amount of indebtedness assumed by the borrower. If the independent consideration requirement or exception is adopted by Texas courts, however, then it is possible that the "equivalency" of independent consideration will be relevant.

B. *Different Lenders*

A recent Texas case involving the principles discussed in *Alamo Lumber* has created some disturbing precedent for lenders in Texas. As mentioned earlier, the court in *Laid Rite* was careful to note that in the cases it had relied upon, the borrower was required to assume or pay an obligation of a third party to the same lender.[60] In *Victoria Bank & Trust Co. v. Brady*,[61] the Corpus Christi Court of Appeals held that in an *Alamo Lumber* situation, the amount of assumed debt is interest even if the borrower is required to assume debt owed to a different lender.[62] The Texas Supreme Court has agreed to review the case and lenders are hoping that the court reverses this aspect of the holding.

The facts in *Victoria* are complicated and the decision is some twenty pages in length.[63] Victoria Bank & Trust Co. (Victoria) agreed to make a loan to a partnership (the Partnership) comprised of Fancher Cattle Co. (Fancher) and Marlyn Brady (Brady).[64] Instead of being executed by the Partnership, Brady and Fancher signed the note as co-makers.[65] Victoria required Brady to mortgage his ranch

60. Laid Rite, Inc. v. Texas Indus., Inc., 512 S.W.2d 384, 389 (Tex. Civ. App.—Forth Worth 1974, no writ). See *supra* notes 25-26 and accompanying text for a discussion of the holding in *Laid Rite*.

61. 779 S.W.2d 893 (Tex. App.—Corpus Christi 1989, writ granted).

62. *Id.* at 901.

63. The case also involves a discussion of the relationship between usury claims and claims under the Texas Deceptive Trade Practices Act. This aspect of the case is beyond the scope of this article.

64. *Id.* at 898. The loan was a line of credit in the amount of $150,000.00. *Id.* at 899.

65. *Id.* at 898. Victoria later attempted to alter the note to indicate that it was executed by the Partnership. *Id.*

in Zavala County, which was subject to a prior lien in favor of Winter Garden Production Credit Association (Winter Garden), as collateral for the loan.[66] Victoria required, as a condition to the making of the loan to Brady and Fancher, that Winter Garden's first lien be paid.[67]

Brady and Fancher executed the note, which stated that it was in renewal and extension of the loan from Winter Garden.[68] A separate loan agreement provided that Victoria was not obligated to advance funds under the note until Victoria had obtained a first lien in the Brady ranch.[69] Victoria subsequently purchased Winter Garden's note and lien, advancing $121,796.75 of the loan to Fancher and Brady.[70] Therefore, Fancher and Brady effectively received a new loan of approximately $28,000. Fancher, on the other hand, received a new loan of $28,000, but became obligated for $150,000. After renewing the note in 1984, Victoria notified Brady and Fancher that it would not renew the note when it matured in 1985.[71] Fancher liquidated enough assets to reduce the balance of the note to the amount of the preexisting indebtedness of Brady to Winter Garden.[72]

Some time later, in an unrelated transaction, Fancher sold a third party some cattle and received a draft drawn on Victoria.[73] When Fancher attempted to cash the draft, Victoria denied payment until Fancher agreed to forfeit $40,000 towards the outstanding balance of the Brady-Fancher note.[74] At the same time, Brady filed suit to enjoin Victoria from foreclosing on the ranch.[75] Subsequently, Brady, Fancher, and Victoria settled, agreeing to postpone the sale in exchange for a new note and a release of claims.[76] Brady and Fancher then defaulted on the renewal note, and Victoria foreclosed its liens on the ranch and sued Brady and Fancher for the deficiency.[77]

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66. *Id.*

67. *Id.*

68. *Id.* at 899. The loan officer had, on several occasions, assured Fancher that he would never have to pay any of Brady's debts. *Id.* at 898-99.

69. *Id.* at 899.

70. *Id.*

71. *Id.*

72. *Id.* Victoria continued to assure Fancher that he would not be obligated to pay Brady's pre-existing debt to Winter Garden. *Id.* Fancher subseqently paid his other obligations to Victoria and assumed that his relationship with Victoria had ended. *Id.*

73. *Id.* at 900.

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

Fancher counterclaimed that the transaction was usurious under *Alamo Lumber* and recovered a judgment in excess of $4,500,000.[78] Fancher's *Alamo Lumber* claim is essentially that, as a condition to the extension of the new line of credit loan, Victoria required Fancher to assume Brady's indebtedness to Winter Garden.[79] Victoria attempted to distinguish *Alamo Lumber* by arguing that the assumed indebtedness must be owed to the same lender extending the new loan.[80] The court of appeals rejected this argument, stating that the Supreme Court in *Alamo Lumber* did not require "identity of lender."[81] In addition, the court rejected Victoria's argument that it received no benefit from Fancher's assumption of Brady's debt to Winter Garden stating that benefit to the lender is immaterial.[82] The court also rejected Victoria's affirmative defenses based upon the release of claims executed by Fancher and upon a savings clause in the loan documents.[83]

The court of appeals arguably did not have to reach its holding that identity of lender is not a pre-requisite to recovery under an *Alamo Lumber* theory. Under the terms of the loan to Brady and Fancher, Victoria was not obligated to advance new money until Victoria had a priority lien in Brady's ranch, which would not occur until Victoria purchased the Winter Garden note.[84] Therefore, as the court pointed out, Fancher did not become obligated to pay Brady's debt until it

78. *Id.* at 900-02. The judgment represented statutory penalties under Article 5069-1.06 under the original note and the two renewal notes. *Id.* at 902.

79. Brady could not argue that the loan was usurious under *Alamo Lumber* since he was required to assume an indebtedness he was already obligated to pay. The principles of *Alamo Lumber* do not apply to a lender's requirement that the borrower pay or assume his own pre-existing indebtedness. Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 928 (Tex. 1984).

80. *Victoria*, 779 S.W.2d at 901.

81. *Id.* The court stated that the Texas Supreme Court in *Alamo Lumber* noted that *Laid Rite* and *Stephens* involved situations in which the debt was owed to the same lender; however, the Supreme court did not limit its holding in such a manner. *Id.* This statement by the court in *Victoria* appears to be incorrect. The court in *Alamo Lumber* did not address the issue of whether the debt the borrower must assume must be to the same lender. The court merely cited *Laid Rite* and *Stephens*, in addition to legal precedents from other states, without comment. *Alamo Lumber*, 661 S.W.2d at 927-28.

82. Victoria Bank & Trust Co. v. Brady, 779 S.W.2d 893, 901 (Tex. App.—Corpus Christi 1989, writ granted) (citing Danziger v. San Jacinto Sav. Ass'n, 732 S.W.2d 300, 304 (Tex. 1987)).

83. *Victoria*, 779 S.W.2d at 901-02. See *infra* notes 148-170 and accompanying text for a discussion of the effect of a savings clause in the lender's loan documentation on an *Alamo Lumber* claim.

84. *Id.* at 901.

was owed to Victoria.[85] Fancher, as a result, was required to assume the obligations of a third party to the same lender. Therefore, one may argue that the court's analysis of identity of lender is dicta.

In addition, the Texas Supreme Court in *Alamo Lumber* did not address the issue of whether the debt assumed or paid by the borrower must be owed to the same lender.[86] As previously noted, the court in *Laid Rite*, in adopting the rule that the assumed debt is interest, was careful to note that all of the cases it relied upon involved assumption of debt to the same lender.[87] The new lender in *Laid Rite* was a subsidiary of the lender of the assumed indebtedness.[88] As a result, the court in *Laid Rite* remanded the case for a determination of whether the new lender was the alter ego of the original lender.[89] Even if the ultimate result in *Victoria* may be correct, the rule of law stated therein should be reversed. *Victoria* is an example of the axiom that "bad facts" make "bad law." Fancher obligated himself to pay $150,000 in exchange for a loan of $28,000. In addition, he was continually assured that he would never be liable for Brady's preexisting debt to Winter Garden. Nevertheless, the holding that the assumed indebtedness need not be owed to the same lender is dangerous precedent.

For example, consider the hypothertical described in Section III.A.1.where Investor agrees to assume Developer's obligations to Lender pursuant to a purchase of property from Developer. Suppose that Developer seeks a loan from Insurance Company, rather than Lender, for $2,300,000, the proceeds of which will be used to purchase the property and pay costs and expenses. Insurance Company purchases Developer's note from Lender, and Investor assumes the obligations evidenced thereby. Investor has assumed Developer's obligations to a different lender than the one extending the new loan. Investor has not suffered any detriment by assuming such debt, and Insurance Company has not exacted compensation greater than it would have received had it just loaned $2,300,000 directly to Investor,

85. *Id.*

86. See *supra* note 81.

87. Laid Rite, Inc. v. Texas Indus. Inc., 512 S.W.2d 384, 389 (Tex. Civ. App.—Fort Worth 1974, no writ). See notes 25-26 and accompanying text for a discussion of the holding in *Laid Rite*.

88. *Id.*

89. *Id.*

without the requirement of the assumption of Developer's debt to Lender.

In addition, consider a situation where a borrower owns property that he purchased subject to a preexisting debt and lien in favor of a mortgage company. The borrower never assumed the preexisting indebtedness; therefore, he is not personally obligated to pay such indebtedness. The borrower, while negotiating a renewal of an existing loan to a different lender, attempts to refinance the obligations encumbering the property with this lender, and the second lender requires the borrower to assume, and therefore become personally obligated to pay, the preexisting obligations to the first lender. The borrower may argue, citing *Victoria*, that as a condition to the renewal of his loan from the second lender, the second lender required him to assume the preexisting indebtedness to the first lender.

The facts in these examples, although not nearly as egregious as those in *Victoria*, are closely aligned with Fancher's assumption of Brady's debt to Victoria. In the first example, a key distinguishing fact from *Victoria* is, again, that Investor will receive independent consideration for his assumption of Developer's debt, i.e., a conveyance of the property. Therefore, if the Texas Supreme Court affirms the holding in *Victoria*, the independent consideration exception to the general rule in *Alamo Lumber* would become more important to lenders in Texas. In the second example, however, the borrower is not receiving any independent consideration for his assumption of the preexisting indebtedness to the first lender. The borrower is, by becoming personally obligated to pay such indebtedness, suffering a detriment.[90] On the other hand, the second lender is advancing new money but not receiving any additional compensation other than an otherwise proper stated rate of interest, for the use, forbearance, or detention of its money. Would the court in *Victoria* hold that usury occurred under these facts? The answer is unclear.

C. *The "Debt of Another" Requirement*

Among the limitations of the *Alamo Lumber* holding is the requirement that the loan is conditioned on the borrower assuming the debt

90. One may argue that the borrower's property was encumbered by the indebtedness before and after borrower's assumption of the indebtedness. As a result, the transfer from nonrecourse to recourse liability is not a significant detriment to the borrower. The assumption does, however, result in the bank having recourse against the borrower's other assets.

of a third party as opposed to one of the borrower's own debts.[91] For example, if a lender, as a condition to an extension of credit, requires a borrower to assume an obligation that he has previously guaranteed or that he is liable for as a partner of the obligor, then the borrower has, in effect, assumed his own obligations or debt. As a result, the third party debt requirement raises issues regarding partnership and agency law, community property law, and limitations on full recourse liability.

In *Sunbelt Service Corp. v. Vandenburg*,[92] the El Paso Court of Appeals addressed each of the foregoing issues in the *Alamo Lumber* context. In 1983, Mr. Vandenburg was involved in acquiring apartment complexes in El Paso, Texas.[93] He owned all the stock in Wayne A. Vandenburg Enterprises, Inc., which, together with Mr. Vandenburg, comprised the two general partners of the Excelsior II limited partnership.[94] Excelsior II purchased the Alto Mesa Apartments, executing a promissory note in the amount of $2,400,000 payable to Sunbelt Service Corporation (Sunbelt).[95]

Excelsior II and an additional general partner, formed another limited partnership known as Excelsior III.[96] Excelsior III acquired the Sandpiper Apartments in El Paso, executing an additional promissory note in favor of Sunbelt in the amount of $2,800,000.[97] The two partnership promissory notes were essentially nonrecourse in nature, limiting the liability of the maker to the extent of the lien security against the respective properties and prohibiting the recovery of any deficiency judgment in case of foreclosure.[98]

When the apartment business in El Paso declined, Excelsior II and Excelsior III became delinquent on their note payments.[99] During the course of negotiations, the parties decided that foreclosure on the partnership properties could be avoided by Mr. Vandenburg and his wife personally executing a $200,000 note to Sunbelt, with the pro-

91. Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 928 (Tex. 1984).
92. 774 S.W.2d 815 (Tex. App.—El Paso 1989, writ denied).
93. *Id.* at 816.
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*

ceeds of the note to be applied to the delinquent partnership notes.[100] Thereafter, the payments on the partnership notes were twice renewed and extended, and Sunbelt also renewed and extended the $200,000 Vandenburg note.[101] Further failures to pay the note obligations resulted in a settlement in which Sunbelt received title to the partnership properties in lieu of foreclosure.[102] Additionally, an agreement was entered in which the Vandenburgs reacknowledged their personal liability under the $200,000 note.[103] Ultimately, when Sunbelt brought suit for collection of the $200,000 note, the Vandenburgs counterclaimed for usury, relying on *Alamo Lumber*.[104]

In essence, the Vandenburgs contended that because: (i) the Excelsior debts were nonrecourse debts; (ii) Mr. Vandenburg, as a general partner of the Excelsior partnerships, had no personal liability under the partnership notes; and (iii) Mrs. Vandenburg was not even a partner of the partnerships, those notes did not constitute debts of Mr. Vandenburg or his wife under an *Alamo Lumber* analysis.[105] The trial court agreed with the Vandenburgs, granting summary judgment on the usury counterclaim against Sunbelt.[106]

The El Paso Court of Appeals reversed the summary judgment and rendered judgment in favor of Sunbelt which had sought summary judgment, holding that there was no usury in the transaction as a matter of law.[107] In reversing the trial court, the court of appeals held that the Excelsior notes were the debts of Mr. Vandenburg by virtue of his status as a general partner of the partnerships, notwithstanding that the partnership notes were nonrecourse in character.[108] The court observed that a general partner of a limited partnership incurs a debt to the same extent as does the partnership, even though the debt may be nonrecourse in nature.[109] The court further held that the

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100. *Id.*

101. *Id.*

102. *Id.* at 817.

103. *Id.*

104. *Id.* The essence of the usury claim was that the entire principal balance of the $200,000 personal loan constituted interest because it was applied to the nonrecourse partnership debts.

105. *Id.*

106. *Id.* at 816.

107. *Id.* at 818.

108. *Id.* at 817.

109. *Id.* (citing Rohdie v. Washington, 641 S.W.2d 317 (Tex. App.—El Paso 1982, writ ref'd n.r.e.)).

partnership notes were likewise the debts of Mrs. Vandenburg under community property law principles, including the presumption that "debts contracted during marriage are presumed to be on the credit of the community."[110] As a result, the court found that the partnership debts were the personal debts of both of the Vandenburgs.[111]

The court rejected the argument that, because the partnership liabilities were nonrecourse and the Vandenburgs had no personal liability in case of default, the partnership debts were not debts of the Vandenburgs under *Alamo Lumber*.[112] Central to the court's analysis was the fact that, notwithstanding the nonrecourse nature of the notes, the general partnerships and their general partners "became obligated for the payment of money" upon execution of the promissory notes.[113] Similarly, liens were placed on partnership real estate by the creditor as collateral security for repayment of the notes.[114] Since debts were created and encumbrances of the real property existed, such debts necessarily implied a creditor-debtor relationship.[115] As the court noted, "had the money been paid as agreed by those who owed it, the liens would have been released without" foreclosing upon the collateral.[116] Therefore, the court held that any newly required obligation by the Vandenburgs to be applied to the partnership debts would not be a third party debt for purposes of *Alamo Lumber* and the interest computation under the loans.[117]

At least one other Texas court has considered the issue of nonrecourse language contained in promissory notes, holding that the presence of such language in a note does not mean that the maker has no liability thereunder. In *Le Boeuf v. Davis*,[118] the court considered the contention of the appellants, the makers of a promissory note, that nonrecourse language contained in a promissory note relieved them from any liability thereunder. Rejecting this argument, the court held:

We do not construe the provision quoted in the note as meaning the

110. Sunbelt Serv. Corp. v. Vandenburg, 774 S.W.2d 815, 817 (Tex. App.—El Paso 1989, writ denied) (relying on Cockerham v. Cockerham, 527 S.W.2d 162 (Tex. 1975)).

111. *Sunbelt*, 774 S.W.2d at 817.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. 306 S.W.2d 185 (Tex. Civ. App.—Amarillo 1957, no writ).

> appellants were not liable in any manner upon the note sued upon but it could mean nothing more than that if after judgment and the foreclosure if the property did not bring as much as the note specified then appellants would not be responsible for any deficiency.
>
> * * *
>
> [T]he fact that there was a provision in the note and deed of trust, that the appellants would not be responsible for any deficiency, would not relieve them from being responsible upon the note.
>
> * * *
>
> [T]he fact that the property might not sell under forced sale for as much as the face of the note in question would not relieve the appellants from being liable upon the note to the extent of whatever the property might bring.[119]

Thus, as the court properly held in *Sunbelt Service*, the presence or absence of full recourse personal liability is irrelevant to the existence of a debt under *Alamo Lumber*. As a result, a borrower, whose property is encumbered as security for a nonrecourse obligation, and who is required to pay all or part of the nonrecourse obligation as a condition of an extension of credit, apparently does not have a claim that the extension of credit was usurious under *Alamo Lumber*.

IV. APPLICATION OF *ALAMO LUMBER* TO CONTINGENT LIABILITIES

A. *Are Guaranties and Collateral Pledges "Assumptions"?*

1. Overview

By its terms, the *Alamo Lumber* holding protects only a borrower who "assumes" a third party's debt to a lender as a condition to that lender's making a loan to the borrower.[120] No Texas court has ever held that a borrower who is required to execute a guaranty or collateral pledge to support the "debt of another" as a condition of a loan may maintain an *Alamo Lumber* usury claim. It is nonetheless useful to review the possible application of *Alamo Lumber* to such contingent liabilities, as those types of liabilities present a recurring problem

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119. *Id.* at 187. *See also* Federal Deposit Ins. Corp. v. University Anclote, Inc., 764 F.2d 804, 806 (11th Cir. 1985) (stating that merely because the borrower "cannot be held liable for a deficiency judgment does not mean that" the borrower "did not incur an indebtedness when it signed the note").

120. Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 928 (Tex. 1984).

in loan restructuring or workout activities involving related borrowing entities. Under existing Texas law, it would appear that a borrower required to guarantee or pledge collateral to support the debts of third parties could be entitled to the protection of *Alamo Lumber*, although difficult valuation and evidentiary issues are raised by the analysis.

Under the Texas usury statutes, "any person who contracts for, charges or receives interest which is greater than the amount allowed by" law is required to forfeit to the "obligor" the statutory penalties.[121] Thus, in order to be entitled to invoke the protections of the usury statutes, a party must be an "obligor" under the law.

An "obligor" under article 5069-1.06 has been defined as a "person who pays, is charged or has contracted to pay interest at a rate in excess of that allowed by law."[122] Furthermore, Texas courts have held that "one who is not by law a maker of a note is not an obligor thereon though as an absolute guarantor he is liable for payment under the guaranty contract."[123]

Texas law clearly sets forth the legal requirements for assumption of a debt. In essence, a party who assumes a debt becomes "primarily" liable for payment of the debt.[124] As a result, it would appear that a party who "assumes" the debt of another must be or become, as a matter of law, primarily obligated for the payment of that debt. Nonetheless, even though such an "assumption" is a necessary condition to *Alamo Lumber* liability, it may not be, as will be seen, sufficient.

2. Guaranties of Payment and Collection

The party who executes an absolute and unconditional guaranty (i.e., waiving presentment, notice of dishonor, protest, and all demands upon the maker or drawee of the debt guaranteed) may be considered, under some circumstances, primarily liable under that guaranty. As a result, a primarily liable party waives its right to require the holder of the guaranteed note to pursue action against the

121. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (1987); *id.* at art. 5069-8.01, 8.02.

122. Patterson v. Neel, 610 S.W.2d 154, 156 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

123. *Id.* (citing Hartnett v. Adams & Holmes Mortgage Co., 539 S.W.2d 181, 183 (Tex. Civ. App.—Texarkana 1976, no writ).

124. Chapman v. Crichet, 95 S.W.2d 360, 364 (Tex. 1936); Brooks v. Erbar, 186 S.W.2d 372, 377 (Tex. Civ. App.—Eastland 1945, writ ref'd w.o.m.).

maker before the guarantor becomes primarily liable.[125] Although guaranties are technically secondary liabilities,[126] the Texas Supreme Court has held that a guaranty of payment of a debt constitutes a primary rather than secondary obligation of the guarantor.[127] Conversely, a "guaranty of collection" is typically an undertaking of the guarantor to pay if the debt cannot be collected by the use of reasonable diligence. A party executing a guaranty of collection is certainly not primarily liable for payment of the debt. Indeed, the principal debtor may be required to be joined as a party in any action seeking collection under such a guaranty.[128]

Guaranties of payment rather than collection are probably more common in current commercial transactions. As a result, a strict reading of the *Alamo Lumber* requirement that a borrower "assume" the debt of a third party could arguably be satisfied by the execution of an absolute and unconditional guaranty of payment, while a guaranty of collection would clearly fall outside the *Alamo Lumber* holding.

3. Other Collateral Pledges

As with guaranties, no Texas court has ever held that a collateral pledge of real or personal property constitutes the "assumption" of a debt for *Alamo Lumber* purposes. However, collateral pledges, such as deeds of trust covering real property and the wide variety of security agreements covering personal property, should be evaluated for *Alamo Lumber* purposes by the "primary" versus "secondary" obligation analysis set forth above. For example, a deed of trust covering real property could require that the beneficiary of the deed of trust attempt to exhaust other remedies against the maker of the debt before proceeding with foreclosure. The character of these types of transactions, however, is subject to contactual variation on a case-by-

125. Hopkins v. First Nat'l Bank at Brownsville, 551 S.W.2d 343, 345 (Tex. 1977) (citing Universal Metals & Mach., Inc. v. Bohart, 539 S.W.2d 874, 877 (Tex. 1976) (in which the guaranty expressly described the guarantors as "primary obligors").

126. A. STEARNS, THE LAW OF SURETYSHIP § 4. 1 (5th ed. 1951). "Since the contract of guaranty is collateral, a primary or principal obligation must exist to which it is secondary, as without a principal debt there can be no guaranty." *Id.* at 59.

127. *See supra* note 125.

128. Ford v. Darwin, 767 S.W.2d 851, 854 (Tex. App.—Dallas 1989, writ denied); Wolfe v. Schuster, 591 S.W.2d 926, 930 (Tex. Civ. App.—Dallas 1979, no writ); TEX. CIV. PRAC. & REM. CODE ANN. § 17.001 (Vernon 1986).

case basis. Accordingly, there are no broad generalizations regarding real or personal property pledges. Borrowers may nevertheless assert that a requirement of a collateral pledge is no different from an "assumption" of debt. However, because a collateral pledgor does not become personally liable to pay the debt, as in the case of a guaranty, the collateral pledge is conceptually distinct from the guaranty under *Alamo Lumber*.[129] Therefore, even if a collateral pledge falls within the ambit of *Alamo Lumber*, the extra "interest" would be based upon the value of the collateral pledged, rather than the amount of indebtedness secured by the pledge.

4. Circumstances in Which *Alamo Lumber* Might be Applicable to Contingent or Secondary Liabilities

As previously noted, the question whether a guaranty or collateral pledge is characterized as an "assumption" of debt for *Alamo Lumber* purposes is dependent, at least in part, on the specific language of the instruments at issue. Notwithstanding the fact that language in a guaranty, deed of trust or similar security agreement might militate in favor of its categorization as a secondary rather than a primary obligation, other factual circumstances may be relevant in the determination.

For instance, a lender might require, as a condition of renewing or extending a loan to a borrower, that such borrower guaranty or execute a collateral pledge to support the loan obligations of a third party who lacks the financial ability to pay his loans. Under such circumstances, it could be argued that, by virtue of the poor financial condition of the borrower, the contingent nature of the guaranty or collateral pledge is merely illusory, since it is highly likely that the guaranty or collateral pledge will be called. As a result, the guarantor or pledgor can argue that undertaking even a "secondary" obligation in support of the renewal or extension of the debt of a destitute borrower effectively constitutes "assumption" of third party debt. To date, no Texas court has addressed this issue.

B. *Valuation and Enforcement of Contingent Obligations*

Whether and how *Alamo Lumber* can be applied to contingent or

129. *But see* Planters' & Mechanics' Nat'l Bank v. Robertson, 86 S.W. 643, 645 (Tex. Civ. App.—1905, no writ) (a party securing the debt of another with a mortgage of real property becomes a surety or guarantor of that debt to the extent of the interest in the land).

secondary obligations is potentially dependent on difficult legal and factual analyses, which have thus far not been undertaken by any Texas court. Two obvious areas of inquiry are valuation and enforcement of contingent or secondary obligations. The valuation analysis is informed to some extent by existing Texas usury law, while a review of enforcement issues relies to a lesser degree on present Texas law.

1. Valuation: The Contingent or Speculative Benefit

If a judicial determination is made that a guaranty or other collateral pledge constitutes an "assumption" of a third party debt under an *Alamo Lumber* analysis, it then becomes necessary to determine the precise value[130] of the "assumption" in order to determine the amount of interest contracted for, charged or received. Obviously, even if a guaranty or other collateral pledge is deemed "interest" under *Alamo Lumber*, no usury violation occurs unless the interest exceeds the maximum lawful rate.

Texas courts in *Beavers v. Taylor* and *Pansy Oil Co. v. Federal Oil Co.* have held a loan not usurious where the borrower's obligation to pay a certain amount is dependent upon a contingency.[131] Moreover, "a contract is not usurious where the lender is to receive uncertain value, . . . even though the probable value" may exceed the amount of lawful interest.[132]

A second line of Texas cases has recently been cited by the United States Court of Appeals for the Fifth Circuit as conflicting with the *Beavers* line of cases. In *Najarro v. Sasi International, Ltd.*,[133] the Fifth Circuit held that promissory notes providing for the payment of

130. The term "value" could be defined in a number of ways for purposes of usury analysis. For instance, value could mean the detriment incurred by the guarantor or pledgor of collateral. Conversely, it could be defined as the benefit received by the lender from the borrower, which would seem to be more consistent with the language and purposes of the Texas usury laws. *See* Goodman v. Seely, 243 S.W.2d 858, 859 (Tex. Civ. App.—San Antonio 1951, writ ref'd) (payment by non-borrower to induce lender to make loan to borrower is not interest). For purposes of this article, concepts of "value" and "valuing" are used as a shorthand summary of the economic analysis relevant to the applicable legal principles.

131. Beavers v. Taylor, 434 S.W.2d 230, 231 (Tex. Civ. App.—Waco 1968, writ ref'd n.r.e.); Pansy Oil Co. v. Federal Oil Co., 91 S.W.2d 453, 457 (Tex. Civ. App.—Texarkana 1936, writ ref'd).

132. *Beavers*, 434 S.W.2d at 231; Ragland v. Short, 245 S.W.2d 368, 370 (Tex. Civ. App.—San Antonio 1951, mand. overruled); Korth v. Tumlinson, 73 S.W.2d 1048, 1050 (Tex. Civ. App.—San Antonio 1934, no writ); Burton v. Stayner, 182 S.W. 394, 395 (Tex. Civ. App.—San Antonio 1916, writ ref'd).

133. 904 F.2d 1002 (5th Cir. 1990).

a "commission" of twenty-five percent, apparently due and payable only in the event of a profit in the underlying transaction, were usurious as a matter of Texas law.[134] Relying on a line of cases holding that "a contract is usurious as a matter of law if there is *any* contingency by which the lender may receive more than the lawful rate of interest,"[135] the court purported to distinguish the *Beavers* line of cases.[136]

As noted by the Texas Supreme Court in *Smart v. Tower Land & Inv. Co.*:

> The contract under construction will not be found usurious on its face unless it *expressly* entitles the lender, upon the happening of a contingency or otherwise, to exact interest at a rate greater than that allowed by law.[137]

The purported conflict appears to be illusory. The *Smart* rule is, as the Fifth Circuit admitted in *Najarro*, easily distinguishable from the holdings of the *Beavers* and *Pansy Oil* cases.[138] Where, as in *Beavers* and *Pansy Oil*, the amount to be paid for the use of the lender's money is uncertain under the terms of the contract at issue, the contract does not expressly entitle the lender to exact interest at a rate greater than that allowed by law and, as a result, there is no usury even though the amount received by the lender may exceed lawful interest.[139]

A guarantor or collateral pledgor seeking to rely on *Alamo Lumber* to avoid a debt would be likely to characterize the entire amount of the guaranty or value of collateral pledged as the "assumed" debt. On the other hand, a lender attempting to avoid *Alamo Lumber* difficulties could argue that the guaranty or collateral pledge does not constitute "interest" at all unless funds are actually realized under such instruments. This is particularly the case where the loan documents contain usury savings clauses.[140]

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134. *Id.* at 1009.

135. Jim Walter Homes, Inc. v. Schuenemann, 668 S.W.2d 324, 328 (Tex. 1984); Dixon v. Brooks, 604 S.W.2d 330, 334 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.).

136. *Najarro*, 904 F.2d at 1009; Dixon v. Brooks, 678 S.W.2d 728, 729 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.); Smart v. Tower Land & Inv. Co., 597 S.W.2d 333, 341 (Tex. 1980).

137. *Smart*, 597 S.W.2d at 341 (emphasis added) (citing W.E. Grace Mfg. Co. v. Levin, 506 S.W.2d 580, 584 (Tex. 1974)).

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

139. *Beavers*, 434 S.W.2d at 231.

140. *See infra* notes 148-170 and accompanying text for a discussion of saving clauses.

2. Valuation: Timing Issues

The application of the above legal principles to the evaluation of contingent obligations raises several questions. First, it must be determined when the valuation of the contingent obligation is to be made. If the value of a guaranty or collateral pledge is to be determined at the inception of the lending transaction at issue, when the underlying note has not been paid at all, a relatively high value might be ascribed to the contingent obligation, because the limit of the guaranty or collateral pledge could be exhausted to satisfy the debt. However, *Alamo Lumber* should not apply where a loan to a borrower in strong financial condition is guaranteed or secured by the borrower attempting to claim usury, because of the remote prospect that the guarantee or collateral pledge will be called on to satisfy the debt. Similarly, a borrower guarantying a debt secured in its entirety by other liquid collateral should not be able to claim successfully that the guaranty is interest under *Alamo Lumber*.

On the other hand, if the value of the contingent obligation is determined at the time a lender has undertaken collection efforts and is deemed to have "charged" or "received" interest, the value of that obligation could be greatly reduced, if for no other reason than the fact that the underlying debt may have been reduced over time before attempts to realize on the contingent obligations are made by the lender. Conversely, the value of the obligation may be larger, at the time of the "charging" or "receipt" of interest, if the borrower's financial condition has deteriorated since the inception of the loan and the lender is forced to seek full recovery from the guarantor or collateral pledgor. In either case, under such circumstances, the lender might be able to rely on independent consideration[141] or "spreading" of interest[142] to avoid usury. Plainly, a number of complex and interrelated variables must be comprehensively addressed by any judicial tribunal attempting to value contingent obligations for *Alamo Lumber* purposes. The analysis is far from simple and obvious.

The problem of valuing contingent obligations at the inception of the loan transaction is complicated further by the presence of contribution, indemnity or subrogation rights that may be available to the guarantor or collateral pledgor against the maker of the note or

141. *See supra* notes 37-59 and accompanying text for a discussion of independent consideration.

142. *See infra* note 149.

against co-guarantors.[143] Particularly where makers, co-guarantors, or other pledgors are solvent, the guarantor or pledgor relying on *Alamo Lumber* should be required to ascribe a value to subrogation or contribution rights to reduce the value of the guaranty or pledge characterized as "interest" under *Alamo Lumber*. This analysis finds support in bankruptcy principles regarding determinations of solvency or insolvency for preference purposes.[144]

In addition, as regards collateral pledges and guaranties, a comparison of the amount of the debt guaranteed or secured to the value of the contingent obligation itself is appropriate. For example, a borrower pledging a parcel of real property valued at $500,000 as security for a $100,000 note could not seriously argue that the entire value of the property pledged is "interest" under *Alamo Lumber*. Likewise, that same borrower arguably should not be able to rely on *Alamo Lumber* at all if the pledged property is never sold or realized on by the lender.

As noted later in this article, the presence of a savings clause in the credit documents may dramatically affect the valuation given to a guaranty or collateral pledge under *Alamo Lumber* analysis.[145] Because a lender may avoid liability for contracting for or charging usurious interest by virtue of a savings clause under existing law, and because receipt of usurious interest may likewise be covered by a savings clause, the determination of when and how to value contingent obligations for purposes of *Alamo Lumber* usury analysis becomes quite problematic. To date, the courts have provided no meaningful guidance in this area. Indeed, given the inherently uncertain nature of when and how contingent obligations may be realized to satisfy debts,

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143. Under Texas law, a surety who pays indebtedness of the principal may bring an action for reimbursement by the principal. Highlands Cable Television, Inc. v. Wong, 547 S.W.2d 324, 327 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.); Seale v. Hudgens, 538 S.W.2d 459, 460 (Tex. Civ. App.—San Antonio 1976, writ dism'd); Fulton v. Edge, 435 S.W.2d 263, 265 (Tex. Civ. App.—Waco 1968, writ ref'd n.r.e.). The general rule of contribution allows a guarantor who has paid more than his proportionate share of the obligation guaranteed to obtain contribution from co-guarantors to equalize their liability. *See* Miller v. Miles, 400 S.W.2d 4, 7 (Tex. Civ. App.—Tyler 1966, writ ref'd n.r.e.)

144. 2 COLLIER ON BANKRUPTCY ¶ 101.31[6] (15th ed. 1980) (guaranty should be included in total indebtedness but appropriate allowances could be made under asset column for possible rights of subrogation and contribution); *see In re* Ollag Constr. Equip. Corp., 57 F.2d 904 (2d Cir. 1978); Wingert v. President Directors & Co. of Hagerstown Bank, 41 F.2d 660 (4th Cir. 1930).

145. *See infra* notes 148-170 and accompanying text for a discussion of savings clauses in loan documents.

their very character may take them beyond the scope of *Alamo Lumber*.

3. Enforcement of Contingent Obligations

A lender holding guaranties or collateral pledges relating to loans that arguably fall within the ambit of *Alamo Lumber* may have several options available to determine how to proceed against the collateral. First, and most simply, the lender may desire to "forge ahead" and commence suit to recover under guaranties or take nonjudicial action to enforce deeds of trust or personal property security agreements. The obvious danger in such a course of action is that the lender may be deemed by a court, long after the fact, to have charged or received usurious interest under *Alamo Lumber*, with the attendant negative consequences of the Texas usury statutes applying with full force.

A second possible course of action for a lender would be to rely on any savings clauses contained in the promissory notes or related instruments.[146] Under such circumstances, the lender could attempt to "effectuate" the savings clauses by realizing on guaranties or other collateral pledges, making a determination as to whether any sums should be rebated under applicable savings clauses and rebating all such sums to the guarantor or pledgor. Taking such a course of action outside the realm of judicial proceedings, however, may itself be fraught with risk. In particular, the lender might make a determination as to appropriate interest or other calculations that would not be supported in a subsequent judicial action.

A third alternative for a lender facing the *Alamo Lumber* issue in the context of contingent obligations would be to seek judicial guidance in the form of a declaratory judgment as to the possible charge or receipt of interest prior to making such a charge or receiving benefits from contingent obligations. In this manner, the savings clauses contained in the loan documents could be effectuated via judicial action, with the relative certainty accompanying a judicial determination. Obviously, such a determination could be time-consuming and expensive and, in many instances, unrealistic in light of both current financial conditions in the business community and the delays often associated with civil litigation in Texas courts. Indeed, the time and

146. *Id.*

expense of litigation, considered with the possibility of a guarantor or pledgor's rapidly deteriorating financial condition, could render this alternative unrealistic at best. Further, a lender who obtained a judicial declaration of the propriety of a proposed course of action or construction of loan documents from a trial court could be subject to liability in the event that the trial court's determination were overturned on appeal. Thus, it appears that no course of action is entirely risk free.

C. *Possible Judicial Treatment of Contingent Obligations*

As described above, contingent or secondary obligations such as guaranties and collateral pledges differ from outright assumptions in several respects. Texas courts have not yet determined whether guaranties and pledges should be treated like assumptions for purposes of the *Alamo Lumber* rule. While certain guaranties or collateral pledges may be the economic equivalents of an assumption, others represent truly contingent obligations which, at the time of documentation of the transaction, are not expected to require ultimate performance. In these cases, Texas courts could choose to simply exclude the contingent obligations from the ambit of *Alamo Lumber*, rely upon the "speculative and contingent" cases to avoid a determination of usury, attempt to "value" the amount of compensation or "interest" represented by the contingent obligation or include as "interest" those amounts ultimately charged or collected under the guaranties or pledge instruments. Based upon the "inception of the contract" cases, creditors will assert that a truly contingent obligation should not result in *Alamo Lumber* usury simply because the guarantor or pledgor ultimately was required to make payments (either directly, or through the liquidation of its collateral) to the lender. Also, because of the difficulties of "valuing" a truly contingent obligation, courts may be reluctant to play the valuation game. In order to provide some certainty in this area, courts should consider the following approach. First, if a guaranty or collateral pledge is a disguised assumption, then such guaranty or pledge may be treated as an assumption for purposes of *Alamo Lumber*, subject to the limitations described above.[147] If a guaranty or collateral pledge is given by a borrower, with respect to a fresh (as opposed to a past due or defaulted) loan to another bor-

147. *See infra* Section V.B.

rower, then the guaranty or collateral pledge should be excluded from *Alamo Lumber* consideration. In addition, if the guaranty or collateral pledge is given to support an extension of credit (whether new, or in the nature of a renewal, extension or modification) to a third party which at the time of the transaction is solvent, has adequately secured the extension of credit, or is otherwise financially able to pay the extension of credit, then the guaranty or collateral pledge should be excluded from *Alamo Lumber* consideration. Finally, subject to the "assumption equivalent" rule suggested above, cross-guaranties provided by affiliated borrowers in connection with simultaneous renewals, extensions and modifications of their loans should be viewed as given to induce the lender to extend credit to the party whose obligation is guaranteed or supported, rather than to extend credit to the party providing the contingent support. Without some attempt to introduce certainty into the area of contingent obligations, *Alamo Lumber* threatens lenders with the prospect of significant and often incalculable liability in loan workout or restructure transactions, thereby creating the prospect that such transactions will be foregone entirely.

V. Possible Defenses and Related Matters

The following is a summary of some potential defenses to an *Alamo Lumber* claim by reliance on a savings clause in the applicable loan documents and, for national banks, reliance on the provisions of the National Bank Act. In a given usury case, other defenses (e.g. bona fide error and *de minimus non curat lex*) may be helpful to a lender. These defenses will not, however, be helpful in most *Alamo Lumber* usury cases, and therefore are not addressed in the article. In addition, we have also provided a brief discussion of the related problems of national banks and thrift institutions under the anti-tying provisions of applicable federal law.

A. *Effect of Savings Clause in Loan Documents*

Texas lenders typically insert into their loan agreements, notes, and other loan and collateral documents, a clause, known as a "savings clause," which expresses an intent on the part of the lender not to violate applicable usury laws. A typical savings clause will provide that, regardless of any other provisions in the loan documents, the lender shall not be deemed to have contracted for, charged, received, collected or applied interest on the loan in excess of the maximum

rate or amount allowed under applicable law.[148] In addition, a savings clause often will provide that any excessive interest shall be applied to the principal amount of the loan, and any remaining excess refunded to the borrower. Also, many savings clauses include a provision for the spreading of the total amount of interest on the loan throughout the term of the loan.[149]

A savings clause evidences the intent on the part of the parties to

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148. The following is an example of a typical savings clause in a promissory note:

> Regardless of any provisions contained herein, the Payee shall never be deemed to have contracted for or be entitled to receive, collect or apply as interest on the Note, any amount in excess of the highest lawful rate, and, in the event Payee ever receives, collects or applies as interest any such excess, such amount which would be excessive interest shall be applied to the reduction of the unpaid principal balance of this Note, and, if the principal balance of this Note is paid in full, any remaining excess shall forthwith be paid to Maker. In determining whether or not the interest paid or payable under any specific contingency exceeds the highest lawful rate, Maker and Payee shall, to the maximum extent permitted under applicable law, (i) characterize any non-principal payment (other than payments which are expressly designated as interest payments hereunder) as an expense, fee, or premium, rather than as interest, (ii) exclude voluntary prepayments and the effect thereof, and (iii) spread the total amount of interest throughout the entire contemplated term of this Note so that the interest rate is uniform throughout such term. Some savings clauses are more simple and merely state that the interest contracted for, charged or received shall never exceed the maximum allowed by law.

See also J. NORTON & T. CONNOR, COMMERCIAL LOAN DOCUMENTATION GUIDE § 7.02 at 7-79 (1990) (example of a form of usury savings clause).

149. Courts in Texas and the Texas legislature have adopted the concept of the spreading of interest over the term of the loan. In the absence of a savings clause, a court in Texas will nevertheless spread interest on the loan over its term. In *Tanner Development Co. v. Ferguson*, the Texas Supreme Court restated the rule that in testing a transaction for usury, the interest stipulated by the parties and judicially determined interest are to be spread over the term of the underlying loan. 561 S.W.2d 777, 786 (Tex. 1977) (affirming Nevels v. Harris, 129 Tex. 190, 196, 102 S.W.2d 1046, 1049 (1937)). In addition, the Texas legislature codified the spreading doctrine for loans secured by real property. TEX. REV. CIV. STAT. ANN. art. 5069-1.07(a) (1987). Article 5069-1.07(a), which also includes a "savings clause" feature of applying excessive interest to principal or refunding such amounts to the borrower, provides that:

> On any loan or agreement to loan secured or to be secured, in whole or in part, by a lien, mortgage, security interest, or other interest in or with respect to any interest in real property, determination of the rate of interest for the purpose of determining whether the loan is usurious under all applicable Texas laws shall be made by amortizing, prorating, allocating, and spreading, in equal parts during the period of the full stated term of the loan, all interest at any time contracted for, charged, or received from the borrower in connection with the loan. However, in the event the loan is paid in full by the borrower prior to the end of the full stated term of the loan and the interest received for the actual period of the existence of the loan exceeds the maximum lawful rate, the lender contracting for, charging, or receiving all such interest shall refund to the borrower the amount of the excess or shall credit the amount of the excess against amounts owing under the loan and shall not be subject to any of the penalties provided by law for contracting for, charging or receiving interest in excess of the maximum lawful rate. *Id.*

limit the interest on a loan transaction to the amounts allowed by applicable law.[150] Texas courts have generally acknowledged the validity of such savings clauses and enforced them to avoid a violation of applicable usury laws.[151] Courts will attempt to give effect to savings clauses if they are reasonably able to do so and will interpret such clauses in such a way as to prevent the lender from collecting usurious amounts under the loan.[152] Courts must construe the terms of savings clauses as a whole and in light of the circumstances surrounding the transaction.[153]

On the other hand, a savings clause will not protect a lender if the loan is usurious by its express terms or is usurious on its face.[154] In order to be usurious on its face, a contract must show an intention to charge interest at a greater rate than permitted by law.[155] For example, a note that expressly provides for interest of 25% per annum, where the maximum rate under Texas law is 18%, is usurious on its face. A lender under this note could not contract for, charge or receive interest at 25% and then rely on a savings clause to avoid a usury claim. If, however, a note has a variable rate of interest that is not necessarily usurious at the time of execution, then such note is not usurious on its face by virtue of the fact that, because of increases in the prime rate, the variable rate later exceeds the maximum statutory rate.[156] A savings clause in such a note may be a defense to a claim of usury if the rate of interest later becomes usurious.

As previously noted, a lender is subject to penalties under Texas

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150. *Nevels*, 129 Tex. at 198, 102 S.W.2d at 1050.

151. *See, e.g., Tanner Dev. Co.*, 561 S.W.2d at 777; *Nevels*, 129 Tex. at 197-98, 102 S.W.2d at 1049; Woodcrest Assoc., Ltd. v. Commonwealth Mortgage Corp., 775 S.W.2d 434, 437 (Tex. App.—Dallas 1989, writ denied); Conte v. Greater Houston Bank, 641 S.W.2d 411, 418 (Tex. App.—Houston [14th Dist.] 1982, writ ref'd n.r.e.); *In re* Casbeer, 793 F.2d 1436, 1447 (5th Cir. 1986); *see also* Imperial Corp. v. Frenchman's Creek Corp., 453 F.2d 1338, 1343 (5th Cir. 1972).

152. Nevels v. Harris, 129 Tex. 190, 197-8, 102 S.W.2d 1046, 1049-50 (1937); *Woodcrest*, 775 S.W.2d at 438.

153. *Nevels*, 129 Tex. at 197, 102 S.W.2d at 1049-50; *Woodcrest*, 775 S.W.2d at 438.

154. *Nevels*, 129 Tex. at 198, 102 S.W.2d at 1050. The court in *Nevels* stated that a lender may not "exact from a borrower a contract that is usurious under its terms, and then relieve himself of the pains and penalties visited by law upon such an act by merely writing into the contract a disclaimer of any intention to do that which under his contract he has plainly done." *Id.*

155. Allied Supplier & Erection, Inc. v. A. Baldwin & Co., Inc., 688 S.W.2d 156, 158 (Tex. App.—Beaumont 1985, no writ).

156. *Cf. id.* (where court held note that bore interest at prime plus 2%, with a 5% late charge on past-due installments was not usurious on its face).

law if it either "contracts for," "charges" or "receives" usurious interest.[157] Savings clauses are typically used to defeat a claim that the lender "contracted for" usurious interest.[158] Until recently, many lenders in Texas were skeptical as to whether a savings clause would prevent a "charge" from being usurious. A savings clause, however, can also provide the lender a defense to a usury claim that it "charged" usurious interest. In *Woodcrest Associates, Ltd. v. Commonwealth Mortgage Corp.*,[159] the lender utilized a savings clause to avoid a claim by the borrower that a demand letter the lender sent to the borrower was a "charge" of usurious interest.[160] The court concluded that the "manifest intent of the parties was to structure the entire transaction so as to avoid contracting for, charging, or receiving usurious interest."[161] Accordingly, the savings clauses in the underlying documents eliminated the borrower's claim that usurious interest was charged.[162]

It is unclear whether a usury savings clause will insulate a lender who receives usurious interest from a usury claim by returning such interest to the borrower. The court in *Nevels v. Harris* stated that a lender cannot "exact" usurious interest and by contract or disclaimer avoid Texas usury laws.[163] In a case not involving a savings clause, a Texas court held that a lender may not collect usurious interest and later credit back overpaid interest and overcome a violation of the usury statutes.[164] But, consider a situation where a lender collects a fee from the borrower that a court may later determine is "interest" under Texas law. It would seem to be consistent with Texas case law

157. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (1987).

158. *See, e.g.*, Conte v. Greater Houston Bank, 641 S.W.2d 411, 420 (Tex. App.—Houston [14th Dist] 1982, writ ref'd n.r.e.) (because of savings clause, demand feature of note did not make loan usurious where borrower paid fees up front, which the court deemed to be interest, but which when spread over the term of the loan were not usurious).

159. 775 S.W.2d 434, 434 (Tex. App.—Dallas 1989, writ denied).

160. *Id.* at 438-39. A "charge" of interest typically occurs by the unilateral act of the lender, such as debiting of the borrower's account, giving a payoff quote, sending a demand letter or including a demand for interest in pleadings. *See, e.g.*, Danziger v. San Jacinto Sav. Ass'n, 732 S.W.2d 300, 303 (Tex. 1987) (payoff quote); Windhorst v. Adcock Pipe & Supply, 547 S.W.2d 260, 260 (Tex. 1977) (debiting of borrower's account); *Woodcrest*, 775 S.W.2d at 437 (demand letter); Moore v. Sabine Nat'l Bank, 527 S.W.2d 209, 210 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.) (pleadings and affidavits).

161. *Woodcrest*, 775 S.W.2d at 438-39.

162. *Id.* at 439.

163. Nevels v. Harris, 129 Tex. 190, 198, 102 S.W.2d 1046, 1050 (1937).

164. *Danziger*, 732 S.W.2d at 302.

to hold that a savings clause prevents the amount from being usurious if the amount of excess interest is, after applicable spreading principles are applied, offset against the principal, and then, if necessary, refunded to the borrower. In such a situation, a court, in order to give effect to the parties' stated intent not to contract for, charge or *receive* usurious interest, should allow the lender to avoid liability under Texas usury laws by such a rebate.

In an *Alamo Lumber* situation, a lender may be able to avoid a usury claim by relying on a savings clause in the applicable loan documents. A loan in which a lender requires the borrower to assume a third party's obligations should not be usurious on its face.[165] The loan documents evidencing the new loan will include the stated amount of the new loan and the lawful interest thereon, without any reference to the amount of the obligation assumed by the borrower. If, on the other hand, the loan agreement or other document incorporates the condition precedent that the borrower assume a third party's indebtedness, as a condition to the new loan, then it is possible that a court will hold that the loan is usurious on its face. Recall that an *Alamo Lumber* claim involves a lender's requirement that a borrower either pay, assume, guarantee or secure an obligation of a third party to the lender. Whether a savings clause will be a defense to an *Alamo Lumber* claim may depend on whether the court holds that the transaction is contracting for, charging or receiving usurious interest. If the court concludes that there is contracting for usurious interest, then there is a greater chance that the court will try to give effect to the savings clause. If, on the other hand, the court concludes that the lender has "charged" or "received" usurious interest, then it is unclear whether the savings clause will defeat a usury claim.

Assuming that all other elements of an *Alamo Lumber* claim are present, a lender's requirement that the borrower assume, guarantee or secure a third party's debt should be "contracting for" usurious interest. Such a transaction is not "charging" usurious interest because "charging" typically involves the unilateral act of the lender, such as demanding a usurious amount of interest or placing a debit on the borrower's account. In addition, in the context of an assumption, guarantee or collateralization, the lender is not "receiving" interest

165. *See* Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 928 (Tex. 1984) (Barrow, J., dissenting). Justice Barrow, dissenting, in his analysis of intent, would require that there be usurious intent, if the loan is not usurious on its face. *Id.*

until he either collects, or attempts to collect, from the assuming borrower or gurarantor, or forecloses upon the additional collateral. The usury under these circumstances results from the parties' agreement that the borrower assume, guarantee or secure a third party's debt. Therefore, a court should hold that such an agreement represents "contracting for" usurious intererst. The mere execution of loan documents that include an *Alamo Lumber* assumption should not be usurious if there is a savings clause included therein.

On the other hand, if the lender requires that the borrower pay a third party's debt, then the lender has "received" usurious interest. In addition, if the lender, after obtaining a borrower's assumption, guaranty or collateral to secure a third party's debt, collects the third party's obligations from the borrower, the lender has received usurious interest. In such event, the lender may find it difficult to use a savings clause to defeat a usury claim.

Unfortunately, *Victoria Bank & Trust Co. v. Brady* is the only Texas case involving an *Alamo Lumber* claim where the lender raised a savings clause as a defense.[166] The court rejected the savings clause as a defense, stating that there was no evidence "that the boilerplate language found in the security agreement was ever in any way effectuated."[167] The court went on to state that "[t]he usurious interest was *charged*; therefore, usury occurred."[168] The court in *Victoria* incorrectly referred to Victoria's actions as the "charging" of usurious interest.[169] Although the facts are slightly more complicated, Fancher, by signing a note as co-maker, agreed to assume Brady's preexisting indebtedness to Winter Garden. As a result, Victoria contracted for usurious interest. Such a transaction would not be "charging" usurious interest because "charging" typically involves the unilateral act of

166. 779 S.W.2d 893, 901-02 (Tex. App.—Corpus Christi 1989, writ granted). See *supra* notes 61-89 and accompanying text for a discussion of *Victoria*.

167. *Id.*

168. *Id.* (emphasis added).

169. *Id.* The court cited *Danziger v. San Jacinto Savings Ass'n*, which held that the lender's payoff quote, reflecting interest greater than an amount allowed by law, was also a usurious charge of interest. *Danziger*, 732 S.W.2d at 304. The court in *Danziger* stated that "[t]he mere charging of excessive interest constitutes usury." *Id.* This statement was in the context of holding that the payoff quote was a usurious charge of interest and that it did not matter that the debtor never paid to the lender the amount charged. *Id. Danziger* does not involve an interpretation of whether a savings clause will prevent a charge of interest from being usurious. Therefore, the court in *Victoria* appears to have mistakenly relied on the language in *Danziger*.

the lender, such as demanding a usurious amount of interest or placing a debit on the borrower's account. Victoria did, however, collect $40,000 from Fancher towards the indebtedness assumed; therefore, Victoria actually collected or received amounts that the court held were usurious. Therefore, the court should have held that the usury savings clause prevented the assumption from being usurious. Once Victoria collected such interest from Fancher, the savings clause may be ineffective to prevent a usury claim as to the amount Victoria actually received from Fancher.[170]

B. *National Bank Act*

A national bank may take advantage of the provisions of the National Bank Act (the Act) in order to avoid or limit any penalties for committing usury. Section 85 of the Act provides that any association may charge interest at the greater of the rate allowed by law by the laws of the state where the bank is located or at a rate based upon the discount rate on 90-day commercial paper.[171] The Act also provides that if a bank knowingly takes, receives, reserves, or charges usurious interest, the bank shall forfeit the entire interest on the indebtedness.[172] If the borrower pays usurious interest, he may recover back twice the amount of the interest paid on the obligation.[173]

Therefore, in some instances, especially where there is "double usury" requiring forfeiture of principal, a national bank may be sub-

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170. This is because once a lender exacts usurious interest, he may not rely on a savings clause to avoid a usury claim. Nevels v. Harris, 129 Tex. 190, 198, 102 S.W.2d 1046, 1050 (1937). In addition, if the transaction were a "charging" of usurious interest, a savings clause may still defeat a usury claim. Woodcrest Assoc. Ltd. v. Commonwealth Mortgage Corp., 775 S.W.2d 434, 437 (Tex. App.—Dallas 1989, writ denied).

171. 12 U.S.C. § 85 (1988). The Act provides that

> [a]ny association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater . . . . *Id.*

172. *Id.* § 86. The Act provides that "[t]he taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of this title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon." *Id.*

173. *Id.* § 86 provides that "[i]n case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid from the association taking or receiving the same . . . ." *Id.*

ject to less severe penalties than under Texas usury laws. As previously noted, if a lender requires a borrower to pay, assume or provide security for a third party's obligations to the lender, as a condition for the making of a loan or the renewal of an existing loan, then, unless the lender otherwise attempts to collect from the borrower on the assumption, guaranty or collateral, the lender will not have received, and the borrower will not have paid, any interest on the loan. Thus, the lender's penalty under the Act would be limited to the interest contracted for on the loan, together with a penalty equal to twice the amount of excess interest actually paid on the loan. These penalties for a usurious transaction are significantly less than the Texas penalty of three times the usurious interest contracted for, charged or received and the possible forfeiture of principal.[174]

C. *Anti-Tying Provisions of the Bank Holding Company Act (BHCA) and the Thrift Institutions Restructuring Act (TIRA)*

Under the BHCA and the TIRA, national banks and thrift institutions are prohibited from conditioning an extension of credit on the customer providing the bank additional credit, property, or services other than that which is related to or usually provided in connection with a loan.[175] A borrower may recover damages for a violation of the anti-tying provisions and, if the customer can prove that the violation resulted in damage to the customer's business or property, treble damages.[176] Courts define an "extension of credit" subject to these provisions broadly to include offering to refinance or extend a loan and an agreement to forbear from collecting on a loan.[177]

The additional credit, property, or services must also be a non-traditional banking practice.[178] For example, a bank cannot require the borrower to purchase real estate from the lender as a condition to obtaining a loan to finance other real estate.[179] In *Nordic Bank PLC*

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174. See *supra* note 2 for a discussion of the statutory penalties under Texas law for usury violations.

175. 12 U.S.C. § 1972 (1988); 12 U.S.C.A. § 1464(q) (West Supp. 1990).

176. 12 U.S.C. § 1975 (1988); 12 U.S.C.A. § 1464(q)(3) (West Supp. 1990).

177. *See, e.g.*, AmeriFirst Properties, Inc. v. FDIC, 880 F.2d 821, 823-24 (5th Cir. 1989); Bruce v. First Fed. Sav. & Loan Ass'n, 837 F.2d 712, 718 (5th Cir. 1988).

178. 12 U.S.C. § 1975 (1988); 12 U.S.C.A. § 1464(q)(1) (West Supp. 1990).

179. Sharkey v. Security Bank & Trust Co., 651 F. Supp. 1231, 1233 (D. Minn. 1987).

v. Trend Group Ltd.,[180] the court stated that a lender's requirement that a borrower, in exchange for an extension of credit, guarantee several loans for which the borrower was not previously obligated constituted a proper claim under the BHCA.[181] Therefore, banks and savings and loan associations which are considering whether to require a borrower to pay, assume, guarantee, or provide additional collateral for a third party's indebtedness to the lender must, in addition to considering whether *Alamo Lumber* applies, consider whether the transaction would violate the BHCA or the TIRA. The existence or absence of an *Alamo Lumber* claim, however, does not preclude the possibility of an additional violation of the anti-tying statutes. Similarly, violation or compliance with the anti-tying statutes does not imply that the transaction is or is not usurious under *Alamo Lumber*.

D. *Application of* Alamo Lumber *in Failed Financial Institution Context*

In recent years, numerous banks and thrift institutions in Texas and throughout the United States have failed and have been placed into receivership or conservatorship under the control of the FDIC, FSLIC, and related governmental entities. Under established federal common law and statutory principles, so-called "federal superpower defenses" are available to the FDIC and its transferees. These superpower defenses could significantly affect the availability of an *Alamo Lumber* claim to a borrower from a failed institution.

1. 12 U.S.C. § 1823(e)

To the extent that a borrower's *Alamo Lumber* claim relies on unrecorded representations or side agreements made by officers or agents of a failed financial institution, such claims are unenforceable against the FDIC in either its corporate or receivership capacity under 12 U.S.C. § 1823(e). Section 1823(e) provides:

> [N]o agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement (1) is in writing, (2) was executed by the depository institution and any person claiming an adverse inter-

180. 619 F. Supp. 542 (S.D.N.Y. 1985).
181. *Id.* at 557.

> est thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution, (3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) has been, continuously, from the time of its execution, an official record of the depository institution.[182]

Thus, unless the borrower's *Alamo Lumber* usury claim is formally committed to writing and approved by the failed financial institution's Board of Directors or Loan Committee, the *Alamo Lumber* claim is unenforceable against the FDIC or related governmental entities.

2. The *D'Oench* Doctrine

Similarly, a borrower's *Alamo Lumber* claim based on alleged oral representations by the officers of a failed institution is unenforceable against a successor institution taking assets via purchase and assumption or other assignment from the FDIC. The holding of the United States Supreme Court in *D'Oench, Duhme & Co. v. FDIC*,[183] protects both the FDIC and its assignees from claims arising from unrecorded side agreements. In fact, 12 U.S.C. § 1823(e) is a codification of the Supreme Court's ruling in *D'Oench*. The Fifth Circuit has indicated that *D'Oench* is the common law counterpart to Section 1823(e).[184]

Under applicable *D'Oench* analysis, "secret" agreements are those which do not appear in the bank's records, and may constitute oral representations or misrepresentations made by bank officers to a borrower.[185] Further, the term "agreement" has been extended to cover the entire transaction between the parties.[186] The first element of the *D'Oench* doctrine is that the maker of a negotiable instrument or other financial obligation lend himself to a secret scheme or arrangement.[187] Borrowers have been held to have lent themselves to such a scheme or arrangement by (i) entering into an oral agreement that contradicts the express terms of the loan documents,[188] (ii) entering

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182. 12 U.S.C.A. § 1823(e) (West 1989); *see e.g.*, Langley v. FDIC, 484 U.S. 86, 92-93 (1987); Campbell Leasing v. FDIC, 901 F.2d 1244, 1248 (5th Cir. 1990); Bell & Murphy & Assoc. v. InterFirst Bank Gateway, N.A., 894 F.2d 750, 752-53 (5th Cir. 1990).

183. 315 U.S.447 (1942).

184. Beighley v. FDIC, 868 F.2d 776, 784 (5th Cir. 1989).

185. *Langley*, 484 U.S. at 92-93.

186. *Id.* at 90-92.

187. *D'Oench*, 315 U.S. at 460.

188. FDIC v. Cardinal Oil Well Serv. Co., 837 F.2d 1369, 1372 (5th Cir. 1988).

into an oral side agreement during a lending transaction,[189] (iii) executing a facially unqualified note that is subject to an unwritten or unrecorded condition upon its repayment,[190] and (iv) leaving an unrevoked guaranty with a bank.[191]

The second element of the *D'Oench* doctrine is that the secret scheme or arrangement has a tendency to deceive the banking authorities.[192] The case law that has developed since *D'Oench* has broadened its scope and applicability. The *D'Oench* doctrine now estops both makers and guarantors of promissory notes from asserting any defense arising out of a fraudulent scheme, including fraudulent representations made to the maker or guarantor.[193] Further, the *D'Oench* doctrine precludes both the assertion of certain defenses and the assertion of some type of "secret agreement" as the basis for an affirmative claim for relief.[194] It is also clear that the *D'Oench* doctrine is available to assignees from the FDIC.[195]

Therefore, unless a borrower from a failed financial institution is able to satisfy the requirements of *Alamo Lumber* through written documents approved by the failed institution's Board of Directors or Loan Committee, it would appear that any *Alamo Lumber* usury claim would be barred as a matter of law against either the FDIC or its assignees.

It should be noted that, even though the records of a failed bank may include a promissory note evidencing a loan to a borrower as well as a note or other instrument indicating the payment or assumption of a third party debt by that same borrower (presumably in another loan file), 12 U.S.C. § 1823(e) and the *D'Oench* doctrine would bar an *Alamo Lumber* usury claim unless written documentation contained in the records of the failed bank expressly demonstrates that the payment or assumption of the third party debt was a condition of

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189. FSLIC v. Lafayette Inv. Properties, Inc., 855 F.2d 196, 197-98 (5th Cir. 1988); FSLIC v. Murray, 853 F.2d 1251, 1255 (5th Cir. 1988).

190. Langley v. FDIC, 484 U.S. 86, 93 (1987); D'Oench, Duhme Co. v. FDIC, 315 U.S.447, 459-60 (1942).

191. *Cardinal Oil Well Serv.* , 832 F.2d at 1372.

192. *See Langley*, 484 U.S. at 92; *D'Oench*, 315 U.S. at 460.

193. *Langley*, 484 U.S. at 92-93; *Lafayette Inv. Properties, Inc.*, 855 F.2d at 198.

194. Kilpatrick v. Riddle, 907 F.2d 1523, 1526 (5th Cir. 1990); Beighley v. FDIC, 868 F.2d 776, 784 (5th Cir. 1989).

195. *Kilpatrick*, 907 F.2d at 1528; Porras v. Petroplex Sav. Ass'n, 903 F.2d 379, 381 (5th Cir. 1990); Campbell Leasing, Inc. v. FDIC, 901 F.2d 1244, 1248 (5th Cir. 1990).

the loan to the borrower. In *Beighley v. FDIC*,[196] the Fifth Circuit noted that the borrower had introduced into evidence numerous documents from the failed bank's official records, which documents made it possible to infer that the failed bank had agreed with the borrower to finance a creditworthy buyer to purchase certain properties.[197] Nonetheless, the court rejected the claimed agreement, observing that no written document stated the alleged financing agreement.[198] As a result, the alleged agreement was held to fall short of the requirements of 12 U.S.C. § 1823(e) and *D'Oench*.[199]

In the *Alamo Lumber* context, a borrower seeking to avoid *D'Oench* and/or 12 U.S.C. § 1823(e) must, therefore, produce records from the failed bank explicitly establishing that the borrower's payment or assumption of a third party debt was a condition of the extension or renewal of a loan to the borrower.

E. Potential Legislative Relief

The legal and practical difficulties of applying the rule of *Alamo Lumber* to cases in which a borrower is required to guarantee the debts of another have resulted in legislative proposals designed to clarify the usury picture. For example, House Bill 2498, a comprehensive usury bill introduced in the Texas legislature by Ashley Smith, includes provisions designed to eliminate the possibility that a borrower's guarantee of another's indebtedness would constitute interest on the borrower/guarantor's loan from the lender.[200] This bill essentially provides that the term "interest" would not, for purposes of Texas usury law, include a guaranty or any compensation received by the lender pursuant to a guaranty.[201]

The bill also defines "guaranty" broadly as an agreement whereby a person (i) assumes, guarantees or otherwise becomes liable for the obligations of another, (ii) provides security for such obligations or (iii)

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196. 868 F.2d 776 (5th Cir. 1989).

197. *Id.* at 782-83.

198. *Id.* at 783.

199. *Id.*; *accord* Bowen v. FDIC, 915 F.2d 1013, 1016-17 (5th Cir. 1990). The *Bowen* court stated:

> Simply put, transactions not reflected on the bank's books do not appear on the judicial radar screen either . . . . Unrecorded agreements—those rooted in the loose soil of casual transactions as much as those that spring from the malodorous loam of outright fraud—are a threat to the ecology of the banking system that we can ill-afford.

200. Tex. H.B. 2498, 72nd Leg. (1991).

201. *Id.* § 10, art. 5069-1.15.

agrees to purchase such obligation or property constituting security for such obligations.[202] This bill would have the effect of eliminating most *Alamo Lumber* concerns for lenders in commercial transactions. The bill, if passed, would become effective on September 1, 1991, and would apply to any loan of money or other extension of credit made or extended before, on or after the effective date, excluding transactions as to which litigation was filed prior to the effective date.[203] As of April 15, 1991, the bill has been favorably reported on by the committee reviewing its provisions. The House, however, has not otherwise taken any action on the bill.

VI. CONCLUSION

As a result of the holding in *Alamo Lumber*, and the resulting interpretations and extensions thereof, lenders in Texas must carefully examine the terms of potential transactions with their borrowers. A lender that requires a borrower to assume a third party's debt as a condition to a loan, or the renewal, extension, or modification of a loan, may be subject to severe penalties under the *Alamo Lumber* doctrine. In addition, a lender must also consider the risks of requiring that a borrower must, as a condition to an extension of credit, guarantee, or provide security for, a third party's indebtedness. The holding in *Victoria* evidences the harsh penalties a lender may face in an *Alamo Lumber* situation. *Victoria* also reveals a willingness on the part of Texas courts to expand the case law interpreting Texas usury laws to "protect" borrowers from usury. In many instances, the facts of a transaction will meet the particular requirements of an *Alamo Lumber* claim. Nevertheless, such transactions may not result in an economic detriment to the borrower, nor do they provide an economic benefit to the lender. In such cases, it will be critical for the lender to convince the court to look to the substance of the transaction and the purpose of Texas usury laws in order to reach the proper result.

In a development which occurred just as this article was going to press, a Texas Court of Appeals clarified the issue of whether or not *Alamo Lumber* applies to a guaranty. In *Bank of El Paso v. T.O. Stanley Boot Co.*, No. 08-90-00048-CV (Tex. App.—El Paso, April

202. *Id.* § 1, art. 5069-1.01(g).
203. *Id.* § 15.

24, 1991, n.w.h.), the El Paso Court of Appeals refused to apply *Alamo Lumber* to a guaranty. The court stated that *Alamo Lumber* is applicable only when a lender requires a borrower to *pay* or *assume* a third party's indebtedness as a condition to an extension of credit. The court further stated that usury is a defense available only to the obligor on a note and not to a guarantor.