GENERAL LITIGATION TRENDS

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39th Annual TBA Legal Conference
April 4-5, 2013
San Antonio, Texas

Biographical Information

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Ed Harrell is a trial lawyer whose primary focus for the past 30 years has been complex litigation, including commercial disputes, consumer and commercial lending, financial institutions, debt collection practices, and deceptive trade practices. Mr. Harrell has defended numerous class actions, including consumer fraud, debt collection, consumer finance, employment discrimination, and breach of warranty. Mr. Harrell has tried more than sixty jury cases to verdict and handled numerous appeals in the same areas.

Mr. Harrell received his law degree from University of Houston in 1977 and his B.A. in Economics from Texas Tech University in 1973. He is licensed to practice in all Federal District Courts in Texas as well as the Fifth, Ninth and Tenth U.S. Circuit Courts of Appeal and the U.S. Court of Claims.

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David maintains an active trial and appellate practice for the financial services industry. David is the primary author of www.FinancialAppellateVoice.com, a blog that routinely reports on lending and fiduciary issues facing financial industry clients.

David's financial institution experience includes (but is not limited to): breach of contract, special servicer litigation, foreclosure litigation, lender liability, receivership and injunction remedies upon default, non-recourse and other real estate lending, class action, RICO actions, usury, various tort causes of action, breach of fiduciary duty claims, and preference and other related claims raised by receivers. David has also specialized in estate and trust disputes including will contests, mental competency issues, undue influence, trust modification/clarification, breach of fiduciary duty and related claims, and accountings.

David is one of twenty attorneys in the state (of the 84,000 licensed) that has the triple Board Certification in Civil Trial Law, Civil Appellate and Personal Injury Trial Law by the Texas Board of Legal Specialization. Additionally, David is a member of the Civil Trial Law Commission of the Texas Board of Legal Specialization. This commission writes and grades the exam for new applicants for civil trial law certification.

David is a graduate of Baylor University School Of Law, *Magna Cum Laude*, and Baylor University, B.B.A. in Accounting.

David has published over twenty (20) law review articles on various litigation topics. David's articles have been cited as authority by federal courts, the Texas Supreme Court (Three Times), the Texas courts of appeals located in Waco, Texarkana, Tyler, Beaumont, and Houston, and cited by McDonald and Carlson in their Texas Civil Practice treatise and William V. Dorsaneo in the Texas Litigation Guide and in the Baylor Law Review, South Texas Law Review, and the Tennessee Law Review. David has presented and/or prepared written materials for over seventy-five (75) continuing legal education courses.

Texas Monthly, Fort Worth Texas Magazine, and D Magazine routinely name David a top attorney in Texas.

I. Introduction

Credit extenders or credit owners remain under attack on many fronts. Borrower suits attacking the right of a lender or its servicer to foreclose or sue on the underlying debt exist by the droves. Many of these actions are brought by borrowers acting "pro se" utilizing Internet "suit templates" seeking to forestall foreclosure. Other borrowers, often represented by counsel, are suing back when sued on the debt or for judicial foreclosure. This article is meant to be a primer on several financial institution litigation issues that the courts are addressing.

II. Borrower Attacks On Pooling And Servicing Agreements Are Routinely Rejected For Lack Of Standing

For some time, home mortgages have been routinely placed in mortgage securitizations. In securitizations, mortgage loans are "pooled," transferred to a securitization trust under a multi-party agreement commonly called a Pooling and Servicing Agreement ("PSA"), and interests in the trust or mortgages sold to investors on the open market. Borrowers under the mortgages are not parties to PSAs.

Courts generally find that borrowers lack standing to bring a claim for breach or "violation" of a PSA or challenge the validity of a loan securitization because they are not parties to it. Several courts hold that a mortgagor whose loan is securitized in a PSA does not have standing to claim breach of the PSA against a trustee of a securitized mortgage trust, the mortgage servicer, or the originating mortgage lender. *See, e.g., Bittinger v. Wells Fargo Bank, N.A.*, 744 F. Supp. 2d 619 (S.D. Tex. 2010); *see also e.g. Herrera v. Wells Fargo* Bank, 2013 WL 961511 (S.D. Tex. March 12, 2013); *In re Walker*, 2012 WL 443014, at *9-10 (E.D. Pa. 2012); *In re Washington*, 2011 WL 6010247 (W.D. Mo. 2011); *In re Smoak*, 461 B.R. 510 (S.D. Ohio 2011).

Under Texas law, specific standing requirements must be satisfied for a plaintiff to maintain suit. A party has standing to sue only if he or she is personally aggrieved by the alleged wrong. *See Nootsie, Ltd. v. Williamson Cnty. Appraisal Dist.*, 925 S.W.2d 659, 661 (Tex. 1996). For standing, there must be (1) a real controversy between the parties, which (2) will actually be determined by the suit. *See Tex. Workers' Comp. Comm'n v. Garcia*, 893 S.W.2d 504, 517-18 (Tex. 1995). A party to a contract may sue for its breach. *See Serv. Emp. Redevelopment v. Fort Worth Indep. Sch. Dist.*, 163 S.W.3d 142, 148 (Tex. App.—Fort Worth 2005, pet. filed). A third-party beneficiary may enforce a contract to which it is not a party if the parties to the contract intended to secure a benefit to that third-party and entered into the contract directly for the third-party's benefit. *See In re Palm Harbor Homes, Inc*., 195 S.W.3d 672, 677 (Tex. 2006); *MCI Telecomm. Corp. v. Tex. Utilities Elec. Co.*, 995 S.W.2d 647, 651 (Tex. 1999). A borrower is neither a party to a PSA nor a beneficiary under it.

In *Bittinger v. Wells Fargo Bank, N.A*, borrower sued alleging breach of a PSA. *See Bittinger*, at 625-26. His claims were rejected because he was not a party to the agreement and did not become a party, agent, or assignee of a party, or a third-party beneficiary of the agreement merely because his loan was pooled with other loans and sold or transferred under the agreement. *See id*. Thus, the borrower lacked standing and had "no ability under Texas law to sue for breach of th[e] contract." *Id*.

Borrower assertions that choice of law provisions in a PSA govern enforcement of a note and deed of trust also finds little traction. Borrowers argue that a PSA choice of law provision "makes" their mortgage controlled by that state's law. This flawed theory often leads to confusion and delay in adjudication. Because the PSA only governs the agreement of the parties to the PSA and *not the enforcement* of the mortgage securitized under the PSA, those provisions

do not provide the law for determining validity or enforceability of the mortgage. Determination whether a lien creates an interest in land and the nature of that interest are governed by the law of the state where the real estate is located.[1] Courts apply the law of the land where the real estate is located in determining the extent and validity of a lien on real property. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 230(2) (1971). "[C]onflict of law rules dictate that the law of the situs of the secure property governs foreclosure procedures applicable to the real estate within the state regardless of any choice of law provision in the contract evidencing the underlying debt." *Hibernia Nat'l Bank v. Sones*, 105 F.3d 653, 654 (5th Cir. 1996), *see also Resolution Trust Corp. v. Atchity*, 913 P.2d 162, 172 (1996) ("[T]he substantive as well as procedural law of the situs applies to a mortgage foreclosure.").

Even if a PSA is purportedly violated, the securitization trustee or the designated holder of the note is vested with the right to enforce the notes and liens and alleged noncompliance with the PSA does not affect that authority. *See* TEX. BUS. & COM. CODE ANN. §§ 1.201(5), 3.205(b) (West 2005); *In re Smoak*, 461 B.R. at 519. Further, a PSA does not eliminate the rights of an owner or holder under the Uniform Commercial Code to enforce a mortgage note. *See In re Smoak*, 461 B.R. at 519. If the source of a holder's right to payment is a negotiable instrument, alleged noncompliance with a PSA does not affect a borrower's obligations under the note. *See In re Walker*, 2012 WL 443014, at *10 (E.D. Pa. 2012).

In *Smoak*, the borrower argued the trustee lacked standing to enforce the mortgage note because the PSA terms were breached. *See Smoak*, 461 B.R. at 519. The court rejected this argument and held a PSA does not alter a holder's rights (whether trustee, lender, or servicer)

[1] *See* Restatement (Second) of Conflict of Laws § 230(1) (1971). Comment a. to section § 230 notes that the rules apply to questions relating to the creation and extent of the lien, its transfer, its foreclosure, its discharge and the redemption of the land from it.

under the UCC. *See id*. Borrowers, as makers of the notes, are also not third-party beneficiaries to the PSA and, therefore, lack standing to assert a purported violation. *See Id*. (citing *In re Almeida*, 417 B.R. 140, 149 n. 4 (D. Mass. 2009)).

III. No Standing to Attack Assignments

In *Thomas v. Wells Fargo Bank, N.A.*, a borrower argued the assignment to a securitization trust was invalid. 2012 WL 3764729, at *8 (Ala. Civ. App. 2012). The court rejected the argument and held that even if the assignment violated the PSA and gave rise to unfavorable tax, regulatory, contractual, and tort consequences, neither the PSA nor those consequences rendered the assignment invalid. *See Thomas*, 2012 WL 3764729, at *8. The court confirmed a PSA violation does not affect the trustee's right to enforce the note. *See id*. at *6. Texas federal courts also have rejected similar attacks on assignments of notes or liens for lack of standing. *See Herrera v. Wells Fargo Bank, supra*, at 8 (collecting authorities).

IV. Litigation Avoidance – Waivers or Releases of Constitutional Claims Respecting Home Equity Loans

It is believed that borrowers may contractually and effectively release or waive Texas home equity loan[2] claims but, to date, no appellate case has addressed the issue.[3] Waiver is essentially unilateral in its character; it results as a legal consequence from some act or conduct of the party against whom it operates; no act of the party in whose favor it is made is necessary to complete it. *See Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396, 401 (Tex. 1967). It need not be founded on a new agreement or be supported by consideration, nor is it essential that it be based on an estoppel. *See id.*

[2] The provisions for making home equity loans are found at TEX. CONST. ART. XVI § 50(a)(6).
[3] Other laws that could affect contractual waivers or releases, *e.g.* CFPB, are beyond this paper.

Case authorities have upheld waivers of constitutional claims. *See Dillee v. Sisters of Charity of Incarnate Word Health Care Sys., Houston, Tex.*, 912 S.W.2d 307, 309 (Tex. App.—Houston [14th Dist.] 1995, no pet.) ["Constitutional rights may also be waived contractually if done so voluntarily, intelligently, knowingly, *i.e.* with full awareness of the legal consequence," *citing D.H. Overmyer Co., Inc. v. Frick Co.*, 405 U.S. 174, 187, 92 S.Ct. 775, 783, 31 L.Ed.2d 124 (1972)]. However, depending on the facts of a particular case, a waiver or release may not be enforceable if the contract is one of adhesion, there is great disparity in bargaining power, or a party receives nothing in return for the waiver. *See id*.

Further, may a borrower be required, as a condition of a forbearance agreement or loan modification, to contractually waive or release constitutional claims, *e.g.*, by admitting the loan balance, agreeing that there are no defenses, offsets or counterclaims to enforceability or expressly waiving and releasing constitutional claims?

It is believed that the answer should be yes for the reasons above. This, too, is untested by appellate authority for home equity loans. Regardless, prudent practice teaches that equitable subrogation should be pleaded to limit a lender's potential loss to the extent that a preexisting constitutionally valid lien on the property was paid at closing of the home equity loan. *See LaSalle Bank Nat'l Ass'n v. White*, 246 S.W.3d 616 (Tex. 2007).

V. Four-Year Statute of Limitations is Applied to Texas Home Equity Claims

A few weeks ago, the Fifth Circuit held that the residual four-year statute of limitations period applies to alleged constitutional violations of the Home Equity Amendment. *See Priester v. JP Morgan Chase Bank, N.A.*, 2013 WL 539048, at *4 (5th Cir. 2013). The opinion also instructs that the claim accrues when "facts come into existence that authorize a claimant to seek a judicial remedy." *Id*. The "legal injury rule" applies to the creation of unconstitutional liens,

which provides that accrual begins "when a wrongful act causes a legal injury, regardless of when the plaintiff learns of that injury or if all resulting damages have yet to occur." *Id*. The Fifth Circuit found that the legal injury occurs when the lender makes a loan violating the Texas Constitution. *See id*. (citing *Rivera v. Countrywide Home Loans, Inc.*, 262 S.W.3d 834, 839 (Tex. App.—Dallas 2008, no pet.). The opinion explained that limitations periods exist to preserve evidence and create settled expectations and would be nullified if parties are allowed to wait many years to demand cure or sue. *Id*. at 5. The limitations period is calculated from the date of closing on the loan. *Id*. at *4-5 *citing Boutari v. JP Morgan Chase Bank, N.A.*, 429 Fed. App'x. 407 (5th Cir. 2011) and *Schanzle v. JPMC Special Mortg. LLC*, 2011 WL 832170, at *4 (Tex. App.—Austin 2011). Home equity claims are therefore barred four years after closing.

In addition to the limitations holding, *Priester* also discussed other important and relevant issues to mortgage litigation. The Court noted that, the mere failure to disclose a cause of action or mere concealment of a cause of action, when the defendant [*i.e.*, lender] owes no duty to disclose, is not fraudulent concealment. *Id*. at 6 (citing *DiGrazia v. Old*, 900 S.W.2d 499, 503 (Tex. App.—Texarkana, 1995, no writ). The opinion reaffirms that a lender does not owe extra-contractual common law duties beyond a loan agreement, and a mortgagor-mortgagee relationship does not include fiduciary duties or fiduciary relationships. *See id*.[4] Finally, it was held that home equity borrowers' damage claims for defamation or credit libel (including actual damages, exemplary damages, or attorney's fees) are derivative claims. In other words, no

[4]It should be also noted that there is no duty of good faith or fair dealing between a lender and borrower. *See Hall v. Resolution Trust Corp.*, 958 F.2d 75, 79 (5th Cir. 1992) (internal quote and citations omitted). *See also FDIC v. Coleman*, 795 S.W.2d 706, 708–09 (Tex.1990) ("The relationship of mortgagor and mortgagee ordinarily does not involve a duty of good faith."); *Lovell v. W. Nat. Life Ins. Co.*, 754 S.W.2d 298, 303 (Tex.App.—Amarillo 1988, writ denied) ("We conclude there exists no special relationship between [mortgagor and mortgagee] and, therefore, no duty of good faith and fair dealing is implied.").

recovery is permitted for borrowers unless the home equity loan is found unconstitutional or void. *See id.* To the extent that the home equity loan is determined to be valid, defamation claims or claims based on collection efforts should be summarily dismissed or alternatively, adjudicated in favor of the lender under *Priester*.

VI. Arbitration Clause In Trust Document May Not Be Enforceable

Arbitration has become a very common method of resolving disputes in today's society. Though there are certainly drawbacks to arbitration, it has at least one advantage over normal litigation in our courts: confidentiality. Accordingly, individuals who create trusts may want to keep any future disputes related to the trust confidential and may want to insert an arbitration clause into a trust document. Is that provision valid and enforceable?

In *Rachal v. Reitz*, a beneficiary sued a trustee for failing to provide an accounting and otherwise breaching fiduciary duties. 347 S.W.3d 305 (Tex. App.—Dallas 2011, pet. granted). The trustee filed a motion to compel arbitration of those claims due to an arbitration provision in the trust instrument. After the trial court denied that motion, the trustee appealed. The court of appeals affirmed. The court held that arbitration is a matter of contract law, and that the trustee had the burden to establish the existence of an enforceable arbitration agreement. The court noted that it was undisputed that neither the trustee or the beneficiary signed the trust document, and that the trust document solely expresses the settlor's intent. The court noted: "Rachal did not establish how the settlor's expression of intent satisfied all of the required elements of a contract or how this expression of the settlor's intent transformed the trust provision into an agreement to arbitrate between Rachal and Reitz." *Id.* at 309-10. Moreover, whether a provision stating the settlor's intent that disputes involving the trust be resolved by arbitration is enforceable as in a contract was an issue of first impression in Texas. The court of appeals noted that only two jurisdictions in the country have considered a similar issue, and both had concluded that a trust is

not a contract and that a beneficiary of a trust cannot be compelled to arbitrate disputes arising under the trust.

There was a dissenting justice who would have ruled that the clause was enforceable. One issue that the dissenting justice had was that the beneficiary may be equitably estopped to deny the effectiveness of the arbitration clause where the beneficiary benefitted from the trust document for years.

The Texas Supreme Court has granted trustee's petition for review, and the Court heard oral argument in this case in November of 2012. The Court has yet to rule on whether the court of appeals correctly determined that an arbitration clause in a trust instrument is not enforceable.

VII. Standing of a Special Servicer To Prosecute Claims

Banks may pool assets together and appoint a trustee to oversee the pool. Under an assignment document, the trustee will have standing to assert claims in the pool. *See Martin v. New Century Mortg. Co.*, 377 S.W.3d 79 (Tex. App.—Houston [1st Dist.] 2012, no writ).

Further, the trustee may hire a special servicer to assert rights under particular documents. The right of the special servicer to do so may also become an issue. For example, in *ECF North Ridge Assocs., L.P. v. ORIX Capital Markets, L.L.C.*, the court of appeals held that a servicer had standing to assert claims under a mortgage and a pooling and servicing agreement ("PSA"). 336 S.W.3d 400, 405-06 (Tex. App.—Dallas Dec. 20, 2010, pet. denied). A servicer filed suit to collect under a commercial mortgage agreement. The defendant asserted that the servicer did not have standing to assert the claim. The trial court found for the servicer and awarded amounts due and owing.

The court of appeals held that a loan servicer on behalf of a loan pool's trustee had standing to bring suit in its own name under the language of the PSA between it and the trustee,

which conferred broad powers on the servicer. The PSA gave the servicer "full power and authority, acting alone, to do or cause to be done any and all things in connection with such servicing and administration which it may deem necessary or desirable." *See id.* The PSA also provided that "without the trustee's written consent[, the servicer shall not,] except as related to a Mortgage Loan which [the servicer] . . . is servicing pursuant to its respective duties herein . . . initiate any action, suit or proceeding solely under the Trustee's name without indicating [the servicer's] representative capacity . . . ." *Id.* The court of appeals noted that the italicized "except" indicated that the servicer could sue in the trustee's name or in its own name if the suit relates to a loan that it is servicing. Based on this language, the court concluded that the servicer had standing to bring claims against the borrower either in its own name or as a special servicer.

The court also addressed the argument that "[i]n order to establish standing to maintain a breach of contract action, a plaintiff must show either third-party beneficiary status or privity." *Id.* at 405-06, n. 2. The court held that "[r]eviewing these cases, we conclude they do not control the current circumstances in which a pooling and servicing agreement specifically gives the servicer the right and responsibility to institute suit against a borrower either in its own name or on behalf of the trustee." *Id.*

Similarly, in *ORIX Capital Markets, LLC v. La Villita Motor Inns, J.V.*, the court concluded the record contained sufficient evidence ORIX Capital Markets had proven its right to enforce a note as the current "special servicer" and pursuant to a servicing agreement containing language similar to the PSA. 329 S.W.3d 30 (Tex. App.—San Antonio 2010, pet. abated)

There are similar holdings in federal courts. In *LaSalle Bank NA v. Lehman Brothers Holdings, Inc.*, there was a dispute over whether the trustee of a securitized trust had capacity to bring claims or whether the servicer of the trust was the sole authorized person to do so. 237

F.Supp.2d 618, 631-34 (D. Md. 2002). The federal district court held that both the trustee and the servicer had capacity to sue: "That [the servicer] and [the trustee] each have the authority to institute suit does not negate the right of [the trustee] to so act." *Id. See also CWCapital Asset Mgmt., LLC v. Chicago Props., LLC*, 610 F.3d 497 (7th Cir. 2010); *Strouse Greenberg Props. VI L.P. v. CW Capital Asset Mgmt. LLC*, 442 F. Supp. 2d 313 (E.D. La. 2006) (special servicer for trustee received preliminary injunction in court on behalf of trust); *In re Tainan*, 48 B.R. 250 (E.D. Pa. 1985) (concluding that a servicing agent is a real party in interest in seeking relief from the automatic stay).

VIII. Credit Reporting Claims After Debtor's Bankruptcy

Because financial institutions regular report to various credit agencies, consumers often file defamation claims based on this reporting. In asserting defamation under Texas law, a plaintiff must allege that a defendant: (1) published a statement; (2) that was defamatory concerning the plaintiff; and (3) while acting negligently with regard to the truth of the statement. *See Nasti v. CIBA Specialty Chemicals Corp.*, 492 F.3d 589, 595-96 (5th Cir. 2007) (citing *WFAA-TV, Inc. v. McLemore*, 978 S.W.2d 568, 571 (Tex.1998)). *See also Visconti v. Bank of Am.*, No. 4:10cv532, 2012 U.S. Dist. LEXIS 140603 (E.D. Tex. Sept. 28, 2012); *Crouch v. J.C. Penney Corp., Inc.*, 564 F. Supp.2d 642, 646 (E.D. Tex. 2008).

Libel in Texas is "a defamation expressed in written [form] . . . that tends to injure a living person's reputation and thereby expose the person to public hatred, contempt or ridicule, or financial injury or to impeach any person's honesty, integrity, virtue, or reputation." TEX. CIV. PRAC. & REM. CODE § 73.001. "In both libel and slander the issues are whether the utterance was made, if it was false, if it damaged the complainant and if the speaker had any privilege." *Peshak v. Greer*, 13 S.W.3d 421, 426 (Tex. App.—Corpus Christi 2000, no pet.). The truth of a

statement is "a complete defense to defamation." *Randall's Food Mkts., Inc. v. Johnson*, 891 S.W.2d 640, 646 (Tex. 1995).

Moreover, the Fair Credit Reporting Act ("FCRA") preempts state law defamation claims unless the customer proves "malice or willful intent to injure" the customer. *See* 15 U.S.C. § 1681h(e); *Young v. Equifax Credit Information Serv., Inc.*, 294 F.3d 631, 638 (5th Cir. 2002). "Malice" for purposes of FCRA preemption requires proof that the defendant made the statements to a credit reporting agency "knowing the statements were false or with a reckless disregard of whether they were false." *See Morris v. Equifax Info. Servs., LLC*, 457 F.3d 460, 471 (5th Cir. 2006); *Meisel v. USA Shade and Fabric Structures Inc*., 795 F. Supp. 2d 481, 488 (N.D. Tex. 2011). For example, in *O'Dea v. Wells Fargo Home Mortgage*, a borrower sued for defamation due to the lender reporting that the borrower was delinquent on its debt. 2013 U.S. Dist. LEXIS 15713 (S.D. Tex. February 5, 2013). The court held that the plaintiff had to prove malice. Because the plaintiff did not do so, the court affirmed judgment for the lender.

In *Priester v. JPMorgan Chase Bank, N.A.*, homeowners sued for declaratory relief against their lender claiming that the lien on their home was void under the Texas Constitution. No. 12-40032, 2013 U.S. App. LEXIS 3097 (5th Cir. February 13, 2013). The court held that the plaintiff's claim was barred by limitations. The plaintiff had also raised defamation claim based on the lender's reporting to credit agencies that the borrower was in default. The plaintiff alleged that as the lien was invalid, the defendant's statements were defamatory. The court disagreed: "The key issue here is the truth of defendants' statements. The alleged defamatory statements were contained in a report to credit agencies that stated that the Priesters were delinquent on their loan payments. Because the loan was valid, and the Priesters were delinquent, the statements to these effects were true, and so no defamation occurred." *Id*. at *21. *See also*

Meisel v. U.S. Bank, No. 05-11-01336-CV, 2013 Tex. App. LEXIS 1740 (Tex. App.—Dallas February 21, 2013, no pet. history) (bank was not liable for defamation via an alleged false credit report where report was technically true).

One area where defamation claims often arise is where the borrower files for bankruptcy, obtains a discharge, and the lender either fails to update a credit report or actively continues to report the debt as active and in default. Under the Fair Credit Reporting Act, Title 515 U.S.C. § 1681s-2(a), it imposes upon lenders a duty to provide accurate information. The section states: "A person shall not furnish any information relating to a consumer to any consumer reporting agency if the person knows or has reasonable cause to believe that the information is inaccurate." 15 U.S.C. § 1681s-2(a)(1)(A). In addition, the Act imposes a duty to correct and update information. *See id*. at § 1681s-2(a)(2). However, liability for any violations does not result until a CRA reports an inaccuracy and the furnisher fails to correct the error. *See, e.g., Davis v. Farm Bureau Bank*, 2008 U.S. Dist. LEXIS 52241 (W.D. Tex. Apr. 30, 2008). In *Davis*, the court affirmed a judgment for the lender where the debtor failed to show that the credit reporting agency ever notified the lender of a dispute. *See id*.

In *In re Luedtke*, the court held that the lender violated the bankruptcy court's confirmation order by affirmatively reporting to the credit agencies that the debtor was in default. No. 02-35082-svk, 2008 Bankr. LEXIS 2118 (Bankr. E.D. Wis. July 31, 2008). The court held: "the confirmation order should not have to tell a creditor whose claim has been reduced or payment stream altered to report the correct amount and payment history to the CRAs; the creditor is bound by the confirmed plan to the new provisions, and if the creditor is going to report at all, the creditor should report the pendency of the bankruptcy or the history of the payments under the plan." *Id.*

In *Barton v. Ocwen Loan Servicing LLC*, the court held that a plaintiff had stated a claim for defamation. 2012 U.S. Dist. LEXIS 137536 (D. Minn. Sept. 26, 2012). The court stated:

> The parties do not dispute that Plaintiff filed for bankruptcy in October 2008, and that a discharge order was issued in January 2009. Yet, her credit report shows that the first mortgage was included in the bankruptcy, and that the second mortgage was overdue - even though the second mortgage appears to have been included in the bankruptcy. Plaintiff alleges that Defendants misrepresented to the credit reporting agency that the second mortgage is due and owing, even though it appears to have been discharged in bankruptcy. Based on these allegations, the Court finds that Plaintiff has sufficiently alleged a credit defamation claim against both Defendants.

Id. *See also Helmes v. Wachovia Bank (In re Helmes*), 2005 Bankr. LEXIS 1182 (Bankr. E.D. Va. June 8, 2005).

In *Kreeger v. U.S. Bank (In re Kreeger),* the Kreegers sought to retain their home by making post-petition payments without reaffirming the debt, but fell behind in those payments. 2001 Bankr. LEXIS 2193, Adversary Proceeding 7-00-00155-WSA, (Bankr. W.D.Va, September 5, 2001). The court found that the creditor made a truthful statement to a credit bureau when it reported the post-discharge status of a discharged secured debt that remained secured post-discharged.

In the end, a lender can be liable for misrepresenting to a credit agency that a borrower still owes a debt that he or she does not. But the lender should not be liable for truthful statements.

IX. Texas Supreme Court Opens Door To A Financial Institution's Potential Liability For Failing To Set Up Account

The Texas Supreme Court issued an opinion that opens the door to customers' claims against banks failing to properly create an account with rights of survivorship language. Historically in Texas, a customer, who allegedly was a party to a joint tenancy account with rights of survivorship ("JTROS"), could not sue a bank for the funds in the joint account without

tendering a valid written bank agreement with the appropriate language contained therein. *Stauffer v. Henderson* is the leading case on interpreting JTROS accounts. 801 S.W.2d 858 (Tex. 1990). In that case, the Texas Supreme Court held that language on a signature card did not create rights of survivorship and noted that under Texas Probate Code section 439(a), the Texas Legislature made a written agreement necessary to create a JTROS account. *See id.* The Court held that "the necessity of a written agreement signed by the decedent to create a right of survivorship in a joint account is emphatic...." *Id.* at 862-63. Furthermore, the Court found that a party could not introduce parol evidence, documents and oral communications before the account agreement was created, in an attempt to prove that the account was intended to be a JTROS account. Numerous Texas courts of appeals have applied this rather black-and-white rule to bar claims as to the ownership of funds in an account.

A. *A.G. Edwards* Opinion – A Customer May Sue For Not Properly Creating A JTROS Account

In *A.G. Edwards & Sons Inc. v. Maria Alicia Beyer*, the Texas Supreme Court held that a customer can potentially raise a claim against a financial institution for failing to create a JTROS account. 235 S.W.3d 704 (Tex. 2007). The plaintiff was a daughter of a man who attempted to transfer the funds in a previous account into a new JTROS account with A.G. *See id*. Edwards ("Bank"). The daughter and father discussed the creation of a JTROS account with a Bank representative. *See id*. After the representative recommended that they create a new JTROS account, the daughter and father delivered all of the documentation necessary to create such an account. *See id*. However, the Bank lost the documentation and before new documents could be signed, the father fell into a coma and later died. *See id*. The Bank paid the funds, which it held in an older account that was not a JTROS account, to the father's estate. *See id*. The daughter sued the Bank for conversion, negligence, fraud, breach of contract, and breach of fiduciary duty.

The jury found for the daughter and awarded her damages and attorney's fees, and the Bank appealed. *See id.*

In the Texas Supreme Court, the principal issue was whether Texas Probate Code section 439(a) barred extrinsic evidence regarding the creation of a JTROS account. *See id.* The daughter argued that section 439(a) only applied to multiple party disputes as to the ownership of the funds in a JTROS account and did not apply to disputes alleging a bank's malfeasance in failing to properly set up such an account. *See id.* The Texas Supreme Court agreed with the daughter: "Section 439(a) does not govern [the daughter's] claim against [the bank]. [The Bank's] failure to take sufficient steps to create the JTWROS account necessary to establish [the daughter's] right of survivorship is a breach of a separate duty owed to [the daughter]." *Id.* The Court did not specify what "duty" it was referring to, but allowed extrinsic evidence of the bank's failure to create the account. *See id.*

The Court found that the evidence was sufficient to establish that the Bank had promised to create a JTROS account but failed to do so. *See id.* The Court then limited its prior Stauffer opinion to "ownership disputes over a joint account" and held that it did not apply to claims against a bank for failing to create a JTROS account. *Id.*

B. Courts Of Appeals' Application Of *A.G. Edwards*

In *Clark v. Wells Fargo Bank, N.A.*, the court of appeals held that a bank did not tortiously interfere with inheritance rights or act with negligence with respect to CDs. No. 01-08-00887–CV, 2010 Tex. App. LEXIS 4376 (Tex. App.—Houston [1st District] June 10, 2010, no pet.). In this case, in the 1990s, Parker Williams purchased six CDs that totaled over $1.2 million and were marked as multi-party accounts with rights of survivorship. *See id.* These CDs listed multiple parties with rights of ownership. *See id.* In July 2004, the defendant informed

Williams that the CDs were not fully covered by FDIC insurance. *See id.* Williams then purchased six new fully insured CDs that were set up in her name only and did not have any right of survivorship language on the account agreements. *See id.*

Williams then died intestate approximately one month later. *See id.* The plaintiffs were not Williams's heirs under the laws of intestate succession and would not receive any of the funds from the new CDs. *See id.* The plaintiffs filed claims for tortious interference with inheritance rights and negligence against the defendant bank. The trial court granted the defendant bank a summary judgment. *See id.*

The court of appeals first held that under Texas Probate Code Section 448, the plaintiffs had no claim regarding Williams cashing in the original CDs. *See id.* Texas Probate Code Section 448 provides that "payments made from a multi-party account to one or more of the individuals listed on the account discharges the financial institution from all claims for amounts so paid whether or not the payment is consistent with the beneficial ownership of the account as between the parties." TEX. PROB. CODE ANN. § 448. The appellate court held that the bank was discharged from claims for the payment it made to Parker as a joint owner when it closed the original CDs: "To the extent that any of claimants' causes of action relate to those original CDs or to actions taken before the original CDs were closed, those claims are ruled by Section 448." *Clark,* 2010 Tex. App. LEXIS 4376 at *12-13. The court then turned to the plaintiffs' tort claims based on the bank's actions that occurred after the original CDs were closed. *See id.*

The court acknowledged that a claimant can have a tortious interference with an inheritance claim: "[o]ne who by fraud, duress or other tortious means intentionally prevents another from receiving from a third person an inheritance or gift that he would otherwise have received is subject to liability to the other for loss of the inheritance or gift." *Id.* at *14. The

court held that in order to have this cause of action the claimant must present some evidence that he or she would in fact inherit or receive the property at issue but for the interference. *See id*. The court held that the plaintiffs did not provide any evidence that they actually had an interest in the new CDs such that they could sustain a cause of action for tortious interference. *See id*. The court also held that the claimants provided no evidence that Wells Fargo acted with intentional tortious conduct. *See id*. The court therefore sustained the summary judgment on the tortious interference with inheritance claim. *See id*.

The plaintiffs also claimed that the bank was negligent when it failed to take sufficient steps to protect their inheritance rights when it opened the new CDs. *See id*. The court held that the plaintiffs did not establish that the bank owed them a duty: "Claimants' pleadings reveal that all of the actions for which Claimants seek to recover on their negligence cause of action were directed at Parker Williams and related to the duties the bank owed to Williams." *Id*. at *17. The court concluded that there was no evidence that the bank owed any duties to the plaintiffs. *See id*.

The court distinguished *A.G. Edwards & Sons v. Beyer*, 235 S.W.3d 704 (Tex. 2007). The court noted that in *A.G. Edwards & Sons*, the father and daughter both sought to open a joint account and both signed the account agreement with right of survivorship. "The context of the language in the opinion makes it clear that the Court was referring to the duties arising out of the contract signed by Alicia and her father." *Clark*, 2010 Tex. App. LEXIS 4376 at *18. In contrast, the court held that the claimants did not have any contractual relationship with the bank: "There is no evidence that they ever participated in the opening of the CDs or, as in *Beyer*, jointly executed any documents with Williams that would have given them any rights to the

funds at issue." *Id.* at *19. Therefore, the appellate court affirmed the trial court's summary judgment. *See id.*

In *Koonce v. First Victoria Nat'l Bank*, the court of appeals reversed a summary judgment in part and found that there was a fact issue as to whether a bank breached a contractual duty to set up a POD account. No. 13-10-00282-CV, 2011 Tex. App. LEXIS 7198 (Tex. App.—Corpus Christi, August 31, 2011, no pet.). Robert Koonce opened a certificate of deposit account at the bank, and approximately two years later instructed the bank to change the CD to a POD account and to designate his son as the beneficiary. *See id.* The bank had Robert sign a file maintenance form that included the sole notation: "Add Beneficiary: Kenneth B. Koonce." *See id.* Two years later, Robert died, and his son took the CD to the bank, the bank distributed the funds of the CD to the son. *See id.* Robert's daughter later sued her brother and the bank claiming that the funds distributed to the son were an asset of Robert's estate and that there was no POD effect. *See id.* The trial court granted summary judgment in favor of the sister, determining that the CD funds were an estate asset. *See id.* Later, the son sued the bank in connection with that judgment alleging that the bank breached its contract with Robert, and with the son as third party beneficiary by failing to change the CD to a POD account. *See id.* He also alleged that the bank was negligent for failing to change the account designation as directed by Robert and violated the DTPA by breaching its warranty that the account designation would be changed as directed by Robert. *See id.* The trial court granted the bank's motion for summary judgment on all of the son's claims. *See id.*

Regarding the breach of contract claim, the bank initially argued that the file maintenance form was sufficient to create a POD account. *See id.* The court of appeals disagreed stating that the probate code requires a "specific, definite written agreement before such property is allowed

to pass outside a testamentary instrument." *Id.* The court found that there was no such specificity present. *See id.* The term "Payment on Death" or "POD" appeared nowhere on the form. *See id.* The term, "Add Beneficiary" on the file maintenance form could have referred to several different matters, and thus, the file maintenance form was simply too vague and ambiguous to comply with the written agreement requirement of the probate code. *See id.*

The court noted that in cases where the issue is ownership of the funds on deposit, the plaintiff may not use extrinsic evidence to show whether the account is a valid right of survivorship or a POD account. *See id.* However, in cases where the issue is whether the financial institution breached its agreement with the decedent in failing to set up the requested account, the plaintiff may utilize extrinsic evidence to prove its claim. *See id.* The court concluded that the bank failed to negate the breach element as a matter of law and that a fact issue existed on this element. *See id.* Therefore, the court of appeals held that the trial court erred in granting summary judgment on the son's breach of contract claim. *See id.*

The bank also challenged the son's negligence claim and asserted that there was no evidence that the bank owed any common-law negligence duty to the son. *See id.* The court of appeals stated: "If the defendant's conduct . . . would give rise to liability only because it breaches a party's agreement, the plaintiff's claim ordinarily sounds only in contract." *Id.* More specifically, "In the absence of a duty to act apart from the promise made," mere nonfeasance under a contract creates liability only for breach of contract. *Id.* The court of appeals noted that it was the son's own contention that the bank owed him a duty arising out of its agreement with Robert to change the CD to a POD account with the son as a beneficiary. *See id.* The court held that the son had identified no duty separate from the contract and had produced no evidence of

any such duty. *See id*. The court of appeals affirmed the trial court's summary judgment on the son's negligence claim. *See id*.

Finally, the court of appeals addressed the son's DTPA claim based upon the bank's failure to properly create the POD account. *See id*. The son contended that because he was a creditor beneficiary of Robert's account, he was a consumer as defined by the DTPA. *See id*. The court assumed, for the sake of argument, without deciding same, that a creditor beneficiary was a DTPA consumer but found that the son produced no evidence that he was a creditor beneficiary. *See id*. The court noted that the son produced no evidence that Robert made him a beneficiary of the CD account out of any legally enforceable duty by Robert to appellant, such as the satisfaction of a debt or contractual obligation. *See id*. The court of appeals thus affirmed the trial court's granting of summary judgment on the son's DTPA claim. *See id*.

C. Conclusion On *A.G. Edwards*

The *A.G. Edwards* opinion is a dangerous precedent for financial institutions. Because extrinsic evidence is not allowed, the issue of whether an account belongs to an estate or belongs to a listed beneficiary should be a rather straight-forward analysis. The issue is whether the appropriate language exists on the forms creating the account. If it does not, the money goes to the estate. Then the beneficiary can seek a damage award against the bank. So, in essence, the depositors' heirs will get a double recovery, the estate gets the money and a particular beneficiary also gets the money.

On what basis did the Texas Supreme Court create such a potentially unfair liability? Although the Texas Supreme Court did not clarify what "duty" the bank breached, a fair reading of *A.G. Edwards* would only support a potential breach of contract claim by a customer. The courts of appeals applying *A.G. Edwards* would agree with that conclusion. The end result of

A.G. Edwards is that customers will now raise their claims arising out of alleged survivorship accounts against banks instead of other family members and will couch those claims in terms of the banks breaching agreements to create survivorship accounts. However, because the language in *A.G. Edwards* is somewhat ambiguous, plaintiffs may attempt to open the door to other tort-based claims, such as negligence and breach of fiduciary duty. If that were allowed, it would be an expansion of existing law.

Banks doing business in Texas should make every effort to properly handle survivorship account documents. Further, banks should revisit their account agreements so that defensive contractual and tort-based clauses may be implemented, such as no-prior representations clauses, arbitration clauses, damage waivers, etc.