

KEEP YOUR EYE ON THE GAME CLOCK

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A pop tune declares: “Time Is On My Side!” While this well worn adage may be true for personal relationships, lenders need to be aware that time is not on their side when a loan is in default. A recent Texas Court of Appeals case shows the dangers of lenders taking their eye off the game clock, and allowing too much time to run down before enforcing their remedies.

In this case, the game clock is something called a “statute of limitations.” The Texas Civil Practice & Remedies Code sets the various time periods within which lawsuits or other actions must be taken. Generally speaking, in most contract actions (for example, foreclosures of deed of trust liens or suits to collect delinquent debts), a lawsuit must be brought within four years of the date of default. Deficiency actions following foreclosures are subject to a separate statute of limitations and must be brought within two years following the date of sale.

The logic behind a statute of limitations is to prevent a party from presenting a “stale” claim. Statutes of limitations bring a certain finality and certainty to all parties involved, forcing a creditor to sue within a time certain and giving the certain assurance to a debtor that a creditor will either sue or lose its right to sue in the future.

A recent Texas Court of Appeals case highlights the need for a lender to be aware of the applicable statute of limitations when a debt is in default. In *MidSouth Telecommunications vs. Best*, 184 S W 3rd 386 (Tex. App.-Austin, 2006), the debtor defaulted on a loan in December of 1999. The creditor entered into a protracted series of negotiations in 2000 with the debtor and the various guarantors of the debt. The negotiations turned into a very extended attempt at a loan workout which was ultimately unsuccessful. When the prospect for collection or workout became dim, in May of 2004, the debtor sued each of the guarantors. The guarantors answered the lawsuit, alleging that the suit was brought outside of the applicable statute of limitations of four years. The Texas Court of Appeals agreed, entering a judgment that the creditor take nothing on its defaulted loan.

The criticism of the creditor in this case was that the creditor waited until more than four years after the date of default to bring the lawsuit to collect the debt. The Court specifically noted that the suit should have been brought in December of 2003, but was ultimately filed five months late. As a result of the creditor’s delay in filing the lawsuit, the creditor recovered nothing, and the debtor and guarantors no longer owed the debt.

The *MidSouth* case highlights the danger of working with a defaulted debtor for any length of time. The creditor could have protected itself by negotiating a “tolling” agreement with the debtor. Texas law recognizes that the parties to a transaction can agree to “toll,” (stop) the running of a statute of limitations. These agreements are typically incorporated into a pre-workout agreement. Alternatively, the creditor could have predetermined and calendared the projected deadline and initiated suit prior to its expiration.

In summary, the clock starts running when a debtor defaults. **If a lender does not take action before the expiration of the applicable statute of limitations, the lender may lose all of its rights with respect to the loan.** However, the lender can take reasonably simple measures in the form of a pre-workout agreement or a tolling agreement in order to stop the clock, or note the applicable deadline and take appropriate action before its expiration.

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