

## Keep your Eye on the Game Clock

By Robert L. Pou III



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.

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ESTABLISHED MORE THAN A QUARTER OF A CENTURY AGO, SETTLEPOU HAS A DEPTH OF EXPERIENCE SERVING THE TRANSACTIONAL, LITIGATION AND REGULATORY NEEDS OF ITS DIVERSIFIED CLIENT BASE. THE FIRM HAS PARTICULAR EXPERTISE IN ASSISTING BANKS AND OTHER FINANCIAL INSTITUTIONS, ASSET MANAGEMENT AND RECOVERY GROUPS, INSURANCE COMPANIES, ENTITIES WITH REAL ESTATE INTERESTS AND COMMERCIAL BUSINESSES.

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 recov-

ered 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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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.

*Meet Your Legal Support Team:*

**Marcus Haywood**

<b>Position:</b> <i>Information Technology Manager</i>	<b>Hobby:</b> <i>Real time modern urban combat simulations; music producer</i>	<b>Sport:</b> <i>Football</i>
<b>Hometown:</b> <i>Dallas, Texas</i>	<b>TV Show:</b> <i>CSI</i>	<b>Sports Team:</b> <i>Dallas Cowboys</i>
<b>Education:</b> <i>Hillcrest High School</i>	<b>Old Movie:</b> <i>Legend of Drunken Master</i>	<p>Marcus Haywood has been working for SettlePou since 2004 and with computers since he was 12 years old. After graduating high school in 1992, he began his career in the computer industry and worked for some of the largest companies in the United States. He excels in virtually every area of computing, including telecommunications.</p>
<b>Family:</b> <i>Mendy Bibby, sister</i>	<b>Recent Movie:</b> <i>Sideways</i>	
<b>Personal Favorites</b>	<b>Book:</b> <i>Digital Fortress by Dan Brown</i>	
<b>Food:</b> <i>Sushi/Sashimi</i>	<b>Music:</b> <i>Vocal House Music</i>	
<b>Drink:</b> <i>Maker's Mark</i>	<b>Vacation:</b> <i>Manhattan</i>	



Marcus Haywood

Information Technology  
Manager

*Meet Your Lawyers:*

**Steven M. Thomas**

<b>Hometown:</b> <i>Born in Coronado, California Grew up in Northern Virginia</i>	<b>Drink:</b> <i>Water or Sam Adams</i>	<b>Vacation:</b> <i>Ely, Minnesota</i>
<b>College:</b> <i>Michigan State University</i>	<b>Hobby:</b> <i>Woodworking</i>	<b>Sport:</b> <i>I enjoy all sports</i>
<b>Law School:</b> <i>William and Mary</i>	<b>TV Show:</b> <i>Centennial (TV mini-series)</i>	<b>Sports Team:</b> <i>Any team that one of my daughters is playing on</i>
<b>Family:</b> <i>Wife, Carrie; daughters, Ashley (21) and Lauren (19)</i>	<b>Old Movie:</b> <i>The Thin Man</i>	<b>What do you consider as the most important qualities of a good lawyer?</b>  <i>Integrity, intelligence, tenacity and experience.</i>
<b>Personal Favorites</b>	<b>Recent Movie:</b> <i>Cinderella Man</i>	
<b>Food:</b> <i>Pizza, Carrie's lasagna, or my Mom's apple pie</i>	<b>Book:</b> <i>The Art of War</i>	
	<b>Music:</b> <i>Oldies, rock &amp; roll, and some of the new stuff</i>	



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### Covenants not to Compete: Landmark Ruling for Employers

By Michael S. Byrd and  
James M. Stanford



The Texas Supreme Court has made the road to enforcing covenants not to compete easier for employers by its recent landmark decision in *Alex Sheshunoff Management Services, L.P. v. Johnson*.<sup>1</sup> Prior to the ruling in *Sheshunoff*, there was a disparity among the courts as to the proper interpretation of both the Covenants Not to Compete Act

(“Act”) and the seminal 1994 Supreme Court case, *Light v. Centel Cellular Co.*<sup>2</sup> Essentially, because of the shortsighted interpretations by the courts, covenants not to compete were extremely difficult to enforce against employees.

Under the Act, a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made, to the extent that it contains limitations as to time, geographical area, and the scope of activity to be restrained which are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interests of the employer.

Following the decision in *Light*, Texas courts had difficulty in agreeing on what promises between an employer and an employee were sufficient to create an otherwise enforceable agreement. The majority of courts held that the “otherwise enforceable agreement” cannot be dependent on future performance. Accordingly, prior to the ruling in *Sheshunoff*, the agreement had to be enforceable at the instant the agreement was made. For example, an employer had to contemporaneously pro-

vide an employee with confidential information when the employee signed an agreement containing a non-compete covenant.

In the *Sheshunoff* case, an employer required an at-will employee who had been working for the employer for four years to sign an employment agreement containing a covenant not to compete several months after the employee was promoted. In the non-compete covenant, the employee agreed for one year following termination that he would not provide services to any of the employer’s clients to whom he had provided services in excess of forty hours within the last year of employment and would not solicit or aid any other party in soliciting the employer’s clients or prospective clients. The non-compete covenant was ancillary to an employment agreement in which the employee agreed not to disclose confidential information in return for the employee’s promise to provide training and access to confidential information. The employer provided the employee with the confidential information and training on an on-going basis some time after the employee signed the agreement.

The employee eventually

resigned and went to work for a competitor in violation of the terms of the covenant, and the employer sued the employee to enforce the covenant. Relying on the holding in *Light*, the lower courts determined that the employment agreement was not “an otherwise enforceable agreement,” since the employer did not make a promise that was enforceable at the time the agreement was made (i.e., the employer’s promise was for future performance). The employer appealed to the Supreme Court of Texas.

The court in *Sheshunoff* found this interpretation of the Act to be flawed and contrary to the legislature’s intent for the Act to make non-compete covenants more enforceable. The court reasoned that if “at the time the agreement is made” means that the agreement must be enforceable the instant it is made, (as set forth in *Light*), then most covenants not to compete executed by at-will employees will be unenforceable. The *Sheshunoff* court concluded that the covenant need only be “ancillary to or part of” the agreement at the time the agreement is made.

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## A Debtor by Any Other Name is Still a Debtor

By Don Gwin



A recent United States Court of Appeals decision shows the importance of making careful lien searches as part of the lender's due diligence process, especially as regards federal tax liens.

Crestmark Bank was making a loan to Spearing Tool and Manufacturing Co. Crestmark documented the loan internally and searched the public records for U.C.C. financing statements and federal tax liens that could have affected its lien position in the collateral. The search reflected no liens or financing statements filed under the specific name which the Bank searched; namely, Spearing Tool and Manufacturing Co., which was the exact legal name of the debtor. The Bank then entered into a credit arrangement with Spearing, and Spearing granted the Bank a security

interest in certain assets, which security interest was perfected through the filing of a U.C.C. financing statement in the name of Spearing Tool and Manufacturing Co.

Spearing subsequently filed a Chapter 11 bankruptcy proceeding. During the proceedings in the bankruptcy court, the Internal Revenue Service took the position that it had prior perfected federal tax liens on all assets of the debtor, and that the Bank was in second lien position. The Bank responded by saying that the federal tax liens were not filed under the exact legal name of the debtor as required by the state's Uniform Commercial Code, and were, therefore, ineffective. Although the correct legal name of the borrower was "Spearing Tool and Manufacturing Co.," the IRS filed its liens under "Spearing Tool &

Mfg. Company Inc." The IRS position was that the notice of tax liens identified the debtor well enough under federal law. The IRS had filed its liens abbreviating certain aspects of the debtor's name but maintaining the critical "Spearing Tool" core of the name.

In the case of *Spearing Tool and Manufacturing Co. Inc., Debtor v. Crestmark Bank; Crestmark Financial Corporation, Appellees*, 4112 F.3d 653, (6th Cir. 2005), the Court ruled in favor of the IRS, applying a more liberal notice standard than that contained in the Uniform Commercial Code. The Court noted that while a U.C.C. financing statement filed under the abbreviated and truncated name used by the IRS would ordinarily have been ineffective, under state law, the IRS is held to a lesser standard under the IRS Code and held that the IRS liens need not "perfectly identify" the taxpayer, but must only "sufficiently identify" a taxpayer so that a lender is placed on notice for further inquiry. Here, the use of the combination of the words "Spearing Tool" was held to have placed Crestmark on reasonable notice that a tax lien may have been asserted against its customer. Crestmark had, in fact, received a prompt in their Secretary of State search result, suggesting their search for slightly differ-

ent or abbreviated names of the debtor. The IRS was determined to have a first priority security interest on all of the assets which the Bank had taken as collateral for its loan.

This case contains important lessons. When performing lien searches automatically, you "get what you ask for." If you order a search in one name only, then the search will not include other names. Lien searches should be broadly cast so that other possible combinations of abbreviations and truncations of a name are searched. This is the format provided by pursuing the Texas Secretary of State "Wild Card Search" for online search and is the format provided by private companies providing search results. Although the additional names on the lien search may cost the Bank more money and effort at the beginning of the loan process, that expense is insignificant when compared to the cost of writing off a loan.

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### Covenants not to Compete: Landmark Ruling for Employers

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Now, when an employer seeks to enforce a non-compete covenant, a court's analysis will focus on whether the employer made contractual promises; whether these promises were fulfilled; and whether the promises by the employer and the employee justify the restrictions in the covenant. The court will then look at the traditional parameters of a covenant not to compete and confirm the reasonableness of the limitations in (1) time, (2) geographical area, and (3) scope of activity to be restrained.

In the aftermath of this ruling, it is important that every business review its existing employment agreements with counsel and further evaluate whether any of its employees should be required to execute an employment agreement with a covenant not to compete. SettlePou routinely counsels its clients on drafting, enforcing, and defending against, covenants not to compete and other related issues.

If you have any questions related to these matters,

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<sup>1</sup>2006 WL 2997287 (Tex.).

<sup>2</sup>883 S.W.2d 642 (Tex. 1994).