

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

IN RE:

MEDICAL SELECT MANAGEMENT,

Debtor.

CASE NO. 401-45298-BJH-11

BANK OF AMERICA, N.A.

Plaintiff,

- against -

ADV. PRO. 401-4100-BJH

**PACIFICARE OF TEXAS, INC. and
MEDICAL SELECT MANAGEMENT,**

Defendants.

PACIFICARE OF TEXAS, INC.,

Counter-Plaintiff,

- against -

**BANK OF AMERICA, N.A., BANK OF
AMERICA CORPORATION, and BANC
OF AMERICA INVESTMENT SERVICES,
INC.,**

Counter-Defendants.

MEMORANDUM OPINION

Before the Court are the motions for summary judgment (the “Motions”) filed by the Chapter 11 trustee for Medical Select Management (the “Trustee”), Bank of America, N.A. (“Bank”), Bank of America Corporation (“Corporation”), and Bank of America Investment Services, Inc. (“BAISI”) (hereinafter, the Trustee, Bank, Corporation, and BAISI are collectively referred to as “Movants”) to the claims and/or defenses asserted against each of them by Pacificare of Texas, Inc.

(“Pacificare”). The motions were finally argued on December 3, 2002. At the conclusion of that hearing, certain of the parties asked for the opportunity to file a post-hearing brief on certain issues. Pursuant to an agreed schedule, the last of those briefs was filed on December 18, 2002, at which time the Court took the Motions under advisement.

This Court has jurisdiction over the adversary proceeding and the Motions in accordance with 28 U.S.C. §§ 1334 and 157. This Memorandum Opinion contains the Court’s rulings on the Motions.

I. FACTUAL BACKGROUND

Prior to the commencement of its bankruptcy case, Medical Select Management (“MSM”) operated as a non-profit independent physician practice group that provided services to patients who were enrolled in health care service plans. MSM contracted with several thousand doctors in Tarrant County, Texas, to build a network of physicians who would then offer their services at negotiated rates to health care service plans such as HMOs and PPOs (“payors”) for their plan enrollees. Pursuant to MSM’s contracts with its doctors, the doctors were given the opportunity to participate in each of the payor contracts entered into by MSM.

MSM contracted with two primary payors - Aetna U.S. Healthcare, Inc. (“Aetna”) and Pacificare. Aetna and Pacificare each paid MSM a monthly “capitation” fee, out of which MSM paid the covered medical charges from the participating doctors for services rendered to plan enrollees. MSM’s ability to make those payments depended on the size of the capitation payments and, to the extent that the capitation payments were insufficient to cover all the medical charges, MSM incurred a loss.

MSM’s relationship with Pacificare underlies this adversary proceeding. Pursuant to MSM’s

capitation agreement with Pacificare, MSM was required to establish a “Security Reserve” for the benefit of Pacificare. *See* App. to Pacificare of Texas, Inc.’s Consolidated Br. in Supp. of Resp. to Bank of America, N.A. and Bank of America Corp.’s and the Trustee’s Mot. for Summ. J. (“App. to Pacificare’s Consol. Br. in Supp. of Resp.”) at App. 162. This Security Reserve was to be funded out of Pacificare’s capitation payments and was to be available to pay claims of the participating doctors if, as relevant here, MSM became insolvent or ceased to do business and thereby failed to pay those claims. *See id.* at App. 164. As amended, the capitation agreement contemplated that Pacificare would have a security interest in the “Reserve Bank Account” and, upon certain events occurring, Pacificare would be entitled to direct how the monies in the “Reserve Bank Account” were utilized to pay claims of the participating doctors. *See id.* at App. 255.

As relevant here, MSM initially maintained certain investment accounts at BAISI into which its monies were deposited. As required by its capitation agreement with Pacificare, MSM began negotiations with BAISI over the terms of an account control agreement which would provide Pacificare protections with respect to the required “Reserve Bank Account.” In this regard, MSM provided BAISI with a draft of a proposed account control agreement. David Mitchell (“Mitchell”), BAISI’s assistant general counsel, worked with MSM to revise that document so that it was acceptable to BAISI and MSM. After BAISI’s legal department signed off on the form of the proposed account control agreement, Kenneth Frost (“Frost”), the BAISI account officer, testified that he executed three copies of that agreement and forwarded them to Fred Miller (“Miller”), an officer of MSM, for signature. Frost testified that he did not keep a copy of the agreement after he signed it. Frost further testified that he expected MSM to sign the agreement and forward it to Pacificare for review and signature. Finally, Frost testified that he expected to learn if Pacificare

had signed the agreement from Miller at MSM and expected to get a fully executed copy of the agreement back through MSM.

Miller signed the account control agreement on behalf of MSM and forwarded it to Pacificare for review and signature. Thereafter, Pacificare signed the account control agreement provided to it by MSM. According to the affidavit testimony of John Lovelady (“Lovelady”), Pacificare’s Director of Network Management in the Dallas-Fort Worth market, he instructed his assistant to mail a fully executed copy of the account control agreement to both MSM and BAISI. MSM received its copy from Pacificare. While Pacificare believes it mailed a signed copy of the fully executed account control agreement back to BAISI, BAISI denies ever receiving that agreement. In any event, once Pacificare signed the account control agreement, it believed that it had rights with respect to MSM’s account at BAISI as set forth in the account control agreement.

After he received the signed account control agreement back from Pacificare, Miller at MSM confirmed to Pacificare that the account control agreement was in place and effective. However, Miller told BAISI just the opposite. Miller told BAISI that Pacificare had refused to sign the account control agreement because it was not “secure” enough. According to what Miller told BAISI, Pacificare wanted a letter of credit arrangement. So, for the balance of BAISI’s relationship with MSM, BAISI was unaware that Pacificare (i) had signed the account control agreement and (ii) thought its protections were in place.

Under the terms of the account control agreement, MSM could not transfer the principal amount of the funds in the Pacificare reserve account at BAISI without Pacificare’s written consent. However, on or about December 12, 2000, MSM closed the Pacificare reserve account at BAISI

and transferred the funds in that account, approximately \$4.9 million, to a demand deposit account (account number 004771354379) at Bank. Pacificare did not consent to this transfer.

Previously, in late July 2000, MSM had opened another account at Bank – *i.e.*, account number 873437 (the “Account”). The Account, and the investments held in the Account, are the focal point of the dispute between Pacificare, Bank, and the Trustee. As directed by MSM, on December 14, 2000, representatives of Bank made the first investment for the Account by investing funds in nonnegotiable certificates of deposit (“CDs”) issued by Bank. Since that date, the Account has only contained nonnegotiable CDs issued by Bank and held by Bank.

Unbeknownst to Pacificare, on December 28, 2000, MSM executed a revolving credit agreement and a note with Bank in the principal amount of \$3 million. Pursuant to a pledge agreement entered into contemporaneously with the revolving credit agreement, MSM pledged and assigned a security interest and lien in the Account and its collateral (the CDs) to Bank. Immediately thereafter, the line was fully advanced. On May 29, 2001, MSM and Bank amended the revolving credit agreement and note to increase the principal amount of the loan to \$7 million. The increased line was fully advanced by early June 2001.

Unbeknownst to Bank, and also in December 2000, MSM submitted a new proposed account control agreement (and related documents) to Pacificare that MSM claimed would grant Pacificare rights to the monies transferred from BAISI and rights to reserve funds from future capitation payments to be made by Pacificare. The new account control agreement (and related documents) were signed in late January 2001. However, not only were the new account control agreement (and related documents) forgeries,¹ they purported to be between and among Pacificare, MSM, and

¹For example, the new account control agreement was purportedly signed by Paul Kaatz on behalf of Corporation. No person by the name of Paul Kaatz works for Corporation or Bank.

Corporation, the holding company parent of Bank which maintains no depository accounts. In fact, the funds transferred from BAISI were deposited into accounts at Bank. Moreover, future capitation payments were made by Pacificare into accounts at Bank.

The parties' competing claims to the Account and its collateral (the CDs) were not discovered until June 2001, after the increased Bank line was fully advanced.

II. PROCEDURAL BACKGROUND

MSM filed its voluntary petition under chapter 11 of the Bankruptcy Code on July 24, 2001 (the "Petition Date"). On August 15, 2001, Bank filed this adversary proceeding against Pacificare and MSM² seeking a determination that Bank has a valid, enforceable security interest with respect to the Account, that Pacificare has no valid security interest in the Account or no rights in the Account superior to Bank's rights, and that Bank is not obligated to honor Pacificare's demand to receive payment of all of the Account's assets. On September 25, 2001, the Court ordered the appointment of the Trustee. The Trustee substituted in for MSM by Order entered on October 30, 2001.

On September 20, 2001, Pacificare filed its Original Answer and Counterclaim against Bank, Corporation, and BAISI, which contained sixteen affirmative defenses and counterclaims seeking declaratory and injunctive relief and damages for breach of contract, tortious interference with contract, intentional and/or negligent misrepresentation, negligence, breach of fiduciary duty and conversion. Both Bank and Corporation filed their answers to Pacificare's claims on October 10, 2001. On October 31, 2001, the Trustee filed his answer and asserted a crossclaim against Pacificare, seeking to avoid any alleged Pacificare security interest as unperfected on the Petition

² The original complaint was filed on July 13, 2001 in the United States District Court for the Northern District of Texas, Civ. Action No. 3-01CV1354-M. It was removed to this Court on August 15, 2001.

Date. On January 10, 2002, Pacificare answered the Trustee's crossclaim and asserted a counter-crossclaim against the Trustee seeking declaratory relief and damages for breach of contract, fraud, intentional and/or negligent misrepresentation and negligence. After several agreed extensions of time, BAISI filed its answer to Pacificare's claims on January 31, 2002.

Bank and Corporation filed a joint motion for summary judgment on February 5, 2002, the Trustee filed his motion for summary judgment on March 22, 2002, and BAISI filed its motion for summary judgment on April 15, 2002. Thereafter, the Motions were heard.

III. THE LEGAL STANDARD

Because Movants seek summary judgment on Pacificare's defenses and/or claims against them,³ Pacificare bears the ultimate burden of proof on each of those defenses and/or claims.⁴ While Movants bear the initial burden of demonstrating the absence of material fact issues, "[t]o avoid summary judgment, the nonmovant must adduce evidence which creates a material fact issue concerning each of the essential elements of its case for which it will bear the burden of proof at

³While certain of the Movants seek affirmative relief, that relief is no longer opposed if Pacificare's defenses and/or claims are disposed of by summary judgment. For example, the Trustee seeks a determination that Pacificare did not hold a perfected security interest in the Account on the Petition Date. Thus, according to the Trustee, he can avoid Pacificare's unperfected security interest in the Account in accordance with § 544(a)(1) of the Bankruptcy Code. Pacificare opposes the Trustee's motion and contends that the funds in the Account were acquired by fraud such that they were held in constructive trust for Pacificare's benefit and thus, the Trustee's strong arm powers are ineffective to cut off Pacificare's interest in the funds. However, if the Trustee is granted summary judgment on Pacificare's constructive trust defense, Pacificare agrees its security interest was unperfected on the Petition Date and is subject to avoidance. Similarly, Bank seeks a determination that it held a valid, perfected security interest in the Account on the Petition Date. While Pacificare believes it has prior rights to the funds in the Account in accordance with certain of its defensive claims addressed hereinafter, if summary judgment is granted in Bank's favor with respect to those claims, Pacificare agrees that Bank had a perfected security interest in the Account on the Petition Date. Thus, the Motions are properly considered "no evidence" motions for summary judgment.

⁴Pacificare's claims against Bank, BAISI, and the Trustee have "evolved" during the summary judgment hearing process. In fact, many of the "claims" currently asserted by Pacificare are not specifically pled in the Original Answer and Counterclaim filed by Pacificare. The evolving claims and legal theories, however, have been fully briefed and argued by the parties. Accordingly, the Court will address all of those claims, notwithstanding the fact that they are not specifically pled in Pacificare's Original Answer and Counterclaim.

trial.” *Abbott v. Equity Group, Inc.*, 2 F.3d 613, 619 (5th Cir. 1993). The summary judgment movant:

need not support the motion with evidence negating the opponent’s case; rather, once the movant establishes that there is an absence of evidence to support the non-movant’s case, the burden is on the non-movant to make a showing sufficient to establish an issue of fact for each element as to which that party will have the burden of proof at trial.

Epps v. NCNM Texas Nat’l Bank, 838 F. Supp. 296, 299 (N.D. Tex. 1993) (citing *Celtox Corp. v. Catrett*, 477 U.S. 317, 322-25 (1986)). “[U]nsubstantiated assertions are not competent summary judgment evidence.” *Abbott*, 2 F.3d at 619. The nonmoving party must “‘come forward with specific facts showing there is a genuine issue for trial’ . . . [and] must do more than simply show some ‘metaphysical doubt as to the material facts.’” *Epps*, 838 F. Supp. at 299 (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986)).

IV. THE MOTIONS

A. BAISI’S MOTION

BAISI seeks summary judgment on all of the claims asserted against it by Pacificare. As noted previously, BAISI’s motion is a “no evidence” motion for summary judgment. In short, BAISI contends that there is either no evidence, or no legally sufficient evidence, in the summary judgment record to establish the essential element(s) of each of the claims Pacificare asserts against it; and thus, summary judgment in its favor is appropriate.

Pacificare opposes BAISI’s motion as to certain of its claims but not others. As a result of discovery taken after its counterclaims were first pled, Pacificare agrees that it cannot proceed on its negligence, breach of fiduciary duty, tortious interference, and conversion claims against BAISI. However, Pacificare contends that it has raised a genuine issue of material fact with respect to its

remaining claims against BAISI; and thus, a summary judgment in BAISI's favor is not appropriate. The Court addresses each of those claims below.

1. Breach of contract

Pacificare contends that BAISI breached the account control agreement when BAISI permitted MSM to transfer its funds out of the so-called Pacificare reserve account without Pacificare's written consent in December 2000, and that BAISI is liable to it for damages flowing from that breach of contract.

In its motion for summary judgment, BAISI contends that because it was not notified of Pacificare's acceptance of the account control agreement – *i.e.*, BAISI contends that the agreement was not delivered back to BAISI and that Miller told BAISI that Pacificare had refused to sign the agreement, an essential element of Pacificare's breach of contract claim is missing. Accordingly, BAISI contends it is entitled to summary judgment.

Pacificare contends that it has raised a genuine issue of material fact regarding its acceptance of the account control agreement and its delivery of that agreement back to BAISI or its agent for that purpose, MSM. Specifically, Pacificare contends that it offered some evidence of its mailing of the fully executed agreement back to BAISI – *i.e.*, Lovelady's testimony that he instructed his assistant to mail copies to both MSM and BAISI and the inference to be drawn from the fact that MSM received its signed copy of that agreement, and that BAISI's summary judgment evidence does not negate the possibility the BAISI actually received the agreement – *i.e.*, Frost testified only that he did not get a signed copy back and Ricks testified that when he took over MSM's relationship, he reviewed "the files" and no account control agreement was in the files he reviewed. Pacificare argues that there is no evidence to suggest that BAISI searched all of its files including, for example, files maintained at its home office in Charlotte, North Carolina. In the alternative,

Pacificare contends that MSM became BAISI's agent for acceptance and delivery of the account control agreement when BAISI chose to deliver all three signed originals of that agreement to MSM, expected MSM to sign and forward those originals on to Pacificare for execution, and expected to learn of Pacificare's execution of the account control agreement (and receive a fully executed copy of that agreement) from MSM.

To form a binding agreement, Texas contract law requires: (i) an offer, (ii) an acceptance in strict compliance with the terms of that offer, (iii) a meeting of the minds, (iv) communication that each party consents to the terms, and (v) execution and delivery of the contract with the intent that it be mutual and binding. *See Interfederal Capital, Inc. v. Flagstar Bank, FSB*, 2001 WL 1645480 at *4 (N.D. Tex. Dec. 19, 2001) (citing *Komet v. Graves*, 40 S.W.3d 596, 600 (Tex. App. – San Antonio 2001, no writ)). To satisfy the delivery requirement, there must be an expression of intent to accept the offer communicated or delivered to the offeror or the offeror's agent. *See Jatoi v. Park Ctr., Inc.*, 616 S.W.2d 399, 400 (Tex. Civ. App. – Fort Worth 1981, writ ref'd n.r.e.); *Lee v. Stroman*, 470 S.W.2d 783, 785 (Tex. Civ. App. – Dallas 1971, writ ref'd n.r.e.). Delivery may not be required, however, if the offer is silent as to method of acceptance and the parties demonstrate that they intended for the contract to become effective. *See Awad Texas Enters., Inc. v. Homart Dev. Co.*, 589 S.W.2d 817, 819-820 (Tex. Civ. App. – Dallas 1979, n.w.h.). For instance, acceptance of a contract by mail is impliedly authorized if reasonable under the circumstances. *See Cantu v. Cent. Educ. Agency*, 884 S.W.2d 565, 567 (Tex. App. – Austin 1994, n.w.h.). Delivery is a mixed question of law and fact to be determined by the trier of fact. *Awad*, 589 S.W.2d at 820; *see also Scaife v. Associated Air Ctr., Inc.*, 100 F.3d 406, 410 (5th Cir. 1996).

Pacificare argues that a fact issue exists as to whether the parties intended the account control agreement to be accepted via delivery of the fully executed agreement to MSM as BAISI's agent,

or whether Pacificare sufficiently delivered the agreement by mailing it back to BAISI. The Court agrees with Pacificare. Based on the summary judgment record, a genuine issue of material fact exists with respect to Pacificare's acceptance and delivery of the account control agreement such that summary judgment on Pacificare's breach of contract claim is improper.

BAISI next contends that even if there was a binding account control agreement, that agreement terminated in accordance with its terms prior to the transfer of funds by MSM in December 2000. Thus, according to BAISI, it could not breach a terminated agreement.

The Court disagrees with BAISI's interpretation of the account agreement and the account control agreement. In accordance with the terms of those agreements, the account control agreement terminated upon a termination of the account agreement pursuant to section 5(e). In turn, section 5(e) provided that the "account agreement . . . automatically terminate[s] ninety (90) days after liquidation of all Collateral in Account with no subsequent deposit." However, the account agreement never terminated because there was never a 90-day period in which there was no "Collateral" in the account. "Collateral" was defined to include all "financial assets credited to the Customer Account." In turn, "financial asset" was defined as "all property, including without limitation, cash . . . , at any time held in the Customer Account." While only four cents (\$.04) remained in the account from March 2000 until August 2000 when the \$4.9 million was deposited, that four cents was a "financial asset" in accordance with the parties' agreement and thus was Collateral. While ironic, because of the four cent interest credit in March 2000, there was never a 90-day period when there was no "Collateral" in the account; and thus, the account agreement did not automatically terminate. Because the account agreement did not terminate, neither did the account control agreement.

Finally, and further in the alternative, BAISI contends that Pacificare waived its right to

assert claims for breach of contract. In support of this contention, BAISI points to the fact that certain Pacificare employees were aware of the proposed transfer of funds from BAISI to Bank in December 2000 and did not object to that transfer. In fact, BAISI points to certain evidence which suggests that Pacificare was pleased by the potential transfer of funds to Bank where Pacificare could better protect itself with respect to the funds. According to BAISI, it is only months later, after Pacificare learned that MSM had defrauded it with the forged new account control agreement with Corporation, that Pacificare cried foul with respect to BAISI's "breach" of the account control agreement by permitting MSM's transfer of the funds from BAISI without Pacificare's written consent.

In turn, Pacificare explains that while certain of its employees may have known in advance of the proposed transfer of funds from BAISI to Bank, the fact remains that it did not consent to that transfer in writing as the account control agreement required. Moreover, according to Pacificare, its delay in making its breach of contract claim known was not a knowing relinquishment of its rights. Rather, according to Pacificare, it took no action earlier because it was unaware of the damages flowing from BAISI's breach until after it discovered (i) it was not perfected in the funds now held at Bank (*i.e.*, it discovered that the new account control agreement was a forgery), and/or (ii) the pledge of those funds to Bank. Relying on the affidavit testimony of Susan Forman ("Forman"), Pacificare contends that it has raised a genuine issue of material fact with respect to BAISI's waiver defense.

The Court agrees. While certain Pacificare employees appear to have known of the proposed transfer of funds in advance of it occurring, and appear to have been in favor of the transfer of funds to Bank so that Pacificare could better protect itself with respect to the nature of investments for those funds, Forman's affidavit does raise fact issues with respect to a knowing and intentional

relinquishment of rights by BAISI. Waiver is inherently factual. *Tenneco, Inc. v. Enter. Prods. Co.*, 925 S.W.2d 640, 643 (Tex. 1996). Unless the facts and circumstances supporting waiver are admitted or clearly established, waiver is a question of fact that survives summary judgment. *See Caldwell v. Callender Lake Prop. Owners Improvement Ass'n*, 888 S.W.2d 903, 910 (Tex. App. – Texarkana 1994, writ denied); *Tenneco*, 925 S.W.2d at 643. Pacificare has raised a genuine issue of material fact regarding whether it waived its right to assert a claim against BAISI for breach of the account control agreement.

For these reasons, BAISI's motion for summary judgment is denied with respect to Pacificare's breach of contract claim.

2. Intentional Misrepresentation

Forman testified in her affidavit that she had a telephone conversation with David Hunter ("Hunter") of BAISI on August 4, 2000 at 3:20 p.m., shortly after \$4.9 million was transferred into the MSM account at BAISI which Pacificare thought was subject to its account control agreement. Forman testified that during this call Hunter "assured" her that the funds were in the account and were protected by the account control agreement.

Hunter testified in his deposition that he is a sales assistant at BAISI. He described his job responsibilities as "predominately administrative things, anything at the direction of the broker to take care of clients, clients' accounts, clients' requests." He graduated from Stephen F. Austin college in 1996. Before joining BAISI as a sales assistant, he worked at Circuit City for about 18 months and then at Empire Funding for about a year. While Hunter says it is possible that he had a conversation with Forman, he does not remember it. Moreover, he denies that he would have told her that MSM's account was subject to an account control agreement because he was unaware of such an agreement and because he would not have answered legal questions about the account.

While he agrees he would have answered factual questions Forman had about the account statement he had faxed to one of her colleagues, he testified that he would not have responded to legal types of questions about the account. Thus, while he does not recall a telephone conversation with Forman, Hunter denies that he would have “assured” her that the funds were “protected by the account control agreement.” He testified that he would have referred such an inquiry to one of BAISI’s brokers.

On this record, it appears that this call is the first call that anyone at Pacificare had with anyone at BAISI. After the \$4.9 million had been transferred into the so-called Pacificare reserve account MSM maintained at BAISI, Pacificare wanted to see a copy of an account statement confirming the deposit. Miller at MSM called BAISI and asked BAISI to fax a copy of the account statement to Pacificare. Hunter is the person at BAISI who faxed the account statement to Pacificare. So, it appears that prior to seeing his name on the fax cover sheet, Forman had never heard of Hunter.

To establish its intentional misrepresentation claim, Pacificare must prove: (i) a material misrepresentation was made by BAISI which was false, (ii) the misrepresentation was either known to be false when made or was asserted without knowledge of its truth, (iii) the misrepresentation was intended to be acted upon, (iv) the misrepresentation was relied upon, and (v) the misrepresentation caused injury. *1488, Inc. v. Philsec Inv. Corp.*, 939 F.2d 1281, 1287 (5th Cir. 1991); *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 758 (Tex. 2001); *Formosa Plastics Corp. USA v. Presidio Eng’rs and Contractors, Inc.*, 960 S.W.2d 41, 43 (Tex. 1998).

As relevant here, even assuming Hunter “assured” Forman that the funds were protected by the account control agreement, there is no evidence that Hunter was authorized by BAISI to make such a representation to Pacificare. Actions of an agent are not presumed to be within the scope of

his or her authority, *In re Westec Corp.*, 434 F.2d 195, 200 (5th Cir. 1970), and employment alone does not clothe an employee with the powers of an agent, *Duke v. State*, 725 S.W.2d 289, 290 (Tex. App. – Houston [1st Dist.] 1986, writ ref’d). The party dealing with the purported agent has a duty to ascertain both the fact of the agency relationship and the extent of the agent’s authority. *Suarez v. Jordan*, 35 S.W.3d 268, 273 (Tex. App. – Houston [14 Dist.] 2000) (citing *Humble Nat’l Bank v. DCV, Inc.*, 933 S.W.2d 224, 237 (Tex. App. – Houston [14th Dist.] 1996, writ denied)). Moreover, the party asserting that an agent binds the principal “is bound, at his peril, to ascertain not only the fact of the agency, but the extent of the agent’s power, and in case either is controverted, the burden of proof is on him to establish it.” *Verna Drilling Co. v. Parks-Davis Auctioneers, Inc.*, 659 S.W.2d 877, 881 (Tex. App. – El Paso 1984, writ ref’d n.r.e.) (citing *Boucher v. City Paint & Supply, Inc.*, 398 S.W.2d 352 (Tex. Civ. App. 1966, no writ)).

Absent evidence of Hunter’s authority to make this “representation” on BAISI’s behalf, BAISI cannot be held liable to Pacificare on an intentional misrepresentation claim. The summary judgment record contains no such evidence. Thus, BAISI’s motion for summary judgment is granted with respect to this claim.

3. Negligent Misrepresentation

Although similar, to establish its negligent misrepresentation claim Pacificare must prove that: (i) BAISI made a representation in the course of its business or in a transaction in which it had a pecuniary interest, (ii) the false information was supplied for the guidance of others in their business, (iii) BAISI did not exercise reasonable care or competence in obtaining or communicating the information, and (iv) Pacificare suffered pecuniary loss by justifiably relying on the representation. *Clardy Mfg. Co. v. Marine Midland Bus. Loans Inc.*, 88 F.3d 347, 357 (5th Cir. 1996) (citing *Fed. Land Bank Ass’n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991)).

For the reasons explained above, even assuming Hunter “assured” Forman that the funds were protected by the account control agreement, there is no evidence that Hunter was authorized by BAISI to make such a representation to Pacificare. *See supra*, p. 15. While Forman testified that she relied on Hunter’s assurance, there is no evidence that her reliance on Hunter’s assurance was justified as she made no inquiry of his title or responsibilities at BAISI. If a party deals with a purported agent without having determined the fact and scope of the agent’s authority, the party does so at the party’s own risk. *Humble Nat’l Bank v. DCV, Inc.*, 933 S.W.2d 224, 237 (Tex. App. – Houston [14th Dist.] 1996, writ denied).

Absent evidence of Hunter’s authority to make this “representation” on BAISI’s behalf, and Pacificare’s justifiable reliance on such a representation, BAISI cannot be held liable to Pacificare on a negligent misrepresentation claim. The summary judgment record contains no such evidence. Thus, BAISI’s motion for summary judgment is granted with respect to this claim.

4. Declaratory Judgment

Pacificare seeks a determination that the account control agreement was valid and binding upon the parties thereto and, as a result, that it had a validly perfected security interest in MSM’s account at BAISI. Whether Pacificare was perfected in MSM’s account at BAISI depends on whether a binding account control agreement was entered into between and among BAISI, MSM, and Pacificare. In turn, that depends on whether Pacificare accepted the account control agreement and communicated its acceptance to BAISI in a legally sufficient manner. Because questions of fact have been raised by Pacificare with respect to these issues, summary judgment is not proper on this claim.

B. CORPORATION’S AND BANK’S MOTIONS

Corporation and Bank seek summary judgment on all of the defenses and/or claims asserted

against them by Pacificare. These motions are also “no evidence” motions for summary judgment. In short, Corporation and Bank contend that there is either no evidence, or no legally sufficient evidence, in the summary judgment record to establish the essential element(s) of each of the defenses or claims Pacificare asserts against them; and thus, summary judgment in their favor is appropriate.

As a result of discovery taken after its counterclaims were first pled, Pacificare agrees that it cannot proceed on any of its claims against Corporation and its breach of fiduciary duty claim against Bank. However, Pacificare contends that it has raised a genuine issue of material fact with respect to its remaining defenses and/or claims against Bank; and thus, a summary judgment in Bank’s favor is not appropriate. The Court addresses each of those claims below.

1. Conversion

Pacificare’s conversion claims arise under two different legal theories. First, Pacificare contends that Bank committed a wrongful offset in violation of the rule announced by the Texas Supreme Court in *National Indemnity Co. v. Spring Branch State Bank*, 348 S.W. 2d 528 (Tex. 1961) which resulted in the Bank’s conversion of Pacificare’s funds. Second, and in the alternative, Pacificare contends that MSM acquired these funds from Pacificare through actual fraud such that the funds were held by MSM in constructive trust for the benefit of Pacificare. When those funds were subsequently pledged to Bank, Bank “converted” Pacificare’s funds. Each legal theory is addressed below.

a. *National Indemnity* rule

As noted previously, Pacificare contends that Bank wrongfully offset the CDs held in the Account against MSM’s debt to Bank in violation of the rule announced by the *National Indemnity*

court.⁵ In *National Indemnity*, 348 S.W.2d at 528, an insurance agent collected premiums for National Indemnity which he regularly deposited in his own bank account on behalf of the insurance company. *Id.* On one occasion after the agent deposited the insurance company’s funds in his bank account, the bank offset the agent’s debt by seizing funds that rightfully belonged to the insurance company. *Id.* at 529. In finding that the bank was not authorized to charge the agent’s account, the Texas Supreme Court held that “when the bank has knowledge that the funds in the account of one of its depositors are trust funds, or if it has knowledge of sufficient facts to charge it with notice, it is the uniform rule that it may not seize and retain the funds held in trust in order to offset a debt of the depositor. *Id.*”

As explained by Pacificare in its brief, the *National Indemnity* rule was elaborated on in *Continental National Bank v. Great American Management and Investment, Inc.*, 606 S.W.2d 346, 350 (Tex. Civ. App. – Fort Worth 1980, writ ref’d n.r.e.). In that case, the court held that a bank’s offset of a developer’s bank account was wrongful where the bank knew of a third-party’s advance of funds for paying costs and expenses for property development. The *Continental National Bank* court explained that after the Texas Supreme Court’s decision in *National Indemnity*:

Texas became committed to follow the “federal” or “equitable” rule, which is: When a bank which has no knowledge or notice that funds on deposit in an account of one with the bank are held as fiduciary it has the right to apply the funds on deposit against the depositor’s individual indebtedness and to retain them until it is established that they were in fact held in the account by the depositor in a fiduciary capacity for another; and, even should the act subsequently be proved, yet may have the right to retain them if, by reason of the lack of notice and because of justified reliance upon the depositor’s apparent ownership, the bank has changed its position to its injury. Conversely, the bank has not the right to seize and so apply the funds where

⁵Bank contends that it did not “offset” the CDs in the Account against MSM’s debt to Bank. Rather, Bank contends that it foreclosed its perfected security interest in the CDs. Thus, according to Bank, the *National Indemnity* rule is simply inapplicable. For purposes of its analysis, the Court assumes an offset occurred but, as explained below, concludes that the *National Indemnity* rule was not violated.

it (a) does have such knowledge, or (b) by reason of the circumstances is ‘on notice’ thereof or, (c) by reason of known circumstances, is charged with the duty of making the inquiry which, if made, would disclose the fact that the funds were held by the depositor as a fiduciary; and, furthermore even when innocently seized, the funds must be yielded up to the equitable owner when the entrustment fact is established unless he who is in possession can and does show that he has changed his position to his injury so that it would be inequitable to require him to yield up the funds.

Id. at 348. Finally, Pacificare notes that “the law of wrongful offset announced in *National Indemnity* has been consistently applied by the Fifth Circuit in cases involving a bank’s attempt to offset a depositor’s debt by taking funds held in trust by the depositor.” Pacificare of Texas, Inc.’s Consolidated Br. in Supp. of Resp. to Bank of America, N.A. and Bank of America Corp. and Trustee’s Mot. for Summ. J. (“Pacificare’s Consol. Br.”), at p. 36.

From this premise, Pacificare contends that Bank had no right to offset the CDs held in the Account against MSM’s debt to Bank because, at a minimum, Bank had a duty to inquire about the nature of the relationship between Pacificare and MSM. In turn, according to Pacificare, that inquiry would have revealed the “pledged nature of the assets.” Pacificare’s Consol. Br. at p. 36.

The Court is unpersuaded by Pacificare’s arguments. As first articulated by the Texas Supreme Court in *National Indemnity*, for funds to be subject to wrongful offset by a bank, they must be held in the depositor’s account in trust for the third party owner of the funds. As further explained by the *Continental National Bank* court, the so-called *National Indemnity* rule can also apply to funds held by the depositor in a fiduciary capacity.

As relevant here, there is no evidence that the funds MSM directed Bank to invest in CDs (which were then held in the Account) were “trust” funds – *i.e.*, funds held by MSM but owned by Pacificare, or funds held by MSM as a fiduciary for Pacificare. In fact, the summary judgment evidence is to the contrary. In accordance with the capitulation agreement between Pacificare and

MSM, the monies paid by Pacificare to MSM were MSM's funds. While MSM was supposed to establish a "Security Reserve" for the benefit of Pacificare and grant Pacificare a security interest in the "Reserve Bank Account," once paid, the monies belonged to MSM. Moreover, the relationship between MSM and Pacificare was not a fiduciary relationship. In the capitation agreement itself, the parties agreed that their relationship "is an independent contractor relationship" and that "[n]one of the provisions of this Agreement shall be construed to create a relationship of agency, representation, joint venture, ownership, control or employment between the parties other than that of independent parties contracting solely for the purpose of effectuating this Agreement." App. to Pacificare's Consol. Br. in Supp. of Resp. at App. 185, ¶ 7.1. Similarly, the agreement provides that it does not cause either party to be responsible for the debts or obligations of the other party. *Id.* In short, in accordance with the parties' agreement, the relationship between MSM and Pacificare was completely devoid of any trust or fiduciary characteristics.

In the absence of a trust or fiduciary relationship, the *National Indemnity* rule simply does not apply. Because the summary judgment record contains no evidence of such a relationship, Pacificare cannot prevail on this aspect of its conversion claim and summary judgment in favor of Bank is appropriate.

b. Constructive trust

In the alternative, Pacificare contends that Bank converted funds held by MSM in constructive trust for its benefit when such funds were pledged to Bank and/or when Bank foreclosed on such funds – *i.e.*, the CDs held in the Account. The Court will analyze Pacificare's constructive trust claim as it relates to the \$4.9 million transferred from BAISI to Bank in December 2000 separately from the capitation payments made by Pacificare after the new account control agreement between and among Pacificare, MSM, and Corporation was supposedly in place – *i.e.*,

after late January 2001.

For the reasons explained more fully below, *see infra* at pp. 44 - 45, the Court concludes that Pacificare failed to raise a genuine issue of material fact regarding at least two of the elements of its constructive trust claim to the \$4.9 million transferred from BAISI to Bank in December 2000. Thus, the \$4.9 million transferred from BAISI to Bank in December 2000 was not held by MSM in constructive trust for Pacificare's benefit. As a result, MSM properly pledged certain of those funds to Bank to secure the \$3 million line of credit on December 28, 2000.

For the reasons explained more fully below, *see infra* at pp. 45 - 50, the Court also concludes that Pacificare failed to raise a genuine issue of material fact regarding one of the elements of its constructive trust claim to the capitation payments made after February 1, 2001 – *i.e.*, unjust enrichment of MSM. Thus, the capitation payments that Pacificare made to MSM after February 1, 2001 (which were invested in CDs and held in the Account) were not held by MSM in constructive trust for Pacificare's benefit. As a result, MSM properly pledged those funds to Bank to secure its line of credit.

However, the parties' briefs address a further issue since they could not anticipate the above rulings by the Court. Specifically, Bank contends that its perfected security interest in the funds is a superior interest to any equitable title Pacificare would have in the funds if it prevailed on its constructive trust claim. Needless to say, Pacificare disagrees. While granting the Trustee's motion for summary judgment on Pacificare's constructive trust claim moots this issue, the Court will address it to assist the parties and to facilitate appellate review.

If the Trustee was not entitled to summary judgment on Pacificare's constructive trust claim

regarding the capitation payments made after February 1, 2001,⁶ and, after trial, the Court concluded that MSM held these funds in constructive trust for Pacificare's benefit, could MSM pledge them to Bank to secure its line of credit? If MSM could grant Bank a valid security interest in the funds irrespective of whether Pacificare prevailed on its constructive trust claim against the Trustee, then a summary judgment in Bank's favor on this claim is appropriate in any event.

A valid security interest cannot "attach" unless the debtor has "rights in the collateral." TEX. BUS. & COM. CODE ANN. § 9.203(b)(2) (Vernon 2001).⁷ While the phrase "rights in the collateral" is not defined in the U.C.C., comment 6 to section 9.203 states that "[a] debtor's limited rights in the collateral, short of full ownership, are sufficient for a security interest to attach." TEX. BUS. & COM. CODE ANN. § 9.203, cmt. 6 (Vernon 2001). In addition, case law holds that a debtor has rights sufficient to create a security interest in property if the debtor has *any* right greater than mere possession. *See e.g., Merchants Bank v. Atchison (In re Atchison)*, 832 F.2d 1236, 1239 (11th Cir. 1987). Thus, a debtor can have "rights in the collateral" even though the debtor lacks full title to the property to be pledged as collateral. *See* 8A ANDERSON ON THE U.C.C. § 9.203:9R (2002); *see also Teton Int'l v. First Nat'l Bank*, 718 S.W.2d 838, 841 (Tex. App. – Corpus Christi, 1986 n.w.h.); *Fricke v. Valley Prod. Credit Ass'n*, 721 S.W.2d 747, 753 (Mo. Ct. App. 1986); *Morton Booth Co. v. Tiara Furniture, Inc.*, 564 P.2d 210, 212 (Ok. 1977). Even voidable title to property constitutes adequate "rights in the collateral" to enter into a secured transaction. *See* 8A ANDERSON ON THE

⁶Because Pacificare failed to raise an issue of material fact regarding at least two of the elements of its constructive trust claim to the funds transferred from BAISI to Bank in December 2000, the Court will not address this claim further. However, because Pacificare raised an issue of material fact regarding all but one of the elements of its constructive trust claim to the capitation payments it made after February 1, 2001, the Court will address this further issue as to those funds.

⁷ Article 9 was revised effective July 1, 2001, and the requirement that the debtor have "rights in the collateral" now appears in Section 9.203(b)(2). Article 9, as it read on the date relevant herein, contained the same substantive requirement, though it was contained in Section 9.203(a)(3). Cases construing Section 9.203(a)(3) are therefore instructive.

U.C.C. § 9.203:9R (2002); *Nat'l Pawn Brokers Unltd v. Osterman, Inc.*, 500 N.W. 2d 407, 410-11 (Wis. Ct. App. 1993); *Ledbetter v. Darwin Dobbs Co.*, 473 So.2d 197, 200-01 (Ala. Civ. App. 1985); *Swets Motor Sales, Inc. v. Pruisner*, 236 N.W.2d 299, 304 (Iowa 1975).

Pacificare contends that Bank's security interest in the funds (which were then invested in CDs and held in the Account) did not attach because MSM lacked sufficient "rights in the collateral" to grant Bank such a security interest. *See e.g.*, Pacificare of Texas, Inc.'s Supplemental Br. in Supp. of Claim to Impose Constructive Trust ("Pacificare's Supp. Br. on Constr. Trust") at p. 13. Pacificare argues that because MSM had only legal title and not equitable title to the funds it paid to MSM (due to the imposition of a constructive trust in Pacificare's favor), MSM could not pledge those funds to Bank. In support of its argument, Pacificare relies on *First National Bank of Alexander City v. Avondale Mills Berelle Employees Fed. Credit Union*, 967 F.2d 556 (11th Cir. 1992) and *In re Boca Arena, Inc.*, 237 B.R. 221 (Bankr. S.D. Fla. 1999).

However, the *First National Bank* case is not relevant here. In that case, the Eleventh Circuit held that a thief, holding void title, could not pledge property because a thief has no "rights in the collateral." 967 F.2d at 559. However, "[u]nder Texas law, a constructive trust is not actually a trust, but rather an equitable remedy imposed by law to prevent unjust enrichment resulting from an unconscionable act." *Southmark v. Grosz (In re Southmark Corp.)*, 49 F.3d 1111 (5th Cir. 1995). Thus, even if Pacificare prevails on its constructive trust claims against MSM, MSM had legal title to the funds while Pacificare had equitable title. That legal title would then be avoided as an equitable remedy to prevent MSM's unjust enrichment. *Id.*; *Haber Oil Co. v. Swinehard (In re Haber Oil Co.)*, 12 F.3d 426, 435-36 (5th Cir. 1994). Accordingly, when MSM granted Bank a security interest, MSM held *voidable* legal title to the funds, not void legal title. As noted previously, voidable legal title provides sufficient "rights in the collateral" with which to grant a

valid security interest.

While the *Boca Arena* case is relevant because it addresses the issue of pledging property held in constructive trust, for the reasons explained below, it is not persuasive.⁸ In that case, the chapter 7 trustee filed an adversary proceeding to determine the validity of a creditor's security interest in stock pledged by a party ("Mullin," an investor and promoter of the debtor) who was alleged to hold the stock in constructive trust for the debtor. The *Boca Arena* court held that Mullin could not pledge shares of stock he was later found to hold in constructive trust without the debtor's permission. 237 B.R. at 224. The court's analysis turned on the fact that Mullin did not rightfully own the shares – *i.e.*, had no "title," and did not obtain the debtor's permission to pledge the shares. In reaching its holding, the court relied on *First Southern Ins. Co. v. Ocean State Bank*, 562 So.2d 798, 799 (Fla. Dist. Ct. App. 1990), where an employee "pilfered the title." *See id.*

Because the *Boca Arena* court failed to address the case law under the U.C.C. that broadly defines "rights in the collateral," and failed to distinguish between void and voidable title, this Court finds its analysis unpersuasive. As noted previously, under the U.C.C., a party holding voidable legal title has sufficient "rights in the collateral" to grant a valid security interest in favor of a third party. Thus, even if Pacificare prevails on its constructive trust claim, under Texas state law MSM's legal title to the funds constitutes sufficient "rights in the collateral" to grant Bank a valid security interest in the funds.

Because the Court has concluded that MSM had sufficient rights in the collateral to grant Bank a valid security interest in the funds, the Court must address Pacificare's next contention. Pacificare argues that its equitable title to the funds (as a beneficiary of a constructive trust) trumps

⁸This is the only case cited by the parties addressing this specific issue. In fact, the *Boca Arena* court noted that "[t]here appear to be no reported cases factually analogous to the circumstances *sub judice*." 237 B.R. at 224.

Bank's perfected security interest in the funds.

In response, Bank argues that any constructive trust imposed in Pacificare's favor, "terminated as a matter of law when Bank acquired its security interest in the funds" because, under the U.C.C.'s broad definition of the terms "purchase" and "purchaser," Bank is a bona fide purchaser who takes free of Pacificare's interest. See Supplemental Brief of Bank on Constructive Trust Issues at p. 17. In support of its good faith purchaser defense, Bank relies on non-U.C.C. cases, the RESTATEMENT OF TRUSTS, and the RESTATEMENT OF RESTITUTION. These authorities all state that a bona fide purchaser takes free of a constructive trust. See e.g., *In re Gen. Coffee Corp.*, 828 F.2d 699 (11th Cir. 1987); *In re CRS Steam, Inc.*, 225 B.R. 833 (Bankr. D. Mass. 1998); *Peirce v. Sheldon Petroleum Co.*, 589 S.W.2d 849, 852 (Tex. Civ. App – Amarillo 1979, n.w.h.); *Gutierrez v. Madero*, 564 S.W.2d 185 (Tex. Civ. App. – Eastland 1978, writ ref'd n.r.e.); *Fitz-Gerald v. Hull*, 237 S.W.2d 256 (Tex. 1951); RESTATEMENT (SECOND) OF TRUSTS § 284; RESTATEMENT OF RESTITUTION §§ 166 cmt. b, 172 cmt. a, 174. While these authorities are relevant, the Court must also look to the U.C.C. because the issue is whether Bank became a bona fide purchaser by extending credit and taking an Article 9 security interest without knowledge of the facts giving rise to Pacificare's claim for the imposition of a constructive trust.

In general, a bona fide purchaser is one who acquires property in good faith, for value, and without notice of any third-party claim or interest. *Madison v. Gordon*, 39 S.W.3d 604 (Tex. 2001). The U.C.C. does not define the term "bona fide purchaser." It does, however, define "purchaser" as "a person who takes by purchase." TEX. BUS. & COM. CODE ANN. § 1.201(33) (Vernon 1994). In turn, "purchase" is defined as "taking by sale, discount, negotiation, mortgage, *pledge*, *lien*, *security interest*, issue or reissue, gift or any other voluntary transaction creating an interest in the property." TEX. BUS. & COM. CODE ANN. § 1.201(32) (Vernon 1994) (emphasis added). Thus,

under the plain language of the U.C.C., Bank is a “purchaser.” *Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d 1238, 1242 (5th Cir. 1976) (“The Code definition of ‘purchaser’ is broad, and includes not only one taking by sale but also covers persons taking by gift or by voluntary mortgage, pledge or lien . . . [i]t is therefore broad enough to include an Article Nine secured party.”); *In re Leeds Bldg. Prods., Inc.*, 141 B.R. 265, 268 (Bankr. N.D. Ga. 1992) (the UCC definitions of ‘purchase’, ‘purchaser’ and ‘good faith’ “clearly include a secured party with a properly perfected security interest in a debtor’s inventory in the definition of ‘good faith purchaser.’”); *A.V. Beebe v. MacMillan Petroleum (Arkansas) Inc. (In re MacMillan Petroleum (Arkansas) Inc.)*, 115 B.R. 175 (Bankr. W.D. Ark. 1990) (creditor which takes security interest by lien is a purchaser under the U.C.C.).

However, Pacificare argues that Bank is not entitled to summary judgment on its good faith purchaser defense because there is an issue of material fact with respect to another element of that defense – *i.e.*, whether Bank gave value for its security interest in the funds. *See* Pacificare’s Supp. Br. on Constr. Trust at p. 12. Citing *Citibank (New York State), N.A. v. Interfirst Bank of Wichita Falls, N.A.*, 784 F.2d 619 (5th Cir. 1986), Pacificare argues that the extinguishment of an antecedent debt is not “value.” According to Pacificare, because MSM owed an antecedent debt to Bank due to million dollar overdrafts on another account at Bank which were repaid from the proceeds of the secured line of credit, Bank did not give “value” to MSM such that Bank qualifies as a bona fide purchaser who cuts off the constructive trust Pacificare alleges in the funds.

The Court disagrees. First, *Citibank* is not on point. *Citibank* holds that extinguishing an antecedent debt of the depositor is not a detrimental change in position regarding the imposition of the so-called *National Indemnity* rule (wrongful setoff of a deposit account by a bank that contains funds held in trust for another). *See supra* at pp. 18 - 21. It has nothing to do with whether “value”

is given by the beneficiary of an article 9 security interest when it extinguishes an antecedent debt.

Moreover, under the U.C.C., “value” is given for rights if the party acquires them “(A) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon . . . (B) as security for or in total or partial satisfaction of a pre-existing claim” TEX. BUS. & COM. CODE ANN. § 1.201(44) (Vernon 1994). Thus, a “purchaser” gives value when it acquires rights in the collateral in full or partial satisfaction of a pre-existing claim. *See* 8A ANDERSON ON THE U.C.C. § 1-201:761(2002). As relevant here, even if the entire availability on the secured line of credit was advanced and then used to repay Bank’s antecedent debt as Pacificare contends, Bank gave value to MSM under the U.C.C. *See id.*; *see also Dick Hatfield Chevrolet, Inc. v. Bob Watson Motors, Inc.*, 708 P.2d 494 (Ka. 1985) (supreme court affirmed that bank gave value by acquiring rights in partial or full satisfaction of pre-existing claim, but reversed on finding of good faith); *Red River Nat’l Bank v. Latimer*, 110 S.W.2d 232, 237-38 (Tex. Civ. App. – Texarkana 1937) (“requirement of valuable consideration is met when it appears that the purchaser would be left in a worse condition than before he purchased, as where he parted with some valuable right.”). Accordingly, Pacificare’s contention that Bank is not entitled to bona fide purchaser status because it did not give “value” must be rejected.

Pacificare next argues that there is an issue of material fact with respect to Bank’s status as a bona fide purchaser because there is sufficient evidence in the summary judgment record from which a jury could conclude that Bank either knew or should have known of Pacificare’s claim to the funds. Specifically, Pacificare points to its evidence that Bank knew that (i) MSM was required to establish a security reserve account for Pacificare’s benefit, (ii) MSM was obligated to maintain that reserve account, and (iii) MSM had large amounts of restricted cash on its balance sheet and not enough unrestricted cash to pledge to Bank as collateral.

However, for the reasons explained below, this evidence does not raise a genuine issue of material fact regarding Bank's status as a bona fide purchaser with respect to those funds acquired by MSM from Pacificare after February 1, 2001. When property that is later subject to a competing claim for the imposition of a constructive trust is "purchased" for "value," the relevant inquiry in determining the transferee's status as a bona fide purchaser is whether the transferee had notice of the facts giving rise to the constructive trust claim at the time of its purchase. RESTATEMENT (FIRST) OF RESTITUTION §§ 172, cmt. a (1937). A person has notice of facts giving rise to a constructive trust claim if he knows the facts or should have known them. RESTATEMENT (FIRST) OF RESTITUTION § 174 (1937). Under the U.C.C., "[a] person has "notice" of a fact when (A) he has actual knowledge of it; or (B) he has received a notice or notification of it; or (C) from all the facts and circumstances known to him at the time in question he has reason to know that it exists. A person "knows" or has "knowledge" of a fact when he has actual knowledge of it" TEX. BUS. & COM. CODE ANN. § 1.201(25) (Vernon 1994).

As relevant here, the factual underpinning for Pacificare's claim that MSM acquired capitation payments from it after February 1, 2001 by fraud is the forged new account control agreement between and among Pacificare, MSM, and Corporation and supposedly signed by those parties in late January 2001. Neither Pacificare nor Bank was aware of the forgery until well after the funds were "purchased" – *i.e.*, pledged, to Bank. In fact, the forgery was not discovered until after this lawsuit was filed. There is no evidence to suggest that Bank knew or should have known that this new account control agreement was a forgery when the funds were pledged to Bank. In fact, there is no evidence to suggest that Bank even knew such an agreement was signed in January 2001. While there is evidence that Mark Tranchina ("Tranchina") at Bank was provided with a copy of the new account control agreement in June 2001, Bank's secured line of credit was fully advanced

by that time. On this record, the Court concludes that Pacificare failed to raise an issue of fact with respect to Bank's status as a bona fide purchaser.

It is settled under Texas state law that a bona fide purchaser will prevail over the beneficiary of a constructive trust. Pacificare concedes as much. *See* Pacificare's Supp. Br. on Constr. Trust at p. 10 ("Texas law recognizes that purchasers of property who take the property in good faith and without notice of the constructive trust claim take the property relieved from the constructive trust"). Where two innocent parties are involved and the recipient of a wrongful transfer is a bona fide purchaser for value, the recipient will prevail over one seeking to impose a constructive trust. *See, e.g. Fitz-Gerald v. Hull*, 237 S.W.2d 256, 263 (Tx. 1951) (once a constructive trust is imposed, a court may reach the property "either in the hands of the original wrong-doer, or in the hands of any subsequent holder, until a purchaser of it in good faith and without notice acquires a higher right, and takes the property relieved from the trust"); *Gutierrez v. Madero*, 564 S.W.2d 185, 190 (Tex. Civ. App. – Eastland 1978) (recognizing Restatement rule that recipient of wrongful transfer who is a bona fide purchaser for value prevails over beneficiary of constructive trust on same property, but holding that gratuitous transferee does not). Similarly, section 168 of the Restatement of Restitution states that "[w]here the owner of property transfers it in fraud of third persons, the transferee holds the property subject to their claims, *unless he is a bona fide purchaser.*" RESTATEMENT (FIRST) OF RESTITUTION, § 168(2) (1937).

Bank has not cited, and the Court has not located, any Texas case in which the holder of a perfected security interest in funds, who is clearly a "purchaser" under the U.C.C., has been treated as a bona fide purchaser under Texas state law and has been held to have rights superior to the beneficiary of a constructive trust. However, there are sound reasons to draw an analogy between the state law concept of a bona fide purchaser and the U.C.C. concepts of "good faith," "value," and

“purchaser.” First, the Fifth Circuit has held that the holder of an Article 9 security interest is a bona fide purchaser under the U.C.C.’s counterpart to a state law bona fide purchaser. *Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d 1238, 1242 (5th Cir. 1976) (holding that the rights of the holder of an Article 9 perfected security interest in goods are superior to the rights of an unpaid cash seller in those same goods). In addition, as between two innocent parties (the defrauded party entitled to the imposition of a constructive trust and the party who took a security interest in the tainted funds without knowledge of the taint), the defrauded party was at least a party to the underlying transaction that gave rise to the constructive trust claim. As a party to the underlying transaction, that party was in a better position to protect itself than was the subsequent lienholder, who may have had no knowledge of the underlying transaction at all, much less the fraud in that underlying transaction. This is particularly true here. In late January 2001, Pacificare executed a new account control agreement that purported to be between and among MSM, Corporation, and itself. Notwithstanding the fact that its new account control agreement was with Corporation, Pacificare deposited the capitation payments it made to MSM thereafter into an account at Bank. The only way Pacificare could have been protected by the new account control agreement it had signed was if it deposited funds into an account maintained at an institution that was a party to the account control agreement – *i.e.*, Corporation. If Pacificare had attempted to deposit funds into an account at Corporation, it would have discovered the fact that the new account control agreement was a forgery because Corporation is a holding company that maintains no customer deposit accounts and it would have refused to accept any deposit. Thus, Pacificare failed to protect itself by recognizing the entity discrepancy between its deposits of funds into an account at Bank and its new account control agreement with Corporation. As between Pacificare and Bank (who had no knowledge of the new account control agreement at all), Pacificare was clearly in a superior position to protect itself with

respect to these funds.

There are other sound policy reasons to treat Bank as a bona fide purchaser under state law. If the holder of a perfected Article 9 security interest does not, as bona fide purchaser, prevail over the beneficiary of a constructive trust, the purpose of the U.C.C. will be vitiated. Lenders would never be able to lend with assurance that they will be protected against unknown parties who may later lay claim to the funds as a result of some undisclosed and undiscoverable transaction. For some commercial borrowers, the result would be an inability to borrow. For others, the cost of borrowed funds would skyrocket, as lenders adjust for the risk that there may be a constructive trust beneficiary out there somewhere able to cut off their perfected security interest. A rule that allows good faith purchasers to assert greater rights than a defrauded party can assert “is designed to promote the greatest range of freedom possible to commercial vendors and purchasers.” *Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d 1238, 1242 (5th Cir. 1976). There is no reason, given the U.C.C.’s recognition of lienors as “purchasers,” to impose a different rule simply because a sale of goods is not involved.

Thus, the Court concludes that even if Pacificare were to prevail at trial on its constructive trust claim against the Trustee regarding the capitation payments made after February 1, 2001, MSM’s pledge of the funds was valid, Bank’s status as bona fide purchaser defeats Pacificare’s beneficial interest in the funds, and summary judgment in Bank’s favor on this claim is appropriate.

2. Breach of Contract

a. Oral contract

Forman testified in her affidavit that in late January 2001 when she learned that the funds in the so-called Pacificare reserve account at BAISI had been moved to Bank, she immediately called BAISI demanding an explanation. While she did not speak with anyone on that date, she

testified in her affidavit that she left such a message. Forman further testified that the following week she participated in a conference call initiated and attended by Lovelady (who apparently does not remember the call as he makes no mention of it in his affidavit) with a “representative” of Bank to discuss the transfer of funds from BAISI to Bank. However, Forman cannot identify this Bank representative by either name or title. According to Forman’s affidavit, this Bank representative explained that MSM’s funds had been transferred from BAISI because BAISI was not set up to handle the reserve account and because the funds would be safer at Bank. Forman testified that this person “assured me that the funds were protected and were pledged to Pacificare.” According to Forman, this person “promised” to send a letter confirming the phone conversation. Finally, Forman testified that a few days later she received a copy of a letter from Tranchina at Bank to Miller at MSM which confirmed that the funds in the Account were pledged to Pacificare and were protected.⁹ From these facts, Pacificare contends that Pacificare and Bank had an oral contract to restrict the Account in Pacificare’s favor which Bank breached by taking a lien on the Account in its favor. Bank contends that these facts, even if true, are legally insufficient to establish an oral agreement between Pacificare and Bank.

“The elements of written and oral contracts are the same and must be present for a contract to be binding.” *Wal-Mart Stores, Inc. v. Lopez*, 2002 WL 31526438 at *4 (Tex. App. – Houston [14th Dist.] Nov. 14, 2002) (citing *Bank of El Paso v. T.O. Stanley Boot Co.*, 809 S.W.2d 279, 284 (Tex. App. – El Paso 1991), *aff’d in part, rev’d in part on other grounds*, 847 S.W.2d 218 (Tex. 1992)). Thus, to form a binding oral contract, there must be: (i) an offer, (ii) an acceptance in strict compliance with the terms of that offer, (iii) a meeting of the minds, (iv) communication that each

⁹However, like the new account control agreement, the parties now agree that this letter was a forgery. In short, Tranchina did not sign or send the letter.

party consents to the terms, and (v) delivery of the acceptance with the intent that it be mutual and binding. See *Interfederal Capital, Inc. v. Flagstar Bank, FSB*, 2001 WL 1645480 (N.D. Tex. Dec. 19, 2001) (citing *Komet v. Graves*, 40 S.W.3d 596, 600 (Tex. App. – San Antonio 2001, no writ)).

The Court agrees with Bank that there is no evidence to establish the existence of an oral contract between Bank and Pacificare. Pacificare asserts that Bank is liable for breach of an oral contract based upon assurances received in a telephone call with an unidentified Bank representative. Given the fact that the Tranchina letter was a forgery, it is unclear if the person who participated in the call with Forman was actually a representative of Bank. However, even assuming that fact in Pacificare's favor, the Court has no way to assess whether that person was authorized to make an "offer" to restrict the Account in Pacificare's favor on behalf of Bank (that Pacificare then accepted such that an oral contract was made by those parties). Apparent authority is determined by only the acts of the principal. An agent's representations as to his or her authority have no effect. *Humble Nat'l Bank v. DCV, Inc.*, 933 S.W.2d 224, 237 (Tex. App. – Houston [14th Dist.] 1996, writ denied). The acts of the principal must be sufficient to "lead a reasonably prudent person using diligence and discretion to suppose the agent had the authority the agent purported to exercise." *Id.*

Absent evidence of this unidentified person's authority to make this "offer" on Bank's behalf, Bank cannot be found to have entered into an oral contract with Pacificare. The summary judgment record contains no evidence of who this person was, much less his authority to make any offer on Bank's behalf. Thus, Bank's motion for summary judgment is granted with respect to this claim.

b. Implied Contract

Pacificare next contends that a contract should be implied from the parties' conduct and that

Bank then breached this implied contract. Pacificare relies upon the facts set forth above – *i.e.*, the “verbal agreement” to restrict the Account in its favor, and the fact that: (i) Bank sent copies of account statements to Pacificare which showed that the Account was pledged, (ii) Pacificare made additional payments into the Account, and (iii) Tranchina never repudiated the new account control agreement when it was sent to him in June 2001.

Bank explains that the reason the account statements showed that the Account was pledged was because it was pledged – *i.e.*, to it (MSM had pledged the Account and its assets, the CDs, to secure Bank’s line of credit) and not to Pacificare.¹⁰ Moreover, it is undisputed that by the time the so-called new account control agreement was provided to Tranchina, Bank’s line of credit was fully advanced. In short, Bank contends that the facts as alleged by Pacificare in the summary judgment record are legally insufficient to state a claim for the existence of an implied contract.

The elements for express and implied contracts are the same and must be present for a contract to be binding. *Univ. Nat’l Bank v. Ernst & Whinney*, 773 S.W.2d 707, 710 (Tex. App. – San Antonio 1989). With express contracts, the assent requirement is expressly stated, while in an implied contract, assent is inferred from the circumstances of the transaction. *See id.* (citing *Haws & Garrett Gen. Contractors, Inc. v. Gorbett Bros. Welding Co.*, 480 S.W.2d 607, 609 (Tex. 1972)).

On this record, the Court agrees with Bank that Pacificare has not come forward with sufficient evidence to establish the existence of an implied contract between Bank and Pacificare. The starting point for Pacificare’s implied contract is the oral “offer” to restrict the Account in favor of Pacificare made by the unidentified Bank representative. All of the other circumstances from which Pacificare contends a contract should be implied flow from that “offer.” If the person who

¹⁰Pacificare now admits that Bank holds a properly perfected security interest in the Account. At the time, Pacificare was unaware of Bank’s lien.

made that “offer” had no authority to make the offer and bind Bank, no implied contract can be found to exist. As noted previously, apparent authority is determined by only the acts of the principal. An agent’s representations as to his or her authority have no effect. *Humble Nat’l Bank v. DCV, Inc.*, 933 S.W.2d 224, 237 (Tex. App. – Houston [14th Dist.] 1996, writ denied). The acts of the principal must be sufficient to “lead a reasonably prudent person using diligence and discretion to suppose the agent had the authority the agent purported to exercise.” *Id.*

Because the summary judgment record contains no evidence of who this person was, much less his authority to make any offer on Bank’s behalf, no contract can be implied from the parties’ conduct. Thus, Bank’s motion for summary judgment is granted with respect to this claim.

c. Promissory Estoppel

Promissory estoppel may be invoked if a promisee has acted in reasonable reliance on an otherwise unenforceable promise. See *Wheeler v. White*, 398 S.W.2d 93, 96 (Tex. 1965); RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981). The elements of promissory estoppel are: (i) a promise, (ii) foreseeability of reliance by the promisor, and (iii) substantial, reasonable reliance by the promisee to his detriment. *Ford v. City State Bank of Palacios*, 44 S.W.3d 121, 139 (Tex. App. – Corpus Christi 2001); *Gilmartin v. KVVU-TV Channel 13*, 985 S.W.2d 553, 558 (Tex. App. - San Antonio, 1998). As relevant here, and as noted above, there is no evidence that the person who made the “promise” was authorized to do so on behalf of Bank. Moreover, there is no evidence that Pacificare reasonably relied on a “promise” made by a person it is unable to identify by name or title. Thus, Bank’s motion for summary judgment is granted with respect to this claim.

3. Intentional Misrepresentation

As noted previously, to prevail on a claim for intentional misrepresentation, Pacificare must prove that: (i) a material misrepresentation was made by Bank which was false, (ii) the

misrepresentation was either known to be false when made or was asserted without knowledge of its truth, (iii) the misrepresentation was intended to be acted upon, (iv) the misrepresentation was relied upon, and (v) the misrepresentation caused injury. *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 758 (Tex. 2001). Pacificare relies upon the oral “assurance” of the unidentified Bank representative to Forman in a telephone call that “the funds were protected and were pledged to Pacificare” as the sole basis for its intentional misrepresentation claim.

Absent evidence of this person’s authority to make this “representation” on Bank’s behalf, Bank cannot be held liable to Pacificare on an intentional misrepresentation claim. *See supra* at pp. 15, 35 - 36. The summary judgment record contains no such evidence. Thus, Bank’s motion for summary judgment is granted with respect to this claim.

4. Negligent Misrepresentation

As noted previously, to establish its negligent misrepresentation claim Pacificare must prove that: (i) Bank made a false representation in the course of its business or in a transaction in which it had a pecuniary interest, (ii) the false information was supplied for the guidance of others in their business, (iii) Bank did not exercise reasonable care or competence in obtaining or communicating the information, and (iv) Pacificare suffered pecuniary loss by justifiably relying on the representation. *Clardy Mfg. Co. v. Marine Midland Bus. Loans Inc.*, 88 F.3d 347, 357 (5th Cir. 1996).

Even assuming the unidentified Bank representative was a Bank representative, and that he “assured” Forman that “the funds were protected and were pledged to Pacificare,” there is no evidence that he was authorized by Bank to make such a representation to Pacificare. *See supra*, pp. 16, 35 - 36. While Forman testified that she relied on this assurance, there is no evidence that her reliance was justified as she apparently made no inquiry of who this person was or his title or

responsibilities at Bank.

Absent evidence of this person's authority to make this "representation" on Bank's behalf, and Pacificare's justifiable reliance on such a representation, Bank cannot be held liable to Pacificare on a negligent misrepresentation claim. The summary judgment record contains no such evidence. Thus, Bank's motion for summary judgment is granted with respect to this claim.

5. Negligence

To prevail on a claim for negligence, Pacificare must prove that: (i) Bank had a legal duty to Pacificare, (ii) Bank breached that duty, and (iii) Pacificare's damages proximately resulted from Bank's breach. *Van Horn v. Chambers*, 970 S.W.2d 542, 544 (Tex. 1998); *Greater Houston Transp. Co. v. Phillips*, 801 S.W.2d 523, 525 (Tex. 1990).

Pacificare contends that "Bank owed Pacificare a duty not to seize and retain the Bank account when it knew or should have known that the funds were pledged to Pacificare as security reserves." Pacificare's Consol. Br. at p. 60. In support of this contention, Pacificare relies solely on *Allied Bank West Loop, N.A. v. C.B.D. & Assocs.*, 728 S.W.2d 49, 58 (Tex. App. – Houston 1987, writ ref'd n.r.e.). In *Allied Bank*, the court overruled the bank's contention that it owed no legal duty to its account customer, C.B.D. Thus, the court held that the bank could be held liable to C.B.D. for its negligence in wrongfully offsetting funds held by C.B.D. in trust for another against a debt owed by C.B.D. to the bank. Of significance, the *Allied Bank* court found that the bank owed a legal duty to its account customer when it knew or should have known of the trust nature of its customer's account.

Here, however, it is not Bank's customer, MSM, complaining of a wrongful offset of the Account. Rather, it is Pacificare, a non-account party, who complains of Bank's action. Moreover, the record contains no evidence from which the Court could find that Pacificare enjoyed a trust or

other fiduciary relationship with MSM. *See supra* at pp. 20 - 21. While Pacificare was supposed to have a security interest in the Account and its assets, a security interest is different from an ownership interest in the Account and its assets. *Allied Bank* is simply not controlling precedent.

Because Pacificare can cite no basis for the imposition of a legal duty from Bank to Pacificare, Pacificare's negligence claim fails as a matter of law.

6. Tortious Interference

To prevail on a claim for tortious interference, Pacificare must prove that: (i) a contract subject to interference exists, (ii) the alleged act of interference was willful and intentional, (iii) the willful and intentional act proximately caused damage, and (iv) actual damage or loss occurred. *ACS Investors, Inc. v. McLaughlin*, 943 S.W.2d 426, 430 (Tex. 1997); *Graham v. Mary Kay Inc.*, 25 S.W.3d 749, 753 (Tex. App. – Houston [14th Dist.] 2000).

Pacificare contends that three separate intentional acts by Bank "caused MSM to breach its contract [the capitation agreement] with Pacificare: (i) Bank moved the funds from BAISI to Bank; (ii) in so doing, Bank stripped the funds of their prior pledged status; and (iii) when Bank seized the funds, it converted Pacificare's funds for the debt of MSM." Pacificare's Consol. Br. at p. 52. In short, Pacificare contends that "[t]hese acts, moving the funds while knowing that they were restricted, and then taking a security interest in them and ultimately seizing the funds constitutes intentional and willful actions by Bank that give rise to tortious interference." *Id.* at p. 53.

Bank contends that there is no evidence of any willful and intentional act by Bank such that Bank could be held liable for tortious interference with the capitation agreement between MSM and Pacificare. Bank contends that it did not cause MSM to move the funds from BAISI to Bank. According to Bank, MSM decided that it would be advantageous to have the funds at Bank instead of at BAISI. Moreover, Bank contends that if MSM transferred the funds in violation of the account

control agreement, Pacificare has claims for breach of contract against others, not a tortious interference claim against it. Bank further contends that there is no evidence that Bank, with the purpose and intent of inducing MSM to breach its agreement with Pacificare, encouraged MSM to move funds from BAISI to Bank. Finally, Bank contends that there is no evidence that Bank's taking of a security interest in the Account and its assets interfered with any rights of Pacificare in any valid agreement between Pacificare and MSM. According to Bank, it reasonably relied on the representations of its borrower, MSM, when it took a security interest in the Account. Specifically, Bank points to MSM's representations that the funds were unencumbered and that it could pledge those funds to secure Bank's line of credit.

The Court has struggled with this claim. While Bank contended initially that it had no knowledge of the specific terms of the capitation agreement between Pacificare and MSM (and the "Security Reserve" requirement contained in that agreement), that contention was incorrect. On this record it is clear that Bank was provided with a copy of the Pacificare capitation agreement during its due diligence. So, there is evidence in the summary judgment record to create an issue of fact regarding Bank's knowledge of an agreement subject to interference.

The second element of a tortious interference claim – *i.e.*, the alleged act of interference was willful and intentional, presents a more difficult analysis. At the final hearing on the Motions, Pacificare agreed that it had overstated its contention in this regard in its brief when it stated that Bank moved the funds from BAISI to Bank and thereby stripped the funds of their pledged status in Pacificare's favor. As Pacificare's counsel conceded, Bank did not give the instruction to move the funds, MSM gave that instruction. However, as clarified at the December 3 hearing, Pacificare's more precise contention is that Bank pressured MSM to enter into the secured revolving line of credit in December 2000 in order to protect itself on a serious overdraft situation which Bank had

allowed to occur with respect to one of MSM's accounts at Bank. According to Pacificare, when Bank pressured MSM to enter into the secured financing facility in late December 2000 so that its unsecured overdrafts could be repaid through an advance on a secured line of credit, it knew (or should have known) of the "Security Reserve" requirement in Pacificare's capitation agreement and it knew (or should have known) that MSM did not have unrestricted funds which it could pledge to Bank to secure a \$3 million line of credit. According to Pacificare, by pressuring MSM to protect it on its unsecured overdrafts, Bank wilfully and intentionally interfered with MSM's contractual obligation to hold the \$4.9 million in a "Reserve Bank Account" which was subject to Pacificare's security interest.

There is evidence that Bank allowed a serious overdraft situation to occur and that Bank was quite concerned about its unsecured exposure to MSM. Moreover, there is some evidence from which the Court could conclude at trial that Bank should have known that MSM did not have sufficient unrestricted funds to pledge to Bank to secure its proposed \$3 million line of credit. Finally, there is evidence of harm to Pacificare from the transfer of the funds from BAISI to Bank and the subsequent pledge of certain of those funds to secure Bank's line of credit.

Where the moving party's submissions do not foreclose the possibility of the existence of certain facts from which "it would be open to a jury . . . to infer from the circumstances" that Bank knew that there were insufficient unencumbered funds to pledge to Bank and therefore wilfully and intentionally interfered with MSM's contractual obligation to hold the \$4.9 million in its Reserve Bank Account, then summary judgment is inappropriate. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986) (citing *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 158-159 (1970)). At this stage, the Court's function is not to "weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." *Anderson*, at 249. There is no issue for trial

unless there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party. *Id.*

Here, the September 30, 2000 financial statement, with its notation "restricted assets as to use," coupled with Bank's knowledge of the terms of the capitation agreement with its reserve account requirement, could be sufficient evidence for a fact-finder to return a verdict for Pacificare after trial. To grant summary judgment in Bank's favor on this claim, the Court would have to weigh that evidence, which is not the province of the Court at this stage of the proceeding. As the Fifth Circuit recently stated, in reviewing a motion for summary judgment the court shall "make no credibility determinations or weigh any evidence." *Thompson v. Goetzmann*, 315 F.3d 457, 469 (5th Cir. 2002). Because Pacificare has raised a genuine issue of fact with respect to each of the elements of a tortious interference claim against Bank, summary judgement is not appropriate.

C. THE TRUSTEE'S MOTION

The Trustee seeks a determination that he can avoid Pacificare's interest in the Account and its assets (the CDs) in accordance with § 544(a) of the Bankruptcy Code because Pacificare failed to perfect its security interest prior to the Petition Date. In response, Pacificare contends that because MSM acquired capitation payments from Pacificare by fraud, those payments were held by MSM in constructive trust for Pacificare. According to Pacificare, because the funds were held by MSM in constructive trust for Pacificare's benefit, they are not property of the estate in accordance with § 541(a) of the Bankruptcy Code and Pacificare's interest in the Account and its assets (the CDs) is not avoidable by the trustee in bankruptcy.

1. Constructive Trust

To prevail on its constructive trust defense to the Trustee's strong arm powers, Pacificare must prove that: (i) MSM acquired capitation payments from Pacificare through actual fraud, (ii)

MSM would be unjustly enriched by keeping these payments, and (iii) Pacificare can trace the property acquired by fraud – *i.e.*, the capitation payments, to an identifiable res. *Haber Oil Co. v. Swinehart (In re Haber Oil Co.)*, 12 F.3d 426, 437 (5th Cir. 1994) (applying Texas law); *Monnig's Dept. Stores, Inc. v. Azad Oriental Rugs, Inc., (In re Monnig's Dept. Stores, Inc.)*, 929 F.2d 197, 201 (5th Cir. 1991) (applying Texas law).

As noted previously, the Court will analyze Pacificare's constructive trust defense as it relates to the \$4.9 million transferred from BAISI to Bank in December 2000 separately from the capitation payments made by Pacificare after the new account control agreement between and among Pacificare, MSM, and Corporation was supposedly in place – *i.e.*, after late January 2001. Turning to the \$4.9 million first, there is no evidence in the summary judgment record from which the Court could find that those funds were acquired by MSM by actual fraud.¹¹ Initially, the Court notes that Pacificare's primary contention regarding the transfer of these funds from BAISI to Bank is that the funds were transferred in breach of the account control agreement between and among Pacificare, MSM, and BAISI and that BAISI is liable to Pacificare for such breach. *See supra* at pp. 9 - 13. However, if the Court concludes that the account control agreement was not effective due to Pacificare's failure to accept that agreement in a legally sufficient manner, Pacificare contends in the alternative that MSM acquired the capitation payments from it by fraud such that these funds were held in constructive trust by MSM for Pacificare's benefit.

The Court disagrees. On this record it appears that Pacificare had been making regular

¹¹To establish actual fraud, Pacificare must prove that: (i) MSM made a material representation that was false, (ii) MSM knew the representation was false or made it recklessly as a positive assertion without any knowledge of its truth, (iii) MSM intended to induce Pacificare to act upon the representation, and (iv) Pacificare actually and justifiably relied upon the representation and thereby suffered injury. *Ernst & Young, L.L.P. v. Pacific Mut. Life Ins. Co.*, 51 S.W.3d 573, 577 (Tex. 2001); *Moorehouse v. Chase Manhattan Bank*, 76 S.W.3d 608, 615 (Tex. App. – San Antonio 2002).

capitation payments to MSM from February 2000 (the stated effective date of the account control agreement) to August 2000 notwithstanding the fact that the “Security Reserve” had not been funded by MSM. There is no evidence to suggest that MSM acquired these capitation payments from Pacificare by fraud. In fact, although Pacificare knew that the Security Reserve had not been funded, it continued to make its regular capitation payments to MSM. In the absence of evidence that MSM acquired these capitation payments from Pacificare through a material misrepresentation which was justifiably relied upon, the funds cannot be subject to a constructive trust in Pacificare’s favor. Pacificare has not pled, nor offered evidence to support, a finding of a material misrepresentation made to Pacificare by MSM that caused Pacificare to continue to make capitation payments to it from February 2000 through August 2000.

Moreover, Pacificare has not offered any evidence that the \$4.9 million which was deposited into the so-called Pacificare reserve account at BAISI in August 2000 (and out of that account in December 2000) came from Pacificare’s capitation payments. In fact, the overwhelming summary judgment evidence is to the contrary. On this record it appears that the \$4.9 million was transferred from another MSM account at BAISI into which Aetna’s capitation payments were deposited. In fact, Pacificare was advised that its security reserve account was funded, in large part, out of MSM’s “cash reserves from other payors” by letter dated October 17, 2000. *See* Second Supplemental App. to Bank’s and Corporation’s Mot. for Summ. J. and Br. in Supp. at App. 429-30. Pacificare has offered no evidence to support its obligation to trace the \$4.9 million to its funds.

Because Pacificare has failed to raise a genuine issue of material fact regarding at least two essential elements of its constructive trust defense, the Trustee is entitled to summary judgment with respect to the \$4.9 million transferred from BAISI to Bank in December 2000.

Turning next to the capitation payments made by Pacificare starting in February 2001, there

is evidence to suggest that these payments were made by Pacificare in reliance on the forged account control agreement submitted to it by MSM. However, the Trustee contends that this fraud by MSM is of no legal consequence because even if the account control agreement had not been a forgery, it would have been legally ineffective to give Pacificare control over these payments as the purported signatory to the new account control agreement, Corporation, is a holding company which maintains no depository accounts. Thus, according to the Trustee, even if Corporation's signature on the new account control agreement had not been forged by MSM, that agreement would have been legally ineffective to give Pacificare control over the capitation payments which were deposited into an account at Bank. In short, the Trustee contends that MSM did not acquire these capitation payments from Pacificare through fraud, MSM acquired the payments through Pacificare's own negligence. Pacificare knew the new account control agreement was between and among Pacificare, MSM, and Corporation and it also knew that it was depositing its capitation payments into an account at Bank, two legally separate entities.

In response, Pacificare contends that its mistake regarding the wrong Bank of America entity would have been revealed but for the forged document. According to Pacificare, but for the forgery, Corporation would never have signed an account control agreement because it maintains no depository accounts. When Corporation refused to sign the account control agreement, Pacificare could have insisted that the correct entity, Bank, sign the agreement before further capitation payments were made.

While the entity discrepancy should not have escaped Pacificare's notice, there is evidence in the summary judgment record to suggest that Pacificare would not have continued to fund capitation payments to MSM if it had realized that there was no valid account control agreement in place after late January 2001. Thus, there is a question of fact for trial regarding whether MSM

acquired these capitation payments by fraud.

However, to avoid a summary judgment in the Trustee's favor, Pacificare must demonstrate that there is also a genuine issue of material fact with respect to the other elements of its constructive trust defense – *i.e.*, unjust enrichment and tracing of its payments to an identifiable res. The Trustee concedes that Pacificare can trace its capitation payments into the assets held in the Account (the CDs). However, the Trustee disputes that Pacificare has raised a fact question with respect to unjust enrichment.

In support of his contention, the Trustee points to the affidavit of Lisa Lansink (“Lansink”),¹² the former Manager of Financial Accounting for Medical Pathways Management Corporation (“Pathways”). In summary, Lansink testifies in her affidavit that MSM was operating at a significant cash flow deficit with respect to claims by health care providers to Pacificare insureds. According to Lansink, the monthly capitation fee paid by Pacificare was insufficient to pay the claims of the health care providers. Thus, as of December 2000, Pacificare “had a cash deficit of \$2.9 Million.” Lansink affidavit at ¶ 5. In other words, MSM had overdrawn its “Main Account” (as defined by Lansink) at Bank by \$2.9 million. Lansink goes on to testify that the funds drawn on the \$3 million line of credit from Bank in late December 2000 were used “for the sole purpose of paying the health care providers of Pacificare.” *Id.* at ¶ 7. Lansink goes on to testify that

[b]ecause of the continuing deficit with respect to payments made to health care providers of Pacificare insureds compared to capitation payments being made by Pacificare, Medical Select Management had exhausted the entire \$3 Million line of credit by May 2001. Pacificare claims, however, continued to mount. Because of the Pacificare deficit, Medical Select Management had again overdrawn the Main Account, this time by approximately \$2.6 Million. On May 30, 2001, Medical Select

¹²Lansink's affidavit is contained in Bank's Second Supplemental Appendix filed on or about August 12, 2002. Also included in the Second Supplemental Appendix is the Affidavit of Retta L. Nelson (“Nelson”), Bank's Custodian of Records. Attached to Nelson's affidavit are copies of bank account statements for MSM's various accounts at Bank.

Management obtained from the Bank an increase in the line of credit from \$3 Million to \$7 Million. The additional \$4 Million from the credit line was deposited into the Main Account. . . . The additional \$4 Million was used by Medical Select Management to pay the health care providers of Pacificare's insureds.

See Lansink affidavit at ¶¶ 9 & 10.

Pacificare objects to Lansink's affidavit testimony for a variety of reasons and asks that portions of it be stricken from the summary judgment record. In addition, Pacificare asks to supplement the record with certain excerpts from her deposition which it claims casts doubt on the accuracy of her affidavit testimony. See Pacificare's Objections to Affidavit of Lisa Lansink and Designation of Excerpts from Deposition of Lisa Lansink, filed on November 27, 2002.

After reviewing Lansink's affidavit and the deposition excerpts tendered by Pacificare, the Court finds Lansink's affidavit testimony somewhat troubling. Even before it reviewed her deposition testimony, the Court believed Lansink's affidavit testimony to be in conflict with other summary judgment evidence before the Court. For example, while Lansink testifies in her affidavit that funds from Bank's line of credit were used "for the sole purpose of paying the health care providers of Pacificare," that testimony is, at best, imprecise. Certain representatives of Bank testified in their depositions that the funds advanced by Bank in December 2000 on the \$3 million line of credit were used to repay outstanding overdrafts on MSM's main account at Bank. See e.g., App. to Pacificare's Consol. Br. in Supp. of Resp. at App. 723:4 - 726:23 (Dep. of Nathan McClellan); App. 504:3 - 506:20 (Dep. of John Curtin). So, when Lansink testifies that the funds advanced by Bank were used "for the sole purpose of paying" claims of Pacificare health care providers, that is incorrect. The funds were used to pay Bank's unsecured claim against MSM arising from the overdrafts. While the funds advanced on the line might be said to have paid Pacificare provider claims *indirectly*, it is inaccurate to state that the funds were used "for the sole

purpose of paying the health care providers of Pacificare.”

Moreover, taken together, Lansink’s affidavit and deposition testimony raise questions regarding whether Pacificare’s capitation payments went solely to pay provider claims of Pacificare’s insureds. On the basis of Lansink’s deposition testimony, it is possible that some of the funds which were supposed to be held in a Pacificare reserve account went to pay other administrative costs of MSM, including the management fee of Pathways, Lansink’s employer.

However, is this unjust enrichment of MSM sufficient to state a claim for the imposition of constructive trust? Pacificare knew of the contractual arrangement MSM had with Pathways. In fact, Pathways negotiated the capitation agreement with Pacificare on behalf of MSM. So, is MSM unjustly enriched because some portion of Pacificare’s capitation payments may have gone to pay Pathway’s management fee? Moreover, what evidence did Pacificare submit to carry its burden of proof on this element of its constructive trust defense to the Trustee’s strong arm powers?

Before the summary judgment record was supplemented by Bank to include the affidavits of Lansink and Nelson on August 12, 2002, Pacificare had failed to discuss unjust enrichment in any of its briefs in any meaningful way (other than to mention it as an element of a constructive trust claim). Rather, Pacificare was focused on establishing the first element of its constructive trust defense – *i.e.*, that MSM acquired capitation payments after February 1, 2001 by fraud. *See* Pacificare’s Consol. Br. at pp. 68 - 71. While Pacificare cites to the affidavits of Forman and Lovelady it submitted in opposition to the Motions in that brief, the cited testimony addresses how Pacificare was damaged by MSM’s misrepresentation (regarding the new account control agreement) and supports the fifth element of its actual fraud claim – *i.e.*, “damages to the defrauded party.” *See id.* at pp. 69 - 70. The cited testimony does not address unjust enrichment of MSM at all.

In its next filed brief, (filed on August 12, 2002), Pacificare acknowledges its obligation to show “some unjust enrichment of the *wrongdoer*,” MSM, and recites that each element “has been satisfied in this case.” *See* Pacificare’s Supp. Br. on Constr. Trust at p. 4 (emphasis added). However, the only discussion of unjust enrichment in that fifteen page brief (not counting the signature page) is the following three sentences:

MSM’s fraud on Pacificare allowed MSM to borrow substantial funds from B of A. Without its pledge of Pacificare’s security reserves obtained through its extensive fraud, MSM would never have received its substantial line of credit from B of A. (*See* Curtain Depo. at 78:12 -79:2; App. in Response to BOA at 481- 482). B of A later took these funds to repay itself when MSM went into bankruptcy.

Id. at p. 8. The balance of that brief addresses why Pacificare’s constructive trust claim is a superior claim to those funds than Bank’s perfected security interest in the funds.

Pacificare filed its last brief in opposition to the Motions – *i.e.*, Pacificare’s Response to Supplemental Briefing Filed by Bank and Trustee, on December 18, 2002. Again, the focal point of that brief is why Bank’s security interest in the funds is inferior to Pacificare’s equitable interest due to the imposition of a constructive trust in Pacificare’s favor. Four sentences of that thirteen page brief are devoted to unjust enrichment, the upshot of which is Pacificare’s conclusion that “no further response is needed.” *Id.* at 13.

As the above demonstrates, the focal point of Pacificare’s unjust enrichment contention is Bank, not MSM. In short, Pacificare objects to Bank’s conversion of its unsecured exposure for overdrafts on Pacificare’s “Main Account” into secured advances on the line of credit. However, even assuming Pacificare prevails on its constructive trust defense against the Trustee, as between Bank and Pacificare, Bank prevails. As a bona fide purchaser for value, Bank can take a security interest in property that is subject to Pacificare’s claim of constructive trust. *See supra* at pp. 22 -32.

On this record, Pacificare has not raised a genuine issue of material fact with respect to any

“unjust enrichment” of MSM. While a portion of Pacificare’s capitation payments after February 1, 2001 were not maintained in a reserve account for Pacificare’s benefit as the capitation agreement required (which gives rise to a breach of contract claim against MSM, now the Trustee), and were instead pledged to Bank to secure Bank’s line of credit, the summary judgment evidence establishes that the funds advanced by Bank on its line of credit were used to repay overadvances on MSM’s Main Account. In turn, those overadvances were incurred in paying legitimate claims against MSM, including, in large part, Pacificare provider claims. MSM did not use Bank’s funds to benefit itself. Rather, MSM used Bank’s funds to pay legitimate operating expenses – the Pathway’s management fee and/or Pacificare provider claims. Thus, the Trustee is entitled to summary judgment with respect to this claim.

2. Declaratory Judgment

In its counter-cross claim against MSM (now, the Trustee), Pacificare also seeks a determination that (i) it has a valid security interest in the original reserve account at BAISI and the Account, (ii) it is entitled to the proceeds of both accounts, (iii) that Bank’s interest in the Account is inferior to its interest, and (iv) Bank must turn over the proceeds of both accounts to it. In his motion, the Trustee seeks a summary judgment disposing of each of these claims.

As noted previously, whether Pacificare was perfected in MSM’s account at BAISI depends on whether a binding account control agreement was entered into between and among BAISI, MSM, and Pacificare. In turn, that depends on whether Pacificare accepted the account control agreement and communicated its acceptance to BAISI in a legally sufficient manner. Because questions of fact have been raised by Pacificare with respect to these issues, summary judgment is not proper on this claim. However, the Trustee is entitled to a summary judgment with respect to Pacificare’s claim of a valid security interest in the Account. Pacificare was unperfected in the Account on the Petition

Date. Moreover, any beneficial interest Pacificare may have had in the funds placed in the Account after February 1, 2001 were cut off by Bank's security interest in the Account.

While Pacificare may be entitled to recover damages from BAISI for breach of the original account control agreement (if Pacificare carries its burden of proof at trial and establishes the existence of a binding agreement among the parties), and Pacificare may be entitled to recover damages from Bank for Bank's alleged tortious interference with the capitation agreement (if Pacificare carries its burden of proof at trial), Pacificare is not entitled to the proceeds of both accounts as the holder of a properly perfected security interest in the accounts.

V. CONCLUSION

For the reasons set forth above, BAISI is not entitled to a summary judgment on the breach of contract and declaratory judgment claims asserted against it by Pacificare, and Bank is not entitled to a summary judgment on the tortious interference claim asserted against it by Pacificare. All other claims and defenses asserted by Pacificare are disposed of by the Motions.

An Order consistent with this Memorandum Opinion will be entered separately.

Signed: February 11, 2003.

Barbara J. Houser
United States Bankruptcy Judge