

**ORAL ARGUMENT - 4/17/96**  
**95-1254**  
**FIRST USA V. ESMOND**

LAWYER: This is an employment case. Dale Esmond was an employee with First USA for 8-9 months before there was any discussion of any loan. The issue in this case is whether an employer commits usury if it terminates the employment of a senior executive for abusing an executive perk if that perk is allowed.

Mr. Esmond was a senior executive with First USA who had an employment contract. That contract obligated Mr. Esmond to devote all his energy, skills and time to the company. It also obligated Mr. Esmond to disclose and deliver to the company all works of offership, program, any development he did while with the company. In exchange for those services, First USA paid Mr. Esmond \$80,000 annually. The contract was to last for 5 years unless it was sooner terminated for cause, or because of Mr. Esmond's death or disability.

After working 8-9 months Esmond requested an \$18,000 loan. First USA wanted to accommodate Mr. Esmond, but recognized that he had never given to any executive or any employee a non-credit card loan. First USA also recognized the potential downside to the employer/employee relationship by expanding its executive perks to include loans to senior executives. And it required that it provided a safeguard if the employment relationship turned sour because of this loan. As a result the employment agreement was amended to expressly provide that Mr. Esmond could be terminated for cause if he breached the note. He did breach the note and he was terminated 5 weeks later.

Esmond contends that First USA contracted for, charged and received usurious interest when First USA terminated his employment for cause. At the TC both Esmond and First USA moved for summary judgment. Mr. Esmond contends that the payments that he could have earned under the employment agreement had he worked the full term of the employment agreement were interest. First USA argued that there was no usury in the case as a matter of law because it did not exact interest. The TC granted Esmond's motion, denied First USA's and the CA reversed the TC's judgment and has remanded the case for trial.

First USA is entitled to judgment as a matter of law because what Mr. Esmond says is interest is not interest. And it's not interest for at least 2 reasons: First, the so-called interest is uncertain and contingent in amount; second, the so-called interest was not given as compensation for the use, forbearance or detention of money. With regard to the first point: if the amount of whatever First USA supposedly charged or received is contingent and uncertain in value it's not interest. Now the reason the so-called interest is contingent and uncertain amount are two-fold: First, the so-called interest is contingent and uncertain an amount because on the day Mr. Esmond was terminated how long that contract would have otherwise lasted was unknowable. We did not know on the day he was terminated how long the contract would exist. The contract could have been terminated sooner than the 5 year stated term because of such factors including his death or disability, which was listed in the contract; the contract also provided for the possibility of termination sooner for cause. And the contract specifically lists 5 for cause reasons that it could have terminated. Because the length of the contract how long it could have lasted was unknowable the day Mr. Esmond was terminated how much Mr. Esmond would have earned under the contract if uncertain and contingent and cannot constitute interest.

There is another reason interest is contingent and uncertain. And that's because the employment agreement had mutual, it had bilateral obligations. First USA was obligated to pay Mr. Esmond salary, but Mr. Esmond was obligated to perform services and work for that salary. Because the

obligations are mutual, the value of the right to terminate the employment agreement consists of the value of the payment that would have been made on this contract whatever the length of that term may have been less the value of Mr. Esmond's obligations under the contract. Whether there is a net difference between the values of what Mr. Esmond would have been paid under the contract, and his services under the contract is uncertain and speculative.

ABBOTT: I think I misunderstood you. I thought I heard you say that because in essence there were mutual obligations it could not be usurious?

LAWYER: Because there were mutual obligations the difference in those values is uncertain and unknown and, therefore, it is not interest.

I want to tell you why the value of his performance under the obligation is uncertain. On the day he was terminated the contract...what his services would have been valued in the future was based on factors beyond any of our control. I mean the value of his services was dependent on market factors, the demand for his services, the economy in general. And because of factors that we had no control over, the value is uncertain.

Now Mr. Esmond claims that the value...he values the impact of the termination of the employment agreement to be \$280,000. And that's what he calls the interest. He says: First USA retained \$280,000 when it terminated my contract. Now the only way that can be true is that if that amendment provided that Mr. Esmond would have to work the full-term of the contract and if he forfeited salary, and if there was no possibility of the mortality or disability of Mr. Esmond. And that's not the case. Nothing was retained by First USA. The obligations under the employment agreement again they were bilateral. And because First USA never had the right to terminate its obligations to pay Mr. Esmond without likewise terminating Mr. Esmond's obligations to perform under the contract. Thus you cannot make the argument that Mr. Esmond makes which is you have to say that the value of the annual payments First USA made over...you have to deduct the value of his services.

GONZALEZ: The CA after analyzing the case and the applicable law and essentially what you've said here came down on the basis that neither party had established the nature of the charge as a matter of law, but the evidence which you have recited there was a fact issue as to whether or not this additional consideration was merely a device to conceal usury and therefore a fact issue for a jury to resolve. You actually disagree with that?

LAWYER: I do disagree with that. There's obviously no fact issue because as a matter of law the so-called interest there cannot be interest if it's uncertain and contingent that as a matter of law. I want to address the CA's comments about there being a fact issue. There is not a fact issue in the testimony and the evidence that was in the trial court.

Based upon this argument that I have just made as a matter of law there is no interest. And this argument is supported by the Texas statute.

ABBOTT: Just to follow-up on that. What you're saying is that if even assuming all these various facts that exist because of the structure of this particular relationship as a matter of law there can be no usury?

LAWYER: I'm saying that based on the argument that I've just made there cannot be usury.

The Texas statute really makes clear and contemplates that interest cannot be contingent and uncertain an amount. It says: Interest which is greater than the amount authorized by this

subtitle shall be forfeited to the obligor, and 3 times the amount of usurious interest. If you don't have interest which is calculable you can't forfeit to the obligor 3 times. The statute clearly calls for a calculable amount. Not only does the statute call for a calculable amount, from the case law the CA specifically I would call your attention to the Beavers v. Taylor case out of the Waco CA. In that case the court explained: And a contract is not usurious where the lender is to receive uncertain value as here even though the probable value is greater than the lawful interest.

There is another reason that no usury was involved in this case. And it will speak a little bit more to what Judge Gonzalez was asking me. And that is because the amendment to the employment agreement was not compensation for the use, forbearance, or detention of money. And the summary judgment proof showed that as a matter of law. The proof before the court were the contracts, and affidavit testimony from executive officers of First USA, including Pamela Patford(?); and that was referenced in the CA's opinion. In it she testified: There had never been a loan to an executive; this was a change in the executive compensation package. She also testified that there was a concern that if there were a default, it would compromise the employment relationship. And because of that First USA wanted to have a mechanism or a means to end the relationship.

From the proof you can see that the amendment related to personnel or employment concerns not lending, not debtor/creditor concerns. Now Mr. Esmond takes that proof and he says: That's just subjective intent; First USAs just telling you that it didn't intend to commit usury. That's not what that proof is. That is proof of the bargain between the parties. That is proof of the substance of the transaction. And that is admissible in every usury case and our evidence was uncontroverted. If Mr. Esmond wanted to controvert that evidence he needed to do so.

HECHT: How would he do it?

LAWYER: I would contend that our evidence was the truth. But he has an element to meet and that is he has to show that it's interest.

HECHT: But if he were going to controvert that how would he go about it?

LAWYER: He has to show that the amendment was interest. Whatever his evidence is that is interest he needed to put it forward. We put forward the evidence that this bargain was made for employment safeguard concerns. And that proof not only showed a different purpose it also showed that the amendment was given for separate and additional consideration.

There is a long line of Texas cases that recognize that a lender imposed condition which entitles a borrower to separate and additional consideration apart from the lending of money is not and cannot be the basis for usury. First USA changed its compensation package. It did this for Mr. Esmond. It changed its employment relationship with Mr. Esmond and for doing that the amendment was granted. The amendment was part of the employment relationship. And because of a change in the employment relationship there was a change in the employment agreement. And that's the bargain and that proof was undisputed. And because of that it shows that the amendment was given for separate and additional consideration.

ENOCH: Do you make the argument that even if you did not have this amendment that his default would have been grounds for termination?

LAWYER: Yes we do make that argument.

ENOCH: And doesn't that weaken your argument that this was additional consideration?

LAWYER: No I don't think so. If we already had the right, then under the law there's nothing to do with usury. And if we didn't have the right, then that amendment was given for separate and additional consideration. If there is no interest in this case there is no usury, and if there's no usury there's no breach of contract. We believe that the summary judgment evidence conclusively established that it went uncontroverted and as such we are entitled that judgment be rendered.

ENOCH: Could Mr. Esmond argue though: If you already had the right to terminate him if he defaulted on the loan, then you're extraction from him of the right to be terminated if he defaulted on the loan would be in essence making a condition of his continued employment this loan payback. Can't he argue that: I was already employed, that you could have terminated me if I defaulted, but you extracted from me this additional agreement that I can be terminated, and so in essence as a condition of making the loan you've made me acknowledge that I could be terminated with the default?

LAWYER: I think he does make that argument or something like that. But what it shows is that First USA, the amendment was not for a lender purpose, because if First USA had the power to terminate Mr. Esmond, then it really shows that the amendment served an employment safeguard means. Because if First USA terminated Mr. Esmond it would only show that there would be an abuse of the executive perk. Because if Mr. Esmond would not suffer would still be receiving payments even though he was terminated because that would supposedly a wrongful termination of the employment. It shows the need for the amendment because there would only be an abuse of the perk if the amendment wasn't there.

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RESPONDENT

ELLIS: May it please the court. I am here in court with my client, Dale Esmond, to argue in opposition to the position taken by First USA, and to argue that this court should affirm the judgment of the TC.

Dale Esmond is here in court and he was in the DC, and in the CA because he suffered a substantial and severe financial loss in 1991. He lost \$280,000, which represented 3-1/2 years of his and his family's livelihood. He lost that money at the hands of First USA, his employer. He lost that money expressly for the reason that he defaulted on a loan, that he was 90 days late in repaying an \$18,000 loan.

GONZALEZ: Wasn't that part of the agreement? You know he said: I am going to be paid \$80,000 a year for 5 years, and the arrangement has changed, and he said I need \$18,000 and you can terminate me if I don't pay the loan. Now where's the usury and where's the interest and where has he been aggrieved by his company?

ELLIS: We acknowledge that. We are here notwithstanding the fact that First USA had contracted expressly and unambiguously for the right to do exactly what it did.

GONZALEZ: Not only First USA but Mr. Esmond contracted for that.

ELLIS: That's right. Both of them contracted. We are here because Texas law imposes penalties and declares contrary to public policy and void both contracts for the excessive compensation for the detention of money as well as charging and receiving excess compensation for the detention of money.

GONZALEZ: What is the interest under the amendment to his employment contract? Where is the interest; can you identify that for me?

ELLIS: Of the amendment by its terms expressly allowed First USA to not only terminate him for any and all reasons, which it already had, it authorized them to do this: If they terminated him for his default on the loan, they could then keep the balance of his unpaid balance.

GONZALEZ: Which he had not earned.

ELLIS: Which he had not earned, but which was owed to him under the contract in the bargain that had been made when he sold his business to First USA. That is the contract was that he could be terminated for any and all reasons and unless it was for cause as defined in the contract he would continue to be paid his salary.

BAKER: The CA says that the agreement specified events which would trigger termination for cause when it was originally executed. Were there specific reasons for cause in the original agreement that provided for the 5 year term?

ELLIS: That were triggered in the events of this case?

BAKER: No, that could trigger a termination by First USA?

ELLIS: Yes, certainly. For example: if he were convicted of a felony they could have terminated him for cause and he would not be owed the rest of his salary.

BAKER: Is it true then as Judge Gonzalez suggests that this was an amendment to that section adding one more reason that was cause for termination?

ELLIS: That's right. And the reason it was added was his default in payment of a note, that is his detention of money.

CORNYN: If they had terminated him because he was convicted for a felony, then you wouldn't have a case?

ELLIS: We would have no case whatsoever.

CORNYN: It is because of the specific reason they terminated him?

ELLIS: Correct. By terminating him for that particular reason they charged and received excess compensation for the detention of money. They also contracted for the right to do just that. So there are alternative theories of liability under the usury statute: charging and receiving and contracting for. Both of them were met in this case.

GONZALEZ: Does the record reflect the terms of the sale from Esmond to First USA for PEP Software?

ELLIS: I believe that the contract of sale is in the record.

GONZALEZ: What does that show?

ELLIS: With respect to this it specifically showed that the parties agreed that Mr. Esmond would sign the employment contract and First USA would also, that is at issue here in this case.

GONZALEZ: There was no other compensation?

ELLIS: No there was compensation.

GONZALEZ: For the assets of the company?

ELLIS: Yes. There was a bulk of compensation for what he sold and what he agreed to do. He sold his assets, he agreed to be an employee of the company for 5 years, under this contract which provided that if he was terminated not for cause if they decided they didn't need him for some reason, he would still get paid through the 5 years.

GONZALEZ: So he was paid for the assets that he sold to First USA, and that's not in dispute?

ELLIS: That's not in dispute.

ENOCH: If an officer of the corporation had borrowed money from the corporation, didn't pay it back, that would not have been grounds for termination under the original employment agreement in this case?

ELLIS: I believe that it would not have. But if it were it would still be the illegal taking and charging of excess compensation for the detention of money. That is if First USA terminated him for nonpayment of the note, that is for default for detention of money, whether it's tied to the original contract or it's tied to the amendment, or it's tied to no contract whatsoever it is charging compensation for the detention of money.

HECHT: Why doesn't the \$280,000 have to be net of the value of his services left here?

ELLIS: The usury statute looks to the question of the amount of interest that was contracted for, charged, or received. It looks at it from the point of view of the lender. What did the lender charge or receive? It is not a measure of contract damages that have to be netted out. It's a matter of what did First USA receive as it took his money?

HECHT: For example: If you pay this money back by maturity, I will transfer you this property and otherwise I won't. Wouldn't you have to look at the value of the property, net of taxes and whatever liens might be against it not just some gross value that was the charge in that case?

ELLIS: If the question is contract damages, yes. Here the question is penalties under Article 5069-1.06. And it is not a matter of netting it out it is what the borrower extracted.

HECHT: But they extracted \$280,000 that he was going to have to pay for for 3-1/2 years of work.

ELLIS: That's correct. They extracted from him at a point in time when he had the right to that money even if he did no work if he were terminated not for cause. So the contract had the effect of entitling First USA to extract that money from him because of his default.

CORNYN: You concede the point they had the right to terminate him for cause?

ELLIS: I concede they had the right to terminate him for any and all reasons.

CORNYN: And so they do not owe him that \$280,000. You're argument is by virtue of charging that in the first instance that constitutes usury?

ELLIS: By charging it it constituted the usury. By contracting to be entitled to extracted constituted usury.

CORNYN: Even though they don't as it turns out owe it to him?

ELLIS: If they terminated him for something other than cause they owed it to him.

CORNYN: Under these circumstances though they terminated him for cause so they don't actually owe it, but it's the contracting for and the charging that get you over the hump in terms of the usury question?

ELLIS: As to the usury claim, that is correct. As to the contract claim it is a little bit different.

ABBOTT: And because that's your stance on the usury claim is it also your position then that had he been employed through the whole time that merely because they contracted for it to begin with it would still have been usury?

ELLIS: Under the precedence of this court, yes. If a contract under any contingency allows for the collection or charging and receiving of excess compensation for the use, forbearance or detention of money, in this case detention of money, yes, it would be usury. The fact that there is a contingency in the contract does not render the contract nonusurious. I believe it was the Smart case here where this court specifically dealt with that issue most recently, and in that particular case the contract provided for prepaid interest for a few months, and then the note went on for a period of time. If the note had been terminated during the first few months of the note and because the contract provided that that prepaid interest was not refundable, then that contingency would have produced usurious interest. That contingency did not happen in that case. In the end the note went on through its lifetime. Yet, the borrower sued for usury and this court held that because the contract provided for that contingency, that could have happened but didn't happen, nevertheless it was a contract for usurious interest, and the court remanded the case to the TC with the imposition of the proper penalty.

SPECTOR: You're saying that any time an employer makes an agreement with an employee to loan money and the rate on the loan is nonusurious, but the contract provides that you can be terminated for cause if you do not repay it then that's a usurious illegal contract?

ELLIS: If the termination for cause has the effect as it did in this case, that is the difference between him being entitled to get the remainder of his pay as opposed to not getting the remainder of the pay.

SPECTOR: But defining it for cause makes it usurious?

ELLIS: What makes it usurious is the fact that it allows First USA here to take something that it otherwise would not have, specifically because of his default on the note. It would be the same as if the employer or any lender said to the borrower: I will lend you this note, but if you're late in paying it I can take X from you.

SPECTOR: Well terminate is the problem here.

ELLIS: Here First USA had the right to terminate him for any and all cause. What they extracted from him in the contract was the right to terminate him from usury, that is for his detention of money and therefore to take his compensation. That's what they contracted for here.

GONZALEZ: Mr. Ellis let me see if I understand your argument. Let's just assume for the sake of argument that Mr. Esmond would have paid the note on time and he would have gotten his \$280,000 and the 5 year term is completed. Under your argument he can then file a lawsuit based on this theory that this transaction was usurious ab initio. Is that correct? Is that your argument?

ELLIS: Under the Smart case that is correct. Here unlike the Smart case the contingency that was built into the contract actually happened. And so he can and did bring this action for charging and receiving, not merely for contract.

HECHT: You say we should look at the charge from the debtor's point of view?

ELLIS: Yes.

HECHT: So if Mr. Esmond could have quit work with First USA and made a lot more money I suppose he would have done that?

ELLIS: Hypothetically I suppose maybe he would.

HECHT: And then the \$280,000 wouldn't be a charge, and he would be able to make more money by quitting? If he had thought the day before all this happened: You know I need to quit this job because I'm only making \$80,000 a year and I could make \$800,000 at this other job; then how would that be a charge?

ELLIS: It would not have been a charge. He would not have been charged the \$280,000 because of his detention of money. He would have been denied the \$280,000 because he quit and left.

HECHT: So why don't you have to net either from the borrower's point of view or the lender's point of view, why don't you have to net what was going to have to be paid from the services that were going to have to be rendered?

ELLIS: Well again I will just repeat. The question is: What was the compensation for the detention of money that was taken?

HECHT: \$280,000. But say in his own mind he's going to have to do \$250,000 worth of work to get that \$280,000. So he's going to be \$30,000 to the good.

ELLIS: At the time this occurred he had the right if he were terminated not for cause let's say or if he quit for a good reason, he had the right to go out and try to make the \$800,000 and still receive the \$280,000.

HECHT: His services were not pledged to First USA?

ELLIS: That's correct. If he terminated his employment for anything other than cause or he left for anything other than not for a good reason, then he was entitled to this money as a matter of his deal with First USA regardless of whether he made \$800,000 or any amount otherwise. That was what he had.

SPECTOR: If he voluntarily quit this job he was entitled to be paid \$80,000 a year?

ELLIS: The contract specifically provided that he was entitled to the remainder of his payment if he quit for a good reason. And then good reason is a matter of whether he quit for a good



reason. That is not what happened in this case. The arrangement that he had with First USA was that if he left for a good reason or if he was terminated not for cause he would nevertheless receive the remainder of the balance of his payment through the 5 year term. That's the deal he made when he sold his business to First USA.

The question is whether or not if he is terminated because of his detention of money and his salary has been kept, was that a charge or receipt of compensation for the detention of money? It certainly was.

ENOCH: So your position would be that any employer who had a employment contract for a term of years that had a salary for a term of years that was cancelable only for cause, that also as a part of the benefit package made low interest loans to its officers could never make as a condition the termination of that employment on a failure to pay that loan without committing usury?

ELLIS: That's right. If the termination triggered the right of the employer to keep his salary. That's correct.

ENOCH: That's what I'm saying. If the employer said that good cause to terminate you would be the failure to pay on this debt, that would be usury. In any circumstance where the employer had a contract for a term of years, that called for a salary to be paid, and termination only in the event of good cause. If the employer put as one of those conditions of good cause the failure of the employee to pay back a loan from the employer, that would be usury?

ELLIS: I think there is one condition that is not mentioned in your example that must be. In this particular case the arrangement was that if he was terminated not for cause, that he would get the remainder of his payment.

ENOCH: No that's my hypothetical. The contract's only cancelable based on cause. So if you didn't have cause you had your one years worth of salary or whatever it is. That's my condition. Any employer that has a contract for a term of years, for a salary for a term of years, that only allows it to be terminated based on cause, if one of those conditions of cause is the failure to pay back an employer to employee loan, that that would be usury?

ELLIS: In the example that you're giving that is that if it can be terminated only for cause, what the result would be is if he's terminated and an issue arises as to whether it was for cause it is a question of breach of contract in that example. And so it would be an offsetting of value of his being free of his work verses what he would have gotten at work. But here that was not his arrangement. It wasn't merely that he could be terminated for cause. It was if he was terminated for other than cause he would continue to get his full amount of his salary. That's the distinction between this case and the hypothetical that you posed.

BAKER: How did Mr. Esmond breach his contract \_\_\_\_\_ when you just argued that First USA had the right to terminate him?

ELLIS: First USA had the right to terminate him for any and all reason. It also had the contractual right based on contract to terminate him for defaulting on the note. But the Law of Texas says that that contract is a contract for the extraction of compensation from a pension.

BAKER: That's how you got \$1,137,000 in usury credit. My question is the TC awarded Mr. Esmond \$243,000 in breach of contract damages. How did you get that?

ELLIS: The court held that the employment contract as amended was usurious. By state law that is contrary to public policy on \_\_\_\_\_ unenforceable. So when Mr. Esmond was terminated that provision in the amendment that default of the note was cause was unenforceable as a defense to his termination. Therefore it was breach of contract.

BAKER: Well isn't the usual cancellation of the principal amount of the loan? I'm still a little confused on how there is a breach where you concede that the contract gave them the right to do that even if it was a usurious contract because there's different penalties under the statute?

ELLIS: The important thing that must be noted here is that there is a distinction between a contractual right and a legal right when that contract deals with the extraction of compensation for the detention of money. Even though I may have the contractual right to charge 1000% late charge, I have that contractual right, I don't have that legal right. There is a distinction between the two. In this particular case, because it was usurious the contractual right was not a legal right, and therefore there was a breach of contract by terminating him as First USA did. That's how the court reasoned. I think the TC was correct.

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#### REBUTTAL

LAWYER: It's clear from the record that the employment agreement was not consideration for the sale of the assets of Mr. Esmond's company. And that's found in the transcript at 1060. The employment agreement was a condition of First USA closing the transaction. That was one of the requirements. It was no \_\_\_\_\_.

SPECTOR: Is counsel correct that if Mr. Esmond quit that he would still be entitled to payment for his salary?

LAWYER: No, that's not really correct. What the employment agreement provided that if he resigned or if the employment relationship were terminated for good reason and good reason is defined as a material reduction in the employee's compensation, then the contract obligated First USA to pay \$80,000 per year. So it's just no quit. I mean he had to have a reduction and that was good reason for...

SPECTOR: They had a right to lower his salary under this agreement?

LAWYER: I'm reading from the contract about what good reason is and it's a material reduction in the employee's compensation.

BAKER: By First USA?

LAWYER: By First USA.

BAKER: That's to only define good reason for?

LAWYER: That's to define good reason.

BAKER: Mr. Esmond having the right to terminate he would still be entitled to \$80,000 per year for the rest. If USA said we can't pay you we are going to reduce it to \$40,000 then he could say I've good reason to terminate and you're obligated to...

LAWYER: And go on. Right. This case isn't anything like the Smart case. In the Smart case as you know in that case the note called for 3 years unearned interest and that was paid up front. And the

hypothetical presented to the court was if the note matured early, then under that promissory note, there would be the event or the contingency being maturity of the note early, then there would be retention of already prepaid unearned interest by the lender. And the SC said in that case: In the absence of a savings clause they're going to find that the lender's expressed authorization to keep the unearned interest make the contract usurious. We are talking about the interest itself being contingent and uncertain an amount. This isn't even close to the Smart case. And in fact our note had a savings clause in it.

If the termination was under the prior existing clause which was for breach of an obligation to the company, there certainly would not be any usury because the employment agreement came 9 months before there was any discussion of the loan. And it had nothing to do with interest or a loan.

Mr. Ellis said and I just want to make sure that I've said this. First USA didn't retain anything. When it terminated its obligation to pay Mr. Esmond's salary, it also terminated Mr. Esmond's obligation to come to work and work for that salary.