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## Dragnet clauses: Fischer v First Int'l Bank, 2003

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**Dragnet clauses:**  
***Fischer v First Int'l Bank, 2003***  
**Roger Bernhardt**

**Boilerplate “dragnet” clause in bank’s trust deed did not, as matter of law, defeat borrower’s claim that bank’s other loans to borrower were not cross-collateralized.**

*Fischer v First Int'l Bank* (2003) 109 CA4th 1433, 1 CR3d 162

In 1989, the Fischers purchased commercial lots. After obtaining a construction loan from First International Bank (FIB), they constructed a large family dining and recreation center on the property. In 1998, the Fischers and FIB entered into a written agreement for two additional loans: a take-out loan to pay off the existing construction loan (Loan #1) and an equipment loan (Loan #2). The loan agreement included the following provision specifying the collateral for each of the two loans:

Loan #1: First deed of trust on commercial property located at 2102 Main Street, Ramona, CA;

Loan #2: Second deed of trust on commercial property located at 2102 Main Street, Ramona, CA, and second deed of trust on single family residence located at 14382 Blue Sage Road, Poway, CA

The agreement contained no reference to cross-collateralization of the loans. The Fischers maintained that they “specifically negotiated” the loan agreement so that their residence would not be collateral for Loan #1. When the Fischers went to the bank to sign final loan documents, including a deed of trust for their residence, they pointed out to the FIB vice-president that the proposed deed of trust incorrectly stated that their home would be collateral for *both* loans. The bank changed the deed of trust so that the definition of the word “note” referred only to Loan #2. However, the fine print of the trust deed contained a “dragnet” clause defining indebtedness as including “all obligations, debts and liabilities, plus interest thereon, of Borrower to Lender.” The deed of trust also included a “due on sale” provision giving FIB the right to “declare immediately due and payable all sums secured by this Deed of Trust upon the sale or transfer” of the residence.

In 1999, the Fischers decided to sell the residence. According to Mrs. Fischer, FIB’s vice-president told her that if the house were sold, Loan #2 would have to be paid off, but the Fischers could retain any excess proceeds from the sale. In reliance on that representation and on their own understanding of the loan agreement, the Fischers sold their home. After Loan #2 was paid off through escrow, \$125,000 remained. FIB demanded that the \$125,000 be applied to Loan #1 and the escrow company issued a check to FIB for \$125,000. FIB returned \$25,000 to the Fischers. The Fischers sued FIB for breach of contract and various tort-based causes. The trial court granted FIB’s motion for summary judgment, finding that the definition of “indebtedness” in the trust deed gave FIB the right to apply the funds from the sale of the residence to the balance of both loans.

The court of appeal reversed, holding that a triable issue of fact existed as to whether the parties had agreed to cross-collateralization of the loans. The court rejected the argument that, as

a matter of law, the dragnet clause defeated the Fischers' suit. The court pointed out that, although California courts have upheld the general validity of dragnet clauses, they have also recognized that those clauses can enwrap an unsuspecting debtor in an arrangement that he or she did not contemplate. Given that a dragnet clause in a trust deed is an adhesion contract that should be narrowly construed against the lender, California courts have consistently adhered to a construction of such clauses that depends more on the actual expectations of the parties than on the literal wording of the boilerplate. The courts have considered factors such as the language and specificity of the dragnet clause; whether the parties were aware of the dragnet clause and appreciated its significance; whether the other loans were of the same type or character as the primary loan; and whether the bank relied on the dragnet clause as the security for the other loans. Applying those general principles, the court did not find an objectively clear and unambiguous expression of mutual intent to cross-collateralize the loans, and held that the conflicting provisions of the loan agreement and the deed of trust created a triable issue of fact regarding the true intentions of the parties.

**THE EDITOR'S TAKE:** Sometimes lenders just cannot resist shooting themselves in their feet. Like those who make full-credit bids at their own foreclosure sales, some also seem unable to stop including in their deeds of trust the same clauses that got them into so much trouble earlier.

Back in 1979, in the first edition of my California Mortgage and Deed of Trust Practice (Cal CEB 1979), I wrote, "creditors will not solve their problems by writing increasingly broad dragnet clauses, but rather by tending toward more specificity in describing subsequent obligations to be included." (The other obligation in this case was contemporaneous rather than subsequent, but the lesson is the same.)

When lenders woke up to that problem, they eliminated the language under which the deed of trust secured any and every obligation anybody could think of, and replaced it with new phrasing under which it secured only notes specifically referenced. But now comes *Fischer v First Int'l Bank* (2003) 109 CA4th 1433, 1 CR3d 162, and, in wanting to have it both ways, the lender forgot the original lesson. Its securing clause refers only to one particular note, but then adds "the indebtedness," and defines that as including everything under the sun. Well, if a lender can get into trouble for making its security provision too broad, it's not going to escape that trouble by moving the broadness over to the definition provision instead.

However, this arrangement was ambiguous, given that the loan agreement stated that the other loan was not covered and the deed of trust said that it was. That means that parol evidence will come in to explain it, and that means that the borrower's interpretation is sure to prevail. If these borrowers say that they did not intend to have their home secure the real estate loan, there is more than enough in the loan documents alone to support that interpretation.

The bank was lucky here: It merely lost its claim that the security covered both the real estate loan and the equipment loan, although it may end up having to pay damages for having taken that position. It could have been worse: Once a loan document is ambiguous,

borrowers can probably have it construed either way, whichever is best for them. In a different setting, for instance, the bank might lose its claim entirely if the borrowers claimed that the mortgage also secured their other loan and the bank violated the one-action rule by unilaterally releasing its security for that loan!

Cross-collateralization is a powerful tool, but in California it can blow up in a lender's face. Lenders and their lawyers should be far more cautious about using it. —*Roger Bernhardt*