



---

January 1999

## Bankruptcy and Creditors' Rights

Roger S. Cox

---

### Recommended Citation

Roger S. Cox, *Bankruptcy and Creditors' Rights*, 52 SMU L. REV. 775 (1999)  
<https://scholar.smu.edu/smulr/vol52/iss3/8>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

# BANKRUPTCY AND CREDITORS' RIGHTS

Roger S. Cox\*

## TABLE OF CONTENTS

I. INTRODUCTION—SCOPE OF SURVEY .....	776
II. BANKRUPTCY .....	776
A. LEGISLATIVE DEVELOPMENTS .....	776
B. PENDING IN SUPREME COURT .....	777
C. HOMESTEADS AND EXEMPTIONS .....	777
1. <i>Rural/Urban Homesteads</i> .....	777
2. <i>Retirement Accounts</i> .....	778
3. <i>Tools of the Trade—Lien Avoidance</i> .....	778
4. <i>Insurance Code Exemptions</i> .....	779
D. DISCHARGEABILITY .....	779
1. <i>Willful and Malicious Injuries</i> .....	779
E. AUTOMATIC STAY .....	781
1. <i>What to Do with the Repossessed Car</i> .....	781
F. SUBSTANTIAL ABUSE .....	782
G. DISMISSAL—SERIAL FILINGS, ETC. ....	784
H. CHAPTER 13 CONFIRMATION .....	786
I. ATTORNEY'S FEES FOR DEBTOR'S COUNSEL .....	787
J. COLLATERAL VALUATION .....	788
K. REAFFIRMATION AND OTHER POST-PETITION ACTIONS .....	789
L. RES JUDICATA—EFFECT OF PLAN CONFIRMATION ....	791
III. OTHER CREDITOR'S RIGHTS CASES .....	791
A. LIMITATIONS—ACKNOWLEDGMENT OF DEBT .....	792
B. LIMITATIONS—REAL ESTATE LIEN DEBT .....	792
C. CROSS-COLLATERALIZATION CLAUSES .....	793
D. LOST NOTES, MISSING INDICES, ETC. ....	794
E. NOTE ACCELERATION—THE CHECK'S IN THE MAIL ...	796
F. ARTICLE 9 PRIORITY—MISFILED FINANCING STATEMENTS .....	796
G. EXEMPTIONS IN THE STATE COURTS .....	796
H. NOTICE OF FORECLOSURE SALE .....	797
I. GARNISHMENT .....	797

---

\* Shareholder, Sanders, Baker & Jesko, P.C., Amarillo, Texas. Board Certified in Business Bankruptcy Law and Commercial Real Estate Law, Texas Board of Legal Specialization and American Board of Certification. The author gratefully acknowledges the contributions of Stephanie Garcia, Legal Assistant with Sanders, Baker & Jesko, P.C., for her able assistance in research support and manuscript preparation.

## I. INTRODUCTION—SCOPE OF SURVEY

**A**LTHOUGH this Article includes developments in the bankruptcy courts, it is this author's purpose to limit the cases surveyed to those involving state law (e.g., homesteads, exemptions) or other developments regarding enforcement of the debtor-creditor relationship. Cases that are limited to an "inside baseball" application of the Bankruptcy Code and related developments are typically avoided. This Article is not intended to be an exhaustive survey of bankruptcy developments but rather an update regarding cases of interest to the Texas-based debtor-creditor practitioner.<sup>1</sup>

## II. BANKRUPTCY

### A. LEGISLATIVE DEVELOPMENTS

No discussion of bankruptcy developments would be complete without at least a mention of the wild ride taken by various bankruptcy legislation in the 105th Congress. Most notable were the bills that passed but not enacted into law. Specifically, both the House and the Senate passed their own version of so-called bankruptcy reform legislation, which included means testing, homestead limits, and other fundamental changes. Those bills, however, never made it through conference; thus no reform legislation was enacted.

The reader should be cautioned that by the time this Survey is published, it is reasonable to speculate that bankruptcy legislation will again be winding its way through Congress. For example, Chapter 12, which lapsed in late 1998, was extended, but only through and including April 1, 1999.<sup>2</sup> Accordingly, one could conclude that Congress anticipates major bankruptcy legislation by that time.

Some bankruptcy legislation, however, did pass. Perhaps most notable was the Religious Liberty and Charitable Donation Protection Act,<sup>3</sup> which provided some protection for charitable and religious contributions. This protection comes by way of limited exceptions to a trustee's avoidance powers, allowing for limited post-confirmation charitable contributions in Chapter Thirteen, and exclusion of qualifying charitable con-

---

1. Judge Lief Clark provides an extensive, thorough analysis of bankruptcy developments in the Fifth Circuit in the Fifth Circuit Symposium published annually by Texas Tech Law Review. See Leif M. Clark, *Bankruptcy*, 29 TEX. TECH L. REV. 355 (1998); Leif M. Clark, *Bankruptcy*, 28 TEX. TECH L. REV. 299 (1997). For other, broader surveys that focus exclusively on bankruptcy law developments, see J. Westbrook & E. Warren, *Recent Developments*, University of Texas School of Law Bankruptcy Conference (1998); G. Pronske, *Recent Developments*, State Bar of Texas Advanced Business Bankruptcy Course (1998); T. Cornish, *Recent Cases That May Affect Your Practice*, Texas Tech Farm, Ranch & Agribusiness Bankruptcy Course (1998).

2. Pub. L. No. 105-277, 112 Stat. 2681 (1998) (Div. C, Tit. I, § 149). However, there is a House Bill pending which would re-extend Chapter 12 through Oct. 1, 1999. See H.R. 706, 106th Cong. § 1 (1999).

3. Pub. L. No. 105-183, 112 Stat. 517 (1998).

tributions in making a substantial abuse determination.<sup>4</sup> Other bills included amendments to the student loan nondischargeability provisions and extension of Chapter 12 through April 1, 1999.<sup>5</sup> Additionally, the 1998 omnibus spending bill also provided certain limited relief for agricultural borrowers.<sup>6</sup>

## B. PENDING IN SUPREME COURT

As this Survey went to press, the new value exception to the "Absolute Priority Rule" found in the "cram down" provisions of Chapter 11 was at stake. Oral argument in *Bank of America National Trust & Savings Ass'n v. 203 N. LaSalle Street Partnership*<sup>7</sup> was held November 2, 1998. An opinion is expected before the end of the Supreme Court term, which could come prior to publication of this Survey.

## C. HOMESTEADS AND EXEMPTIONS

### 1. Rural/Urban Homesteads

The Fifth Circuit addressed urban and rural homestead exemptions in *In re Crowell*.<sup>8</sup> The debtor sought to invalidate a creditor's lien on a forty-two acre tract of land on which the debtor claimed a rural homestead. Even though the property had at some time been rural in nature, the property had been within the city limits of Keller, Texas since 1979. City sewer and water services were available to the property, and the city provided police and fire protection. Additionally, numerous platted residential subdivisions surrounded or were adjacent to the subject property. Based upon the factors previously articulated in *U.S. v. Blakeman*,<sup>9</sup> the Fifth Circuit determined that the homestead was urban in nature. Accordingly, the homestead claim would be limited to one acre. The Fifth Circuit additionally affirmed the bankruptcy court's requirement that the debtor designate the one acre portion of the property that he would claim as his urban homestead.<sup>10</sup>

---

4. As amended, section 548 of the Bankruptcy Code now defines a qualified charitable contribution to be a payment that does not exceed 15% of the gross annual income of the debtor for the year in which the contribution is made. In the avoidance context, contributions may also qualify if they are consistent with the debtor's past practices in making charitable contributions. 11 U.S.C. § 548(a)(2), (4) & (b) (1998).

5. Pub. L. 105-277, 112 Stat. 2681 (1998).

6. *See id.* (Div. A., Tit. VIII, §§ 801-04).

7. *In re* 203 N. LaSalle St. Partnership, 126 F.3d 955 (7th Cir. 1997), *cert. granted sub nom.* Bank of America Nat'l Trust & Savings Ass'n v. 203 N. LaSalle St. Partnership, 118 S. Ct. 1674 (1998) (No. 97-1418).

8. *Crowell v. Theodore Bender (In re Crowell)*, 138 F.3d 1031 (5th Cir. 1998).

9. 997 F.2d 1084 (5th Cir. 1992). Those factors include:

- (1) the location of the land with respect to the limits of the municipality;
- (2) the situs of the lot in questions;
- (3) the existence of municipal utilities and services;
- (4) the use of the lot and adjacent property;
- (5) the presence of platted streets, blocks, and the like.

*Id.* at 1091 n.14 (quoting *In re Bradley*, 960 F.2d 502, 511-12 n.18 (5th Cir. 1992)).

10. *See Crowell*, 138 F.3d at 1035-36.

## 2. Retirement Accounts

In *In re Swift*,<sup>11</sup> the Fifth Circuit, recognizing the typically exempt nature of a Keogh plan and an IRA, also held that a cause of action for malpractice in causing the loss of the exempt nature of those plans is itself exempt. The Fifth Circuit, noting the liberal construction given homestead exemptions, reasoned that numerous Texas cases had extended exemption claims to the proceeds of exempt property.

One common theme runs through all of these decisions. The proceeds, insurance, causes of action, etc., are a substitute for the exempt property that is lost. To be effective, the substitute must be treated as if it were the lost item. Otherwise, the protection provided by the exemption would be meaningless, and creditors could attack the unfortunate debtor more effectively than they could the average debtor who is less in need of the protection.<sup>12</sup>

This author does not read the Fifth Circuit to say that all proceeds of homestead property are forever exempt, but rather an example would be found in *In re Osborne*,<sup>13</sup> in which an Oklahoma bankruptcy court held exempt the proceeds paid upon the forced disposition of a homestead in addition to a cause of action filed to recover damages on the lost homestead.<sup>14</sup>

## 3. Tools of the Trade—Lien Avoidance

In *In re Duvall*,<sup>15</sup> Judge Ronald King provides the most thorough analysis of the lien avoidance provisions of section 522(f) of the Bankruptcy Code since the 1994 amendments. In 1994, Congress amended section 522(f) to limit lien avoidance against tools of the trade to the extent the value of those tools exceeds \$5,000.<sup>16</sup> In *Duvall* the court acknowledged that despite the 1994 amendments, a debtor could still avoid a perfected, but non-purchase money, non-possessory security interest in tools of the trade.<sup>17</sup> The FSA claimed a pre-petition lien exceeding \$167,000 against property worth approximately \$55,000, representing the value of the debtor's claimed exemption. The court concluded that the FSA's secured claim equaled \$55,000, less the debtor's lien avoidance of \$5,000, for a net

---

11. See *State Farm Life Ins. Co. v. Swift (In re Swift)*, 129 F.3d 792, 801 (5th Cir. 1997).

12. *Id.* at 801 (footnotes omitted). The court cited section 31.002 of the Texas Civil Practice and Remedies Code, which provides certain protection to the proceeds of exempt property: "A court may not enter or enforce an order under this section that requires the turnover of the proceeds of, or the disbursement of, property exempt under any statute, including [s]ection 42.0021, Property Code." TEX. CIV. PRAC. & REM. CODE § 31.002(f) (Vernon 1997).

13. 176 B.R. 217, 220 (Bankr. E.D. Okla. 1994).

14. The *Swift* opinion also includes a thorough analysis of the accrual of a cause of action for negligence in causing the defect in the debtor's Keogh and IRA plans. See *Swift*, 129 F.3d at 795-801.

15. 218 B.R. 1008 (Bankr. W.D. Tex. 1998).

16. 11 U.S.C. § 522(f) (1994).

17. See *Duvall*, 218 B.R. at 1010-12.

lien of slightly over \$50,000.<sup>18</sup>

#### 4. Insurance Code Exemptions

In *In re Bailey*,<sup>19</sup> Judge Sharp of the Eastern District reiterated that court's earlier holdings regarding the conflict between the Insurance Code exemptions<sup>20</sup> and those found in the Texas Property Code.<sup>21</sup> That court had previously held that to the extent there is a conflict between the unlimited exemption in the Insurance Code and the limited personal property exemptions in the Property Code, the legislative intent was that the Insurance Code would prevail.<sup>22</sup> As noted in earlier surveys, this statutory conflict has been the subject of numerous other Texas Bankruptcy Court opinions.<sup>23</sup>

### D. DISCHARGEABILITY

#### 1. Willful and Malicious Injuries

The United States Supreme Court addressed the poorly worded statute that is the exception to dischargeability for "willful and malicious injury."<sup>24</sup> In *Kawaauhau v. Geiger*<sup>25</sup> the Supreme Court held that a debt arising from a medical malpractice judgment attributable to negligent or reckless conduct did not fall within the willful and malicious injury exception to discharge. The Court, noting that the word "willful" modifies the word "injury," reasoned that nondischargeability "takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury."<sup>26</sup> The Court also noted that 523(a)(6), as written, incorporates the concept of an intentional tort as opposed to a negligent or reckless tort, intentional torts being those that require that the actor intended "the *consequences* of an act" as opposed to intending the act itself.<sup>27</sup> This would appear consistent with the Fifth Circuit's similarly narrow ap-

---

18. See *id.* at 1023-24. Again, the court provides a thorough analysis of the history of lien avoidance in light of *Owen v. Owen*, 500 U.S. 305 (1991), and its progeny and the concept of an allowed, secured claim under *Dewsnup v. Timm*, 502 U.S. 410 (1992).

19. 217 B.R. 523 (Bankr. E.D. Tex. 1997).

20. See TEX. INS. CODE ANN. art. 21.22 (Vernon Supp. 1997). This provision provides essentially an unlimited exemption for certain insurance interests and insurance proceeds.

21. See TEX. PROP. CODE ANN. § 42.001 (Vernon Supp. 1998) (limiting the total exemption on certain personal property to \$60,000 for a married couple or family).

22. See *In re Atkins*, 217 B.R. 522, 523 (Bankr. E.D. Tex. 1997). See also *In re Young*, 166 B.R. 854 (Bankr. E.D. Tex. 1994).

23. Compare *In re Borchers*, 192 B.R. 698 (Bankr. W.D. Tex. 1996) with *In re Scott*, 193 B.R. 805 (Bankr. N.D. Tex. 1996). See generally Roger S. Cox, *Bankruptcy and Creditors' Rights*, 50 SMU L. REV. 989, 1009-10 (1997).

24. Section 523(a)(6) of the Bankruptcy Code provides that a discharge in bankruptcy "[D]oes not discharge an individual debtor from any debt . . . for willful and malicious injury . . . to another." 11 U.S.C. § 523(a)(6) (1997).

25. 118 S. Ct. 974 (1998).

26. *Id.* at 977. The Court continued: "Had Congress meant to exempt debts arising from unintentionally inflicted injuries, it might have described instead 'willful acts that cause injury.' Or, Congress might have selected an additional word or words, i.e., 'reckless' or 'negligent' to modify 'injury.'" *Id.*

27. See *id.*

proach in *In re Delaney*,<sup>28</sup> in which the court held that injuries resulting from an accidental discharge of a shotgun being wielded by the debtor in a threatening manner gave rise to a dischargeable claim. In that case, the Fifth Circuit also struggled with the poor wording of the same statute.<sup>29</sup>

Shortly after the narrow approach taken in *Geiger*, the Supreme Court reiterated the traditionally broader approach applied to section 523(a)(2)(A) claims based on actual fraud.<sup>30</sup> In *Cohen v. De La Cruz*,<sup>31</sup> the Court held that a "debt" for money, property, etc., obtained by fraud includes statutory or exemplary damages, attorneys' fees, or other elements of recovery under state law and is therefore non-dischargeable along with the principal amount of the underlying claim.<sup>32</sup>

During the survey period, however, the Fifth Circuit addressed willful and malicious injury on at least two separate occasions, one of which gave that court an opportunity to re-examine what some might have considered an overly narrow reading of the statute. In *In re Walker*,<sup>33</sup> the State of Texas sued a university professor in state court, alleging that he had improperly retained professional fees in violation of his contract with the University of Texas. The court addressed other issues, including a claim of qualified immunity by the debtor and 11th Amendment issues arising from the state's status as a party. Regarding dischargeability, however, the court noted that even in light of *Kawaauhau* there remained the possibility that in a combination contract and tort claim, a fact issue remains whether the actor committed an act resulting in a "willful and malicious injury."<sup>34</sup> Essentially, the court concluded that the trial court should determine whether the professor was aware of his obligations to the university regarding professional fees. Presumably, if the professor was aware and nevertheless knowingly retained those fees with the intent of depriving the university of fee income to which it actually was entitled, it would be possible that such a claim would be nondischargeable.<sup>35</sup>

---

28. *Corley v. Delaney (In re Delaney)*, 97 F.3d 800, 803 (5th Cir. 1996).

29. *See id.* at 802. Again, the statute describes a willful or malicious injury, although Congress does not describe how an inanimate injury can be either willful or malicious.

30. For example, the Court previously held that in cases of actual fraud, the creditor need only establish "justifiable reliance" to support a section 523(a)(2)(A) claim as opposed to the more stringent "reasonable reliance" standard specified in section 523(a)(2)(B). *See Field v. Mans*, 116 U.S. 437 (1995). *See generally* Roger S. Cox, *Bankruptcy and Creditors' Rights* 50 SMU L. REV. 989, 900-02 (1995).

31. 523 U.S. 213 (1998).

32. *See id.* at 217. The court concluded:

In short, the text of § 523(a)(2)(A), the meaning of parallel provisions in the statute, the historical pedigree of the fraud exception, and the general policy underlying the exceptions to discharge all support our conclusion that "any debt . . . for money, property, services, or . . . credit, to the extent obtained by" fraud encompasses any liability arising from money, property, etc., that is fraudulently obtained, including treble damages, attorney's fees, and other relief that may exceed the value obtained by the debtor.

*Id.*

33. *Board of Regents v. Walker (In re Walker)*, 142 F.3d 813 (5th Cir. 1998).

34. *See id.* at 823-24. The court cited *McIntyre v. Kavanaugh*, 242 U.S. 138 (1916), an intentional conversion case that essentially was reaffirmed in *Kawaauhau*.

35. *See Walker*, 142 F.3d at 824.

Shortly thereafter, in *In re Miller*,<sup>36</sup> the court addressed whether a claim based upon alleged misappropriation of proprietary information and misuse of trade secrets was nondischargeable. The Fifth Circuit reversed the lower court judgment to the effect that the claim was nondischargeable based upon the state court judgment, primarily because the Fifth Circuit found that the issue of the debtor's intent was not litigated in the state court case.<sup>37</sup> The court found that the jury's finding that the debtor acted "wrongfully" in misappropriating funds did not include a finding of fraudulent intent as necessary to find a debt nondischargeable for fraud in a fiduciary capacity.<sup>38</sup>

The court took the same approach regarding willful and malicious injury. More importantly, however, the court took the opportunity to analyze willful and malicious injuries in light of the Supreme Court's opinion in *Kawaauhau*.<sup>39</sup> The Fifth Circuit adopted the concept of "implied malice" for determining whether a claim results from a "willful and malicious injury" for dischargeability purposes.<sup>40</sup> The court specifically held that an injury is willful and malicious "where there is either an objective substantial certainty of harm or a subjective motive to cause harm."<sup>41</sup> The Fifth Circuit concluded that the *Kawaauhau* opinion does not foreclose, and "even encourages," the implied malice approach.<sup>42</sup> In concluding that the state court did not preclude litigation of the intent issue, the court held that if the debtor's actions "were at least substantially certain to result in injury to [another], then the debt is nondischargeable under section 523(a)(6)."<sup>43</sup>

Obviously, this may be a more common sense approach to what is admittedly a poorly worded statute. That said, however, it is impossible to tell whether the Fifth Circuit overstepped the narrow bounds of *Kawaauhau*.

## E. AUTOMATIC STAY

### 1. *What to Do with the Repossessed Car*

What does a secured creditor do when, after repossessing a car but prior to disposition, the debtor files bankruptcy? Chief Judge Robert McGuire of the Northern District provides some guidance in *In re Zaber*.<sup>44</sup> In *Zaber*, the debtor filed an emergency motion to hold the secured creditor (GMAC) in violation of the automatic stay and also for turnover of

---

36. *Miller v. J.D. Abrams, Inc. (In re Miller)*, 156 F.3d 598 (5th Cir. 1998) *cert. denied* *Miller v. J.D. Abrams*, 119 S. Ct. 1249 (1999); *J.D. Abrams v. Miller*, 119 S. Ct. 1250 (1999).

37. *See id.* at 603. Apparently, there were confusing or inconsistent findings by the state court jury. *See id.* at 601-02.

38. *See id.* at 602-03. *See also* 11 U.S.C. § 523(a)(4) (1998).

39. *See In re Miller*, 156 F.3d at 603-04.

40. *See id.* at 606.

41. *Id.*

42. *See id.*

43. *Id.*

44. 223 B.R. 102 (Bankr. N.D. Tex. 1998).



property of the estate. GMAC repossessed the debtor's car on April 12, and on April 15, the debtor filed Chapter 13, notifying GMAC and furnishing it with proof of insurance effective March 1 and continuing through September of that year. There was no evidence that GMAC had any other concerns regarding the debtor's potential flight, concealment of the automobile, or insurance coverage.

GMAC refused to return the car without payment of its pre-petition claim for repossession fees, which the debtor agreed to pay at \$100 per month. The parties apparently continued in negotiations for a number of days; however, although GMAC indicated a willingness to "work out an agreed order," GMAC never relinquished possession of the vehicle.<sup>45</sup> Negotiations broke down, and an emergency hearing was set. GMAC, however, still refused to return the vehicle to the debtor.

The court noted a split of opinion on this issue<sup>46</sup> and recognized the secured creditor's continuing right to adequate protection.<sup>47</sup> The court concluded that although GMAC was permitted a reasonable time to respond, the automatic stay was violated at the time that negotiations between the debtor and creditor broke down. The court awarded actual damages and reasonable attorney's fees. The court did not, however, impose punitive damages.<sup>48</sup>

*Zaber* is imperative reading for the secured creditor and creditor's counsel who find themselves in this awkward position. While *Zaber* does not provide a precise answer to every situation, the cautious creditor's counsel should generally advise the creditor to return the vehicle unless there is a specific reason why the creditor's adequate protection would be unreasonably compromised. When in doubt, creditor's counsel should also take every effort to bring the matter to the court's attention as soon as possible on an emergency basis.<sup>49</sup>

#### F. SUBSTANTIAL ABUSE

One issue that rose to the fore in the area of consumer Chapter 7 cases is the concept of substantial abuse, the statutory authority for which is

---

45. *Id.* at 104.

46. *See id.* at 104. The court emphasized that in *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), the creditor sought relief from the automatic stay before the debtor moved for turnover relief. In *Zaber*, the creditor was perceived to have assumed that the stay did not apply or that it would determine its own adequate protection. *See Zaber*, 223 B.R. at 105.

47. *See Zaber*, 223 B.R. at 104. "There is no argument, however, of the right of the creditor to protection. The question here is who has the duty to seek that protection." *Id.* at 104 (quoting *GMAC v. Ryan*, 183 B.R. 288, 289 (Bankr. M.D. Fla. 1995)).

48. *See id.* at 107.

49. If the creditor cannot articulate why it is an emergency situation, then there is probably no compelling reason for refusing to relinquish the car. A good example is provided by *In re Crowe*, 160 B.R. 299 (Bankr. N.D. Tex. 1993), which involved a purely possessory mechanic's lien that would have lapsed upon relinquishment of possession. In that situation, the Bankruptcy Court refused to compel turnover of the vehicle. *See id.* at 301.

apparently found at section 707(b) of the Bankruptcy Code.<sup>50</sup> Essentially, section 707(b) provides that a case can be dismissed for "substantial abuse" upon a motion by the court or by the United States Trustee.<sup>51</sup> The statute is silent, however, with respect to what constitutes substantial abuse.<sup>52</sup>

Judge John C. Akard of the Northern District was the first Texas bankruptcy judge to weigh in on this issue in the case of *In re Heasley*.<sup>53</sup> In *Heasley*, the court adopted a modified totality of the circumstances test in order to determine whether a Chapter 7 case should be discharged for substantial abuse.<sup>54</sup> This test apparently originated in *In re Krohn*, a Sixth Circuit opinion.<sup>55</sup> According to the test, a court is to ascertain from the "totality of the circumstances whether [a debtor] is merely seeking an advantage over his creditors, or instead is [an] 'honest'" debtor and entitled to a discharge.<sup>56</sup> The court continued that the "debtor's good faith and candor in filing schedules and other documents, whether he has engaged in 'eve of bankruptcy purchases,' and whether he was forced into Chapter 7 by unforeseen or catastrophic events" should also be considered.<sup>57</sup>

Most notably, the approach taken in *Heasley* includes consideration of debtor's "ability to repay his debts out of future earnings."<sup>58</sup> According to the Sixth Circuit, and apparently Judge Akard, "[t]hat factor alone may be sufficient to warrant dismissal," even though such "means testing" is excluded from the Bankruptcy Code.<sup>59</sup> To Judge Akard's credit, the court analyzed the (somewhat unusual) facts in *Heasley* under the more specific standards enumerated by the Fourth Circuit in *In re Green*.<sup>60</sup> The factors analyzed by Judge Akard are as follows:

first . . . whether the [bankruptcy] petition was filed because of sudden illness, calamity, disability, or unemployment . . . second . . . whether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay . . . third . . . whether the debtor's proposed family budget is excessive or unreasonable . . . forth . . . whether the debtor's schedules and statement of current income and expenses reasonably and accurately reflect his true financial condition . . . fifth . . . whether the petition was filed in good faith . . . sixth . . . the relation of a debtor's future income to future . . . expenses.<sup>61</sup>

---

50. 11 U.S.C. § 707(b) (1998).

51. *See id.*

52. *See id.*

53. 217 B.R. 82 (Bankr. N.D. Tex. 1998).

54. *See id.* at 87.

55. *See id.* (citing *In re Krohn*, 886 F.2d 123, 126-27 (6th Cir. 1989)).

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.* (citing *In re Krohn*, 886 F.2d at 127).

60. *See id.* at 86 (citing *Green v. Staples (In re Green)*, 934 F.2d 568, 572 (4th Cir. 1991)).

61. *Id.* at 87-88.

Also to Judge Akard's credit, the facts in *Heasley* were somewhat egregious, the debtors' schedules were repeatedly and inexplicably amended time and again, and the debtors attempted to use Chapter 7 to prefer one group of unsecured creditors over another. In other words, the debtors' conduct certainly warranted dismissal for substantial abuse. Despite this author's concern about a premature jump start on "means testing" (see below), *Heasley* was not quite a "means test" case in the sheep's clothing of "substantial abuse."

Two later cases, however, were to the contrary. In *In re Lampkin*,<sup>62</sup> Judge Frank Monroe of the Western District dismissed a case for substantial abuse based primarily on the debtors' ability to pay a dividend of nearly forty percent to their unsecured creditors in a hypothetical three-year Chapter 13 plan. Admittedly, it is somewhat overly simplistic to say that *Lampkin* was simply a "means test" case, but the bottom line is that the debtors in *Lampkin* were given a period of time within which to convert to Chapter 13 or else have their case be dismissed based primarily upon their ability to repay debts.<sup>63</sup> Similarly, Chief Judge McGuire of the Northern District, in *In re Laman*,<sup>64</sup> dismissed a Chapter 7 case based primarily upon a similar "means test" approach.<sup>65</sup>

This author certainly agrees that a number of consumer bankruptcy filings are abusive or perhaps otherwise stretching the Bankruptcy Code to its limits and that the *Heasley* case is a good example. However, if Congress intended for "means testing" to be a predicate to relief under Chapter 7, Congress could have so provided. In fact, much of the 1998 legislative-session debate centered around that very issue.<sup>66</sup> As Judge Akard noted in *Heasley*, Congress failed to define what was meant by "substantial abuse." But nevertheless, some bankruptcy courts have already imposed means testing as a condition to Chapter 7 relief. It remains to be seen how the Fifth Circuit, which fashions itself as a "plain meaning" court, would view this broad reading of the statute.

#### G. DISMISSAL—SERIAL FILINGS, ETC.

A number of Texas bankruptcy courts during the Survey period addressed the problem of serial filings, specifically in Chapter 13 cases. First, in *In re Rowe*,<sup>67</sup> the district court affirmed a bankruptcy court's dismissal of a Chapter 13 filing that had been the fifth successive Chapter 13 petition filed by a debtor in an apparent effort to stave off foreclosure on the debtor's home. Significantly, the debtor filed the last Chapter 13 peti-

---

62. 221 B.R. 390, 394 (Bankr. W.D. Tex. 1998).

63. *See id.* at 392-94.

64. 221 B.R. 379 (Bankr. N.D. Tex. 1998).

65. *See id.* at 381-86. The court also noted that the debtors enjoyed a fairly sizable retirement account.

66. *See, e.g.*, David E. Leta, *Do the Ends Justify the Means Test?*, NAT'L L.J., Sept. 28, 1998, at B5; Evelyn H. Biery et al., *Proposed Bankruptcy Legislation Hurts Middle Class Most*, TEX. LAW., Aug. 10, 1998, at 26.

67. 220 B.R. 591, 594-95 (Bankr. E.D. Tex. 1997).

tion at 4:00 p.m., on the day before a scheduled foreclosure sale. There was some conflicting testimony in the record regarding notice of the bankruptcy, but the foreclosure sale occurred. The bankruptcy court refused to void the foreclosure sale, noting that in the Fifth Circuit, actions taken in violation of the automatic stay are voidable and not void.<sup>68</sup>

Shortly thereafter, Judge Clark of the Southern District dismissed a Chapter 13 case based on the debtor's unreasonable delay in providing the court with accurate and complete schedules.<sup>69</sup> In *In re Nassar*, the bankruptcy court dismissed the bankruptcy petition because a totality of the circumstances indicated that the petition was filed in bad faith.<sup>70</sup> The *Nassar* court found that the debtor failed to provide accurate schedules and failed to make other disclosures, which was especially troublesome given the debtor's apparent ability to manipulate the amount of compensation available from his closely held corporation. Accordingly, the court dismissed his case with prejudice against refiling for 180 days.<sup>71</sup>

In the Northern District, Judge Akard addressed dismissal of serial Chapter 13 filings in at least two published opinions. First, in *In re Martin*,<sup>72</sup> the court dismissed the debtors' third filing with prejudice against refiling for 180 days. Apparently, the schedules were inadequate and potentially misleading, compounding the problem faced by the court.

A few months later, however, Judge Akard expressed frustration at the inaction of creditors affected by what had been at least the sixth consecutive filing by the debtor in *In re Tuckey*.<sup>73</sup> The court traced the procedural history of all six filings, culminating in the court's issuance of one last show cause order. The notice specifically invited all creditors to appear and present evidence of damages incurred as a result of the debtor's violation of a prior court order. The debtor did not bother to appear; more importantly, however, neither did any creditors. The court stated,

in more than twelve years as a United States Bankruptcy Judge, this court cannot recall one instance of a creditor objecting to a repeat filing by a debtor. . . . The only conclusion the court can draw is that creditors are not concerned about repeat filings. If creditors are not concerned about repeat filings, should the court be concerned about them? I think not.<sup>74</sup>

The court declined to impose sanctions against the debtor.<sup>75</sup>

---

68. See *id.* at 595 (citing *In re Jones*, 63 F.3d 411, 412 (5th Cir. 1995)).

69. *In re Nassar*, 216 B.R. 606 (Bankr. S.D. Tex. 1998).

70. See *id.* at 608. The court focused on the following factors: "(1) whether the debtor has stated his debts and expenses accurately; (2) whether he has made any fraudulent representation to mislead the bankruptcy court; and (3) whether he has unfairly manipulated the bankruptcy code." *Id.*

71. See *id.*

72. 215 B.R. 119, 121 (Bankr. N.D. Tex. 1997).

73. 222 B.R. 549 (Bankr. N.D. Tex. 1998).

74. *Id.* at 552.

75. See *id.* The opinion does not indicate the ultimate procedural disposition of the case. But the court did indicate that it would be less proactive in seeking out serial filings given the creditors' apparent lack of interest. See *id.*

In conclusion, courts have understandably grown impatient with serial filings, especially those designed to thwart the legitimate remedies of secured creditors or when a debtor otherwise flaunts the disclosure and filing requirements under the Bankruptcy Code. That said, bankruptcy courts will only go so far to protect the rights of creditors that take no action to protect themselves.

#### H. CHAPTER 13 CONFIRMATION

Speaking of good faith in a Chapter 13 context, Judge Lief Clark provides in *In re McLaughlin*<sup>76</sup> an analysis of the good faith required in connection with confirmation of a Chapter 13 plan. The debtors filed a Chapter 13 plan that proposed to pay the holder of a judgment based on a breach of fiduciary duty less than two percent on her claim while providing substantial payments to other creditors. The court found that the plan was not proposed in good faith<sup>77</sup> and that the plan did not meet the best interest of creditors test (in other words, whether the creditors would realize more than in a Chapter 7 liquidation).<sup>78</sup>

*McLaughlin* is included in this Survey not so much for its result but because of its good faith analysis. Fundamentally, the court notes that the requirement that a plan be proposed in good faith is separate and distinct from the best interest of creditors test.<sup>79</sup> According to Judge Clark, some courts seem to “conflate” those two tests, “effectively holding the best interests test to be determinative of the good faith issue.”<sup>80</sup> Having separated the two issues, the court then provides an extensive analysis of the good faith requirement of plan confirmation. Noting issues addressed by other courts,<sup>81</sup> the court acknowledged the delicate balance of having to be “mindful of the fresh start purposes of the Code” while at the same time being “wary of attempts by debtors to abuse the Code’s remedies.”<sup>82</sup> In addressing the totality of the circumstances behind the plans proposed in *McLaughlin*, the court focused on three factors: “the debtor’s pre-petition conduct leading to the [pre-petition state court] judgment, the timing of the debtor’s petition in relation to that judgment (and the timing of their failure to appeal that judgment), and the extremely unfavorable treatment that the objecting creditor receives

---

76. 217 B.R. 772 (Bankr. W.D. Tex. 1998).

77. *See id.* at 775-78.

78. *See id.* at 778-82.

79. *See id.* at 775.

80. *Id.* “This mixing of the two issues is needlessly confusing and serves no apparent purpose. We conclude that the § 1325(a)(3) good faith requirement must be met separately from any consideration of the liquidation analysis required by § 1325(a)(4).” *Id.*

81. The litany of relevant circumstances found in the case law includes but is not limited to the debtor’s earning potential and past employment history, the duration of the plan, the accuracy of information provided by the debtor, whether the plan is preferential to certain creditors, whether the debt involved would be dischargeable in Chapter 7, prior bankruptcy filings by the debtor, and the sincerity and motivation of the debtor.

*Id.* at 776.

82. *Id.*

under the terms of the proposed plan.”<sup>83</sup> The court concluded that, while it did not wish to “penalize” the debtors for the presence of any one of those factors, the “synergistic effect of these factors leads us to the conclusion that these plans have not been proposed in good faith.”<sup>84</sup>

### I. ATTORNEY'S FEES FOR DEBTOR'S COUNSEL

The Fifth Circuit addressed the issue of attorney's fees for debtor's counsel in an opinion issued after the Survey period. Given its potential impact on existing cases, however, it is included in this Survey. For reasons described below, its ultimate significance has yet to be seen. In *In re Pro-Snax Distributors, Inc.*,<sup>85</sup> the Fifth Circuit held that Chapter 11 debtor's counsel is not entitled to compensation from the estate for services rendered after the appointment of a trustee. The court based its decision on the plain meaning of section 330 of the Bankruptcy Code, which governs compensation to professionals. Crucially, the court noted that in the 1994 amendments to the Bankruptcy Code, Congress removed the words “the debtor's attorney” from that section's list of persons who could be compensated from the bankruptcy estate.<sup>86</sup> Although the court struggled with what some might classify as an inequitable result,<sup>87</sup> the court nevertheless concluded that the statute was clear and unambiguous on its face and that it specifically excluded the debtor's attorney.<sup>88</sup> “[I]n the absence of any ambiguity, our examination is confined to the words of the statute, which are assumed to carry their ordinary meaning.”<sup>89</sup> When a debtor ceases to be a “debtor in possession,” effectively serving in lieu of a trustee, there is no longer a statutory basis for awarding fees to counsel for a debtor.

Of perhaps even more importance to the typical Chapter 11 case (if there is such a thing) is language found later in the opinion when the Fifth Circuit analyzes the pre-trustee fees of the debtor's counsel. Debtor's counsel argued that a “reasonableness test,” inquiring whether the services were “objectively beneficial toward the completion of the case at the time they were performed,” should be the appropriate test.<sup>90</sup> The ob-

---

83. *Id.* at 778.

84. *Id.*

85. *Andrews & Kurth, L.L.P. v. Family Snack, Inc. (In re Pro-Snax Distribs., Inc.)*, 157 F.3d 414, 425 (5th Cir. 1998).

86. See 11 U.S.C. § 330 (1998); *Pro-Snax*, 157 F.3d at 422.

87. “We decide the issue before us bound by our conventions of statutory construction, even though common sense might lead the lay observer to conclude that a different result is perhaps more appropriate. The law, and the rules to which we adhere in order to interpret it, does not always conform to the dictates of common sense.” *Pro-Snax*, 157 F.3d at 424-25.

88. “In this case, we are faced with a statute which is clear on its face. It excludes attorneys from its catalog of professional officers of a bankruptcy estate who may be compensated for their work after the appointment of a Chapter 11 trustee.” *Id.* at 425.

89. *Id.* See also *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 566 (1994) (“As long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute.”).

90. *Pro-Snax*, 157 F.3d at 426.

jecting creditors (who also happened to be the petitioning creditors in the initial involuntary filing) urged a more stringent test of “whether [debtor’s counsel] services resulted in an identifiable, tangible, and material benefit to the bankruptcy estate.”<sup>91</sup> The Fifth Circuit chose the latter, more stringent test. While it is hard to argue against the court’s conclusion that “any work performed by legal counsel on behalf of a debtor must be of material benefit to the estate,”<sup>92</sup> what is of more concern is the court’s approval of the District Court’s instruction to “consider strongly the debtor’s lack of success in obtaining confirmation of the Chapter 11 plan.”<sup>93</sup> In other words, “the chances of success must outweigh the costs of pursuing the action.”<sup>94</sup> Even though the bankruptcy court found support for the debtor’s plan among other creditors, the Fifth Circuit concluded that debtor’s counsel “should have known from the outset that the [d]ebtor’s prosecution of a Chapter 11 plan would fail,”<sup>95</sup> and, therefore, fees should not be allowed.

A cynical reading of *Pro-Snax* indicates that the Fifth Circuit suggests that debtor’s counsel, gazing into its crystal ball, should be able to predict, prior to taking a Chapter 11 case, whether the case would have some likelihood of success. This could have a chilling effect on distressed businesses being able to locate counsel, because in many cases debtors come to Chapter 11 with an inherently unconfirmable plan in the absence of creditor cooperation. Many Chapter 11 cases define success by other than a confirmed plan, and other cases are dismissed or converted with the cooperation and agreement of all parties. Does *Pro-Snax* suggest that fees for debtor’s counsel are inherently unavailable in such cases or that counsel will be subjected to a 20-20 hindsight test? Only time will tell.

## J. COLLATERAL VALUATION

Most regular readers of this Survey are familiar with the saga of *In re Rash*.<sup>96</sup> The Supreme Court in *Rash* held that for purposes of confirming a debt adjustment plan in which a debtor proposes to retain and use collateral, a replacement cost should be used.<sup>97</sup> Although the Supreme Court ended a long and tortured history of that case, courts are still left to address collateral valuation issues.

In *In re Davis*,<sup>98</sup> Judge Felsenthal of the Northern District addressed valuation in a post-*Rash* setting.<sup>99</sup> In *Davis*, the court addressed the tim-

---

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

96. *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879 (1997).

97. *See id.* at 1886.

98. 215 B.R. 824 (Bankr. N.D. Tex. 1997).

99. Prior to the Survey, Judge Felsenthal also addressed collateral valuation in *In re Jenkins*, 215 B.R. 689 (Bankr. N.D. Tex. 1997), in which the court went through a thorough analysis of valuing a vehicle in a motion to lift stay/adequate protection setting in light of the Supreme Court’s instructions in *Rash*.

ing of valuation, specifically "whether, for [Chapter 13] confirmation purposes, the value of a vehicle should be determined as of date filing the bankruptcy petition or the date of confirmation."<sup>100</sup> As a fundamental proposition, the court concluded that the vehicle should be valued as of the plan confirmation date, which is the effective date as of which a secured creditor must receive property of the value of its secured claim.<sup>101</sup> The secured creditor argued that the petition date was the more appropriate valuation date; however, the court concluded that the creditor had been adequately protected by pre-confirmation disbursements that exceeded the depreciation between the petition date and the confirmation date.<sup>102</sup>

In effect, the *Davis* court concluded that a vehicle securing a claim may be valued as of the petition date to determine *adequate protection* payments, which should protect the secured creditor until confirmation. For *confirmation* purposes, however, the court concluded that the confirmation date was more appropriate.<sup>103</sup> Assuming Judge Felsenthal's analysis is correct, this again illustrates the need for the secured creditor to take appropriate steps to make sure that its interest is adequately protected pending confirmation. Unfortunately, in districts where pre-confirmation disbursements are prohibited, such a practical approach may prove problematic, theoretically leaving the secured creditor only the remedy of seeking relief from the automatic stay if its interest cannot be adequately protected.

#### K. REAFFIRMATION AND OTHER POST-PETITION ACTIONS

Three opinions from Judge Akard of the Northern District are illustrative of the trouble that a creditor or its representative can get into by careless or even overreaching steps taken post-petition. In *In re Smith*,<sup>104</sup> an entity apparently acting as a collection agent for a retailer sent what appeared to be a fairly standard inquiry regarding redemption, reaffirmation, or surrender of property securing a consumer debt. This collection service, however, failed to provide debtor's counsel with evidence of the creation or perfection of a security interest, but rather simply demanded that the debtor exercise one of the three options.<sup>105</sup> After being presented with the letter, the court entered an order denying reaffirmation and issuing injunctions in which the court denied the reaffirmation, found the claim to be unsecured, and enjoined the creditor from taking any post-petition collection actions. The creditor representative filed a

---

100. *Davis*, 215 B.R. at 825.

101. *See id.*

102. "The adequate protection payments protect GMAC's interest in the vehicle from petition date to confirmation date." *Id.* at 826.

103. *See id.*

104. 223 B.R. 108 (Bankr. N.D. Tex. 1998).

105. *See id.* at 109. "The letter did not contain an description [*sic*] of the collateral nor any indication of its value. No evidence of the asserted purchase money security interest was attached to the letter." *Id.*



motion for new trial; however, once again, the underlying documentation was lacking. The court denied the motion, stating that it was simply asking for nothing more than a creditor would otherwise be required to attach to its proof of claim.<sup>106</sup>

In *In re Allen*,<sup>107</sup> the debtors presented for approval a reaffirmation agreement with their mortgage company, that included bankruptcy attorney's fees of \$125.<sup>108</sup> The court found that reaffirmation agreements are governed by section 524(c) of the Bankruptcy Code, which contains no separate provision regarding the imposition of attorney's fees by a creditor who happens to be a party to a reaffirmation agreement. The court, finding that no other request for approval of attorney's fees had been filed, held that the creditor should be enjoined from collecting any such fees.<sup>109</sup>

Faced with what can only be described as a bizarre set of facts arising over a series of cases, Judge Akard took some serious steps with respect to lawyers who had engaged in a pattern of filing objections to dischargeability of credit card debt without serving debtors or debtor's counsel. In *In re Drago*,<sup>110</sup> the court noted that typically debtors learned of objections only when matters arose on the trial docket.<sup>111</sup> When the cases were called for trial, no one would appear on behalf of the creditor, and the court typically awarded sanctions. The court subsequently became aware that one law firm had filed all or substantially all of those cases. The court traced the procedural history of three different Chapter 7 cases and discussed the efforts of various creditors represented by these lawyers to compromise and settle claims arising out of those activities. The court refrained from imposing monetary sanctions on the lawyers, given a series of personal problems that had beset them during the time in question. The court did, however, suspend the lawyers from practice in the Bankruptcy Courts for the Northern District of Texas for a four year period.<sup>112</sup>

The lesson for the consumer lender from this trilogy of cases is quite simple: when asserting a claim, submit the documentation giving rise to your claim, and when seeking to deprive a debtor of the fresh start to which he or she is entitled, do so only when: (a) there are suitable grounds for doing so, and (b) with full and adequate notice to the debtor

---

106. *See id.* at 110. "Nothing less should be required in connection with a creditor's request for a reaffirmation agreement, surrender, or redemption." *Id.*

107. 215 B.R. 503 (Bankr. N.D. Tex. 1997).

108. *See id.* at 504.

109. *See id.* at 505. The court also required the creditor to file an affidavit by an executive officer of the creditor certifying that attorney's fees had not and would not be charged against the debtors, their escrow account, or their note. The court also noted that "preparation of a claim is a ministerial act for which no attorney's fees should be charged against a debtor." *Id.* at 504.

110. 219 B.R. 460 (Bankr. N.D. Tex. 1998).

111. *See id.* at 461.

112. *See id.* at 467.

and debtor's counsel. These rules seem obvious, but they remain honored in the breach.

#### L. RES JUDICATA—EFFECT OF PLAN CONFIRMATION

Although the author intended to avoid discussions of the technical aspects of plan confirmation, one case bears mentioning that might otherwise be overlooked because it arose in the state courts. In *Geary v. Texas Commerce Bank*,<sup>113</sup> the Texas Supreme Court held that the executor of the estate of a deceased person who was originally liable as a guarantor of an obligation of a Chapter 11 debtor corporation was entitled to assert the *res judicata* effect of a Chapter 11 plan confirmation order. Relying initially on the Fifth Circuit's holding in *Republic Supply Co. v. Shoaf*,<sup>114</sup> the court determined that, as a fundamental concept, it is possible for a guarantor to enjoy *res judicata* protection; but, according to the Texas Supreme Court, the *Shoaf* court did not address the issue of whether the parties were identical in both suits in order for *res judicata* to apply.<sup>115</sup> The court concluded, however, that identity of parties existed. The court determined that the corporation's plan of reorganization addressed the interests of the guarantor by purporting to release the guarantor's joint debt and concluded that the guarantor "was therefore a party to the bankruptcy and can assert *res judicata* because the bankruptcy proceeding affected his liabilities as executor."<sup>116</sup>

The Fifth Circuit, however, also addressed the issue of *res judicata* in a plan confirmation context in *In re Taylor*.<sup>117</sup> *Taylor* is not analyzed in this Survey, but the court distinguished the case (involving a determination of a tax claim) from *Shoaf*. The court declined to assign *res judicata* effect to confirmation of a plan that purported to discharge a tax debt without invoking what the court perceived was the normal process for determination of tax claims.<sup>118</sup>

### III. OTHER CREDITOR'S RIGHTS CASES

What follows are several randomly selected cases of interest that provide insight into the enforcement (or defense) of the debtor-creditor relationship. The Survey does not include every case but rather a selection of cases to provide insight and reminders to the prudent practitioner.<sup>119</sup>

---

113. 967 S.W.2d 836, 839 (Tex. 1998).

114. 815 F.2d 1046 (5th Cir. 1987) (entitling plan confirmation order releasing debtor's guarantor to *res judicata* effect).

115. *See id.* at 838.

116. *Id.* at 839.

117. Internal Revenue Service v. Taylor (*In re Taylor*), 132 F.3d 256 (5th Cir. 1998).

118. *See id.* at 262-63.

119. For an inclusive survey of cases that bear not only on enforcement of the debtor-creditor relationship but also on documentation and creation of that relationship, see David A. Weatherbie, *Recent Case Update*, University of Texas Mortgage Lending Institute (1998). Similar presentations are provided by Mr. Weatherbie for the State Bar of Texas Advanced Real Estate Law Course. *See* David A. Weatherbie, *Recent Case Update*, State Bar of Texas Advanced Real Estate Law Course (1998).

### A. LIMITATIONS—ACKNOWLEDGMENT OF DEBT

In a case originally arising as a bankruptcy case, the Fifth Circuit addressed statutes of limitations under state law—specifically, whether and to what extent a writing can serve as an acknowledgment of a debt sufficient to toll or renew limitations under Texas law. In *In re Vineyard Bay Development Co.*,<sup>120</sup> the debtor objected to a proof of claim that had been filed by a secured creditor based upon what amounted to a state law statute of limitations defense. The creditor asserted that debtor's counsel had written two letters that effectively acknowledged the debt under state law. In one or both letters, however, counsel had apparently stated that limitations had expired and reiterated that the statements contained in the letter were not to be considered an admission. In the second letter, counsel made more affirmative statements that might have constituted an acknowledgment of the debt under state law; however, the second letter was written after the bankruptcy filing.

In effect, an acknowledgment of a debt under state law operates as a new obligation and not a mere revival of the prior debt.<sup>121</sup> Whether an acknowledgment of a debt contains the unequivocal statements necessary to defeat limitations under state law is a question of law.<sup>122</sup>

Apparently, the first letter did not rise to the level of an acknowledgment of the debt, especially given the reservation against intending any admission in the letter.<sup>123</sup> The court invoked bankruptcy law, however, to invalidate the second letter. It reasoned that an acknowledgment of a debt is in effect a new obligation, and the new obligation would have required bankruptcy court's approval because it was made post-petition.<sup>124</sup> Finally, the court declined to apply estoppel based upon oral representations, given the writing requirement under the Texas Civil Practice and Remedies Code.<sup>125</sup>

### B. LIMITATIONS-REAL ESTATE LIEN DEBT

*Cadle Co. v. Butler*<sup>126</sup> addressed the requirements for renewing and extending limitations on real estate lien debt, which is governed by sections 16.036 and 16.037 of the TEXAS CIVIL PRACTICE AND REMEDIES

120. *Kearns v. Vineyard Bay Dev. Co. (In re Vineyard Bay Dev. Co.)*, 132 F.3d 269 (5th Cir. 1998).

121. *See id.* at 271 (citing *Allied Chem. Corp. v. Koonce*, 548 S.W.2d 80, 81 (Tex. Civ. App.—Houston [1st Dist.] 1977, n.w.h.)).

122. *See id.*

123. *See id.*

124. *See id.* at 272.

125. *See id.* Again, *Vineyard Bay* addressed Texas law. Under federal law, the threshold for acknowledgment of a debt appears to be less stringent. *See Midstates Resources Corp. v. Farmer's Aerial Spraying Serv., Inc.*, 914 F. Supp. 1424, 1427 (N.D. Tex. 1996) (Settlement letter sent by debtor's counsel constituted acknowledgment of debt under federal statutes, which applied to FDIC's assignee.). *See also United States v. J.R. LaPointe & Sons, Inc.*, 950 F. Supp. 21, 24 (D. Maine 1996) (Borrower's application for settlement of FMHA debt constituted acknowledgment of debt under Federal statute of limitations.).

126. 951 S.W.2d 901 (Tex. App.—Corpus Christi 1997, n.w.h.).

CODE.<sup>127</sup> In *Butler*, the maturity date of a real estate lien debt was not reflected on the deed of trust. The note matured in 1988, with a number of oral extensions. No written extension was signed until October 1993. Meanwhile, in March 1993, Cadle abstracted a judgment against the maker of the note. Cadle's judgment lien prevailed over the deed of trust lien because of the lack of a recorded, properly executed extension agreement.<sup>128</sup> According to statute, the maturity date stated in the original instrument is conclusive evidence of the maturity date of the debt.<sup>129</sup> Even if the parties had been able to look to the underlying loan document given the missing maturity date in the deed of trust, oral extensions would not have been binding on the bona fide purchaser. Accordingly, the intervening judgment lien prevailed.<sup>130</sup>

### C. CROSS-COLLATERALIZATION CLAUSES

Another bankruptcy case decided during the Survey period may have state law implications. In *In re Conte*,<sup>131</sup> Judge Sharp of the Eastern District addressed a cross-collateralization clause under which a credit union/credit card issuer refused to release the title to a motor vehicle after payment of a car loan so long as the same issuer held an unpaid debt on an outstanding credit card balance. The credit union asserted that a cross-collateralization clause in the automobile loan documents provided the creditor a security interest securing the payment of the credit card debt.

Judge Sharp recognized well established law upholding the validity of cross-collateralization clauses,<sup>132</sup> and he also recognized statutory authority for future advances in similar security.<sup>133</sup> The court, however, determined that cross-collateralization clauses "apply only to indebtedness which was reasonably within the contemplation of the parties to the security instrument at the time it was made."<sup>134</sup> Even though Judge Sharp declined to consider parol evidence (which was to the effect that the debtors did not intend for the credit card debt to be secured by the vehicle), the court determined that securing the credit card debt by the car was not contemplated by the parties<sup>135</sup> and held that the credit union no longer held a valid lien against the debtor's vehicle upon payment of the initial

---

127. The statute provides the express requirements for renewal and extension of real estate lien debt, at least as to protect against claims of bona fide purchasers. Essentially, the renewal must be executed by the debtor, acknowledged, and recorded. See TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.036-.037 (Vernon Supp. 1998).

128. See *Cadle Co.*, 951 S.W.2d at 913.

129. See TEX. CIV. PRAC. & REM. CODE ANN. § 16.036(D) (VERNON SUPP. 1998).

130. See *Cadle Co.*, 951 S.W.2d at 913.

131. 217 B.R. 767 (Bankr. E.D. Tex. 1998).

132. See *id.* at 769.

133. See *id.* (citing TEX. BUS. & COM. CODE ANN. § 9.204(c) (Vernon 1991)).

134. *Id.*

135. For example, the truth in lending disclosure did not indicate that the car loan would also secure future advances, and the court was also concerned about the location of the cross-collateralization clause on one of the documents, being placed on the reverse side of the document. See *id.* at 771.

car loan.<sup>136</sup>

Superficially, it might be tempting to say that Judge Sharp purported to invalidate cross-collateralization or future advances clauses; however, a careful reading of the opinion reflects the contrary. The court expressly recognized the validity of such clauses. But from a drafting standpoint, it might be wise to include such clauses on the face of any loan documentation, especially in a consumer loan, or otherwise provide some conspicuousness or other indication from the face of the documents that such cross-collateralization or future advance coverage was intended. Whether these extra steps are actually required under state law is questionable, but *Conte* clearly indicates that, at a minimum, such clauses will be given close scrutiny in consumer bankruptcy cases.

#### D. LOST NOTES, MISSING INDICIES, ETC.

Some remnants of the days of failed banks remain. At least three cases published during the Survey period are instructive. In *Beal Bank v. Caddo Parish-Villas South, Ltd.*,<sup>137</sup> a federal district court, reviewing an appeal from a bankruptcy claim objection, addressed recovery on a lost note following assignment of the lost note. Although *Beal Bank* involved Louisiana law, the statute in question was substantially similar to section 3.309 of the Texas version of the Uniform Commercial Code (UCC), which governs enforcement of lost instruments.<sup>138</sup> One additional twist, which was not uncommon during the time of large note sales by the FDIC, was that *Beal Bank* took the assignment of the note *after* the note had been misplaced by its assignor. In other words, *Beal Bank* had taken a transfer or assignment of a lost note. The district court found that *Beal Bank* complied with section 3-309(a) and that *Beal Bank* proved the terms of the lost instrument.<sup>139</sup> The district court concluded that *Beal Bank* was entitled to enforce the note, even as the assignee of the party that had already lost the note.<sup>140</sup> One would assume that the result would be the same under Texas law. Texas law generally allows assignment of claims and causes of action, which should include the right to recover on a lost note provided the other statutory and common law requirements can be met by the new owner of the note.

Speaking of assignment, the Dallas Court of Appeals in *Ashcraft v.*

---

136. *See id.* at 771-72.

137. 218 B.R. 851 (Bankr. N.D. Tex. 1998).

138. This case involves application of Louisiana's version of U.C.C. Section 3.309(a). The Louisiana statute, like section 3.309 of the TEXAS BUSINESS AND COMMERCE CODE, allows a person to recover on a lost instrument if: (1) the person was in possession of the instrument when lost; (2) the loss was not the result of transfer or a lawful seizure; and (3) the person cannot reasonably retain possession of the instrument because it was destroyed, lost, etc. *See* TEX. BUS. & COM. CODE ANN. § 3.309 (Vernon Supp. 1999).

139. *See Beal Bank*, 218 B.R. at 855.

140. "There is absolutely nothing in the text of the statute or the legislative history to indicate that a party entitled to enforce a lost instrument under Section 3-309(a) cannot assign this right to another party." *Id.* at 856.

*Lookadoo*<sup>141</sup> held that the purchaser of a note deficiency from the Resolution Trust Corporation was not entitled to enforce an underlying guaranty obligation of that same indebtedness because the guaranty obligation was not expressly mentioned in the loan sale agreement. This case may be an anomaly, and it certainly would appear to contravene the general rule that the guaranty follows the underlying obligation, at least superficially. But the court apparently found distinguishing facts in that case arising out of specific language in the purchase and sale agreement from the RTC to the note buyer.<sup>142</sup> It is not this author's position to describe an opinion as correct or incorrect. Suffice it to say that the opinion may be an aberration, and the dissent would appear somewhat more persuasive.<sup>143</sup>

In *Commercial Services of Perry v. Wooldridge*,<sup>144</sup> the court of appeals affirmed a take nothing judgment in favor of the maker of a variable interest rate note. The variable rate was tied to the published rate of a bank that had failed. Thus, the variable rate provided in the note was tied to a published rate that no longer existed. The court acknowledged that variable rate notes are clearly considered promises to pay a fixed amount of money<sup>145</sup> and also acknowledged that recent case law allowed the holder of a note tied to a no longer published rate to apply a "reasonable" rate of interest based upon evidence of such a rate.<sup>146</sup> This, however, did not excuse the holder of the note from putting on evidence of what that reasonable rate would be. The court also declined to apply a statutory rate under section 3.112(b), which the court found applied in situations only where the instrument is silent as to the calculation of interest.<sup>147</sup> Accordingly, the court concluded that because the holder of the note failed to prove "a reasonable sum certain due and owing on the note," it should take nothing because it failed to prove its claim as a matter of law.<sup>148</sup>

As with some of the other cases described above in which the creditor was denied recovery, the court did not invalidate recovery in such a situation. Rather, the court simply insisted upon a relatively low threshold of evidence, in this case, evidence of what a reasonable or replacement rate should be. Presumably, this could have been accomplished by expert testimony of a banker, or even evidence of other published rates in effect at the time.

---

141. 952 S.W.2d 907, 913-14 (Tex. App.—Dallas 1997, writ denied) (*per curiam*).

142. *See id.* at 911-13.

143. *See id.* at 917-21 (Wright, J., dissenting).

144. 968 S.W.2d 560 (Tex. App.—Ft. Worth 1998, no pet.).

145. *See id.* at 564.

146. This issue was resolved in *Bailey, Vaught, Robertson & Co. v. Remington Invs., Inc.*, 888 S.W.2d 860, 866 (Tex. App.—Dallas 1994, n.w.h.).

147. *See Wooldridge*, 968 S.W.2d at 565 (citing TEX. BUS. & COM. CODE ANN. § 3.112(b) (Vernon Supp. 1998)).

148. *Id.* at 565-66.

### E. NOTE ACCELERATION—THE CHECK'S IN THE MAIL

In *Star Food Processing, Inc. v. Killian*, Star executed a note containing a waiver of "notices, demands for payment, presentations for payment, notices of intention to accelerate the maturity, protest and notice of protest."<sup>149</sup> The waiver did not, however, mention notice of acceleration. After default, the creditor's counsel faxed a notice of acceleration and demanded payment in full. According to the borrower, however, the borrower had placed a late payment in the mail two hours before the fax notice of acceleration. Thereafter, the borrower kept sending regular payments, but they were returned, because those payments did not constitute payment in full as demanded by the acceleration. Apparently deciding that the "check's in the mail" defense worked, the court concluded that the acceleration was improper because payment had been made before the acceleration.<sup>150</sup>

The obvious moral of this story is twofold: first, the careful drafter should make sure that any waiver provision in a note is broad enough to include (expressly) notice of acceleration. Secondly, and perhaps more important, if this case is valid, then it may be wise to include a provision to the effect that payment is only deemed made upon actual receipt by the holder of the note at the specified place for payment, thus contractually precluding the "check's in the mail" defense to acceleration.

### F. ARTICLE 9 PRIORITY—MISFILED FINANCING STATEMENTS

In *Franklin National Bank v. Boser*,<sup>151</sup> the holder of a purchase money security interest (PMSI) in cattle sued a bank that had foreclosed a prior, perfected security interest in the same cattle. Unfortunately for the holder of the PMSI, he had filed his financing statement in the local records of the county clerk, rather than with the Secretary of State, which is the proper place for filing. The PMSI holder attempted, unsuccessfully, to invoke the "good faith filing exception" contained in section 9.401(b), which provides some relief for a secured party who, in good faith, files a financing statement in the improper place, at least as to other persons with knowledge of that financing statement.<sup>152</sup> The court concluded that this good faith exception does not apply to a second-in-time creditor as against a prior, perfected lienholder.<sup>153</sup> Accordingly, the bank prevailed, and the PMSI holder ultimately paid the price for the improper filing.<sup>154</sup>

### G. EXEMPTIONS IN THE STATE COURTS

In not so much a significant development, but rather a reiteration of what should by now be a well established law, a Houston Court of Ap-

---

149. 954 S.W.2d 124, 125 (Tex. App.—San Antonio 1997, writ denied).

150. *See id.* at 126.

151. 972 S.W.2d 98 (Tex. App.—Texarkana 1998, no pet.).

152. *See id.* at 103 (citing TEX. BUS. & COM. CODE ANN. § 9.401(b) (Vernon 1991)).

153. *See id.* at 103-04.

154. *See id.* at 104-06.

peals, in *Lozano v. Lozano*,<sup>155</sup> reiterated the exempt nature of a properly established individual retirement account. The court determined that "evidence that an account is an individual retirement annuity is sufficient to establish that it is exempt unless evidence is presented that the IRA does not qualify for such treatment under the [Internal Revenue Code]."<sup>156</sup>

#### H. NOTICE OF FORECLOSURE SALE

In *Sanders v. Shelton*,<sup>157</sup> the court of appeals found that a notice of a substitute trustee's sale that stated that the sale would occur "between the hours of 10:00 a.m. and 4:00 p.m." was sufficient to give notice that the sale would not occur before 10:00 a.m. The notice, therefore, met the requirements of the Property Code, even including the amendments that limit the sale to three hours following the earliest time stated in the notice.<sup>158</sup> While it would clearly be better practice simply to provide on the notice the earliest time of the sale, the court found that the notice containing the somewhat outdated language of between 10:00 a.m. and 4:00 p.m. was sufficient to provide notice of the earliest time of the sale. Under the plain meaning of the statute, the only remaining requirement is that the sale must begin at the time stated in the notice or not later than three hours thereafter.<sup>159</sup>

#### I. GARNISHMENT

*Rowley v. Lake Area National Bank*<sup>160</sup> provides somewhat of a primer on the issues in a garnishment action. The *Rowley* court starts with the fundamental proposition that a plaintiff in garnishment "merely steps into the shoes of his debtor as against the garnishee."<sup>161</sup> In *Rowley*, the creditor sought to garnish a bank that held funds to be disbursed to a builder to whom the builder's customer was indebted. The bank, however, had no deposit or debtor-creditor relationship with that builder. Therefore, because the bank was not indebted to the builder/judgment debtor, there were no funds subject to garnishment.

Another important issue which often arises in garnishment action is that of attorney's fees incurred by the garnishee. In *Rowley*, the some-

---

155. 975 S.W.2d 63, 66-68 (Tex. App.—Houston [14th District] 1998, no pet.). Under Texas law, most qualified retirement accounts, such as the IRA in question in this case, are exempt from creditor claims. See, e.g., TEX. PROP. CODE ANN. § 42.0021 (Vernon 1997).

156. *Lozano*, 975 S.W.2d at 67. The court concluded that because the statute in question provides that such an account is exempt *unless it does not qualify* under the Internal Revenue Code, the burden upon the debtor is merely to show only that the plan or account is of the type listed in the statute. Then, the burden would shift to the creditor to show that the plan or account is not a qualified plan. See *id.* at 67 n.4.

157. 970 S.W.2d 721, 725 (Tex. App.—Austin 1998, no pet.).

158. See *id.* at 724-26.

159. See *id.* at 725-26. The court also disposed of other claims that the alleged irregularity in the sale notice contributed to an inadequate sale price. See *id.* at 726-27.

160. 976 S.W.2d 715 (Tex. App.—Houston [1st District] 1998, no pet.).

161. *Id.* at 719.



what unusual twist was that the garnishment was contested. The court reversed the trial court in part based upon TEXAS RULE OF CIVIL PROCEDURE 677, which provides that "where the answer is contested, the costs shall abide the issue of such contest."<sup>162</sup> The court of appeals remanded the case for consideration of the appropriate award of attorney's fees, reasoning that under prior case law, the term "costs" has "consistently been interpreted to include attorney's fees."<sup>163</sup>

---

162. *Id.* at 721 (citing TEX. R. CIV. P. 677).

163. *Id.* (citing *Moody Nat'l Bank v. Riebschlager*, 946 S.W.2d 521, 525 (Tex. App.—Houston [14th District] 1997, writ denied)).