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## Bankruptcy and Creditors' Rights

Roger S. Cox

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# BANKRUPTCY AND CREDITORS' RIGHTS

Roger S. Cox\*

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

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I. INTRODUCTION—SCOPE OF ARTICLE

**A**LTHOUGH this article discusses developments in the bankruptcy courts, the author limited the cases surveyed to those involving state law (homesteads and exemptions) and other developments that directly impact enforcement of the debtor-creditor relationship. Except for relevant developments in the Supreme Court, cases that are limited to an “inside baseball” application of the Bankruptcy Code have been avoided. The focus of this article is on updating cases of interest to the Texas-based debtor/creditor practitioner.<sup>1</sup>

Of particular interest this year are legislative developments, both in Congress and in the Texas Legislature. As this article goes to press, bills are pending in Congress that will substantially impact (under the guise of bankruptcy reform) the Bankruptcy Code and availability of relief for individual debtors. Substantial Texas legislation is already in place that should impact the nature and extent of real property homestead claims for local debtors.

II. LEGISLATIVE DEVELOPMENTS

A. BANKRUPTCY CODE AND OTHER FEDERAL STATUTES

1. *Bankruptcy Reform*

No significant bankruptcy reform legislation had passed as of the end of the 1999 Congressional legislative session. Senate Bill S625, however, passed in early 2000. This bill, which resembles legislation that passed in both Houses in 1998 would have a far-reaching impact on the bankruptcy system. Of particular interest to the Texas practitioner is the amendment that purports to limit state homestead exemption levels claimed by bankruptcy debtors. Specifically, the most recent version of the Senate bill would have provided a value limitation cap of \$100,000 on a state homestead claim in bankruptcy. Legislator’s efforts to amend the Bankruptcy

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1. As a supplement to this review of Texas bankruptcy developments, readers should review Judge Lief Clark’s extensive and thorough analysis of bankruptcy developments in the Fifth Circuit. See Leif M. Clark, *Bankruptcy*, 30 TEX. TECH L. REV. 441(1999); 29 TEX. TECH L. REV. 355 (1998); 28 TEX. TECH L. REV. 299 (1997). See also Dean G. Pawlowic, *Banking Law*, 30 TEX. TECH. L. REV. 425 (1999); J. Westbrook & E. Warren, *Recent Developments*, University of Texas School of Law Bankruptcy Conference (1999); G. Pronske, *Recent Developments*, State Bar of Texas Advanced Business Bankruptcy Course (1999); F. Koger, *Recent Bankruptcy Cases You Need to Know About*, Texas Tech Farm, Ranch & Agribusiness Bankruptcy Course (1999).

Code to allow the states to opt out of the legislation were unsuccessful.<sup>2</sup>

Although no significant reform legislation actually passed, the situation is very dynamic and any bill that is reported out of conference committee could have substantial impact on bankruptcy practice in general, and perhaps even on state homestead exemptions. Past legislation has been widely criticized for its impracticality and unintended consequences, thus, the prudent practitioner is urged to stay aware of legislative developments.<sup>3</sup>

## 2. *Family Farmer Bankruptcies*

Chapter 12 was extended for an additional nine months, until June 30, 2000,<sup>4</sup> but its ultimate fate remains uncertain. Given its political nature, future extensions will likely be passed, and it may even be included in any meaningful reform legislation.

### B. STATE LAW—HOMESTEADS

Texas voters recently approved two constitutional amendments.<sup>5</sup> The net effect was to expand the urban homestead and to provide for enhanced reverse mortgage availability. The resulting amendments to the Texas Property Code clarify the distinction between urban and rural homesteads, expand the urban homestead, and make substantial changes to the urban business homestead.

The Property Code now provides that an urban homestead may be comprised of up to ten acres.<sup>6</sup> The ten-acre tract must be contiguous and it must include a business homestead in order to claim the homestead as a business homestead.<sup>7</sup> A somewhat vague statutory definition of the *rural* homestead has now been amended to provide a more specific definition of the *urban* homestead. An urban homestead is now statutorily defined as real property that is located within a municipality, its extraterritorial jurisdiction, or a platted subdivision; is served by police and fire protection; and is served by three of the following municipal services—electric, natural gas, power, storm sewer, or water.<sup>8</sup>

These amendments are at least in part the result of efforts to clarify the relatively new home equity loans now available in Texas, but it is too early to determine the full effect these changes will have on debtors and creditors and on the claiming of these kinds of exemptions in future bankruptcy cases. Another amendment to the Property Code indicates

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2. Bankruptcy Reform Act of 1999, S. 625, 106th Cong. (1999).

3. Current legislative highlights are generally available at the American Bankruptcy Institute's website (visited Jan. 27, 2000) <<http://www.abiworld.org>>.

4. Extension of Family Farmer Debt Adjustment, Pub. L. 106-70, 113 Stat. 1031 (1999).

5. 1999 Tex. Bal. Meas. 2 (SN).

6. See TEX. PROP. CODE ANN. § 41.002 (Vernon Supp. 2000).

7. The new amendment took effect January 1, 2000. But the old urban homestead law still applies to most liens in place prior to the new effective date.

8. See TEX. PROP. CODE ANN. § 41.002(c) (Vernon Supp. 2000).

that in the event of a conflict between state and federal law regarding a value limitation for state law purposes, the Texas statute will apply:

The extent of any conflict between this subchapter and any federal law that imposes an upper limit on the amount, including the monetary amount or acreage limit, of homestead property a person may exempt from seizure, this subchapter prevails to the extent allowed under federal law.<sup>9</sup>

Presumably, this change resulted from recent Congressional efforts to limit the value of a homestead claim available to bankruptcy debtors. While the unlimited value of a Texas homestead would clearly be governed under state law, it is likely that a preemption issue would arise in a bankruptcy context if such limiting legislation were to become part of the Bankruptcy Code.

### III. BANKRUPTCY CASES

#### A. UNITED STATES SUPREME COURT DEVELOPMENTS

The Court recently addressed an important Chapter 11 reorganization issue.<sup>10</sup> The decision is worth mentioning here even though it does not directly impact Texas law because the Supreme Court finally addressed the so-called "new value" exception to the absolute priority rule.<sup>11</sup> In *LaSalle*, the debtor proposed a capital infusion by the old equity shareholders, who would become or remain the sole owners of the company after confirmation. The debtor attempted to cram down the plan over the objections of a class of creditors.

The Court found that the plan was unconfirmable, not so much because it invalidated the new equity exception, but because the opportunity to infuse new capital was exclusively afforded to one group—the old shareholders.<sup>12</sup> The Court did not absolutely invalidate the new equity exception, and because of this some commentators have suggested that the Court left open the possibility of a new value plan being confirmable in a cram-down process if the other parties in interest were allowed an equal opportunity to effectively engage in competitive bidding for the new eq-

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9. *Id.* at § 41.008.

10. *Bank of Am. Nat'l Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999).

11. Under the absolute priority rule, the holder of any claim or interest that is junior to the claims of a class voting against a plan should not receive or retain any claim or interest. *See* 11 U.S.C. § 1129(b)(2)(B) (1994). *See also* *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) (even if new value exception exists, promise of future work [so called "sweat equity"] does not qualify as money or money's worth).

12. *See LaSalle*, 526 U.S. at 1422-23. The Court concluded that:

whether a market test would require an opportunity to offer competing plans or would be satisfied by a right to bid for the same interest sought by old equity, is a question we do not decide here. It is enough to say, assuming a new value corollary, that plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of §1129(b)(2)(B)(ii).

*Id.* at 1424.

uity infusion.<sup>13</sup>

## B. HOMESTEADS AND EXEMPTIONS

Numerous developments in the bankruptcy case law involving Texas exemption and homestead claims arose during the *Texas Survey* period. For future reference, the reader is cautioned to review these cases, especially those that focus on the distinctions between urban and rural homesteads, in the context of the new Property Code amendments.

### 1. Availability of Homestead to Satisfy Non-Dischargeable Support Claims

In *In re Davis*,<sup>14</sup> an *en banc* Fifth Circuit reversed an earlier panel decision that threatened the viability of the Texas homestead laws.<sup>15</sup> Davis' wife "obtained a [non-dischargeable] judgment from the bankruptcy court" based on a claim for "alimony, child support, and maintenance."<sup>16</sup> She also sought turnover relief, which would have permitted her to foreclose on the couple's homestead. The bankruptcy court and district court, successively, found that such relief was not unavailable because the debtor's homestead was not subject to execution.

An earlier panel of the Fifth Circuit reversed the lower court's decision based upon a somewhat tortured reading of § 522(c) of the Bankruptcy Code.<sup>17</sup> Interpreting § 522(c) in conjunction with state law, the court ruled that the Davis homestead would be subject to execution. The *en banc* panel based its decision on § 522(c), finding that this section of the Bankruptcy Code did not preempt well-established state homestead law.<sup>18</sup> The court noted that state exemption claims have long been controversial because they have the effect of reducing assets that would otherwise be available to pay claims:

Federal bankruptcy law affords debtors a fresh start by enjoining collection of discharged debts, § 524, and by permitting the debtors to retain certain limited amounts and types of exempt property, § 522. Exemptions have been perennially controversial, because they reduce assets potentially available to pay creditors and arouse charges of abuse of bankruptcy. Exemptions are also fought over by states'-rights advocates, who value the traditional state legislative prerogative to adjust exemptions to local economic conditions, and by advocates of federal uniformity, who want to raise—or lower—exemptions based on conceptions of national equity. Congress al-

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13. See generally ABI Real Estate Committee, *A Round Table Discussion: Supreme Court Decision in 203 N. LaSalle St. Partnership*, 7 AM. BANKR. INST. L. REV. 389 (1999).

14. 170 F.3d 475 (5th Cir. 1999), cert. denied 120 S. Ct. 67 (1999).

15. *In re Davis*, 105 F.3d 1017 (1997).

16. *Davis*, 170 F.3d at 477.

17. § 522(c) provides that property exempted under V 522 of the Bankruptcy Code is not liable for any debt except for a limited category of debts, including those found non-dischargeable under §§ 523(a)(1) or 523(a)(5) of the Code. 11 U.S.C. § 522(c) (West 1994). The former wife's claims originally arose under § 523(a)(5).

18. See *Davis*, 170 F.3d at 481-83.

layed the controversy between state and federal advocates by providing in the 1978 Bankruptcy Code that states could opt out of prescribed federal exemptions altogether or could allow their citizens to select either schedule.

Exemptions are easy to claim. The debtor files a list of exempt property protected by applicable federal or state law with the court. If the exemptions are not objected to, the property becomes exempt and unavailable to be levied on by pre-petition creditors or managed by the trustee.<sup>19</sup>

But the court nevertheless read § 522(c) to provide that certain claims to survive bankruptcy and any liens against the property securing those claims would similarly survive. That does not mean that this Bankruptcy Code section provides any affirmative relief that could be taken to preempt state exemption law. Even though these unique claims may survive bankruptcy as non-dischargeable, as well as with the added protection of § 522(c), state exemption law is not preempted. Thus, exempt property, such as the Davis homestead, would not be subject to execution. In effect, the creditor is left with the available collection remedies under state law, and no more. The court concluded:

for all these reasons . . . § 522(c)(1) does not "create" "liability" of exempt property for specified debts following bankruptcy. Instead, the section permits creditors holding such claims to proceed against the property after bankruptcy *based on the rights and remedies they would have had under state law if bankruptcy had not been filed.*<sup>20</sup>

## 2. Rural Homestead-Remainder Interest

Debtors Dean and Patricia Eskew<sup>21</sup> claimed a rural homestead interest in property they had previously conveyed as a life estate to Dean's parents. The couple retained a remainder interest in the property. The trustee and a creditor objected to the claim, arguing that the debtors' reversionary interest was non-possessory in nature. But, the facts of the case indicate that the debtors had previously owned the property in fee, remained in possession of the property at all times, as well as farmed the property, paid the property taxes, and otherwise cared for it. In other words, the debtors' use of the property never changed from the time they moved across the street from it and conveyed the life estate to Dean's parents.<sup>22</sup>

The court's analysis acknowledged the requirement of occupancy or possession by the claimant.<sup>23</sup> The court began with the presumption that a reversionary interest in and of itself is not possessory, and would not, by itself, support a homestead claim. On the other hand, authority cited by

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19. *Id.* at 478 (footnotes omitted).

20. *Id.* at 481 (emphasis added).

21. *In re Eskew*, 233 B.R. 708 (Bankr. W.D. Tex. 1998)

22. *Id.* at 710.

23. *Id.* (citing *Laster v. First Huntsville Properties Co.*, 826 S.W.2d 125, 130 (Tex. 1991) ("homestead protection . . . can arise only in the person or family who has a present possessory interest in the subject property")).

the *Eskew* court did acknowledge the possibility that a person with a present possessory right could be entitled to a homestead claim.<sup>24</sup> The court concluded that because the debtors also retained a current possessory interest in the property under an oral lease with Dean's parents, a possessory interest sufficient to support the debtor's homestead claim had been established.<sup>25</sup>

The *Eskew* court failed to address the fact that the debtors had apparently moved "across the road" from the subject property some years prepetition. In other words, the court did not take into account the manner in which what appears to be a lack of actual residence on the property affected the homestead claim. The *Brooks*<sup>26</sup> court did address the issue.

### 3. Rural Homestead Must Be a "Home" to be a Homestead

The debtor in *Brooks* lived with his mother in a house that was adjacent to (but not on) three tracts of land in which the debtor owned an interest and claimed a rural homestead. The debtor operated a ranch on two of the three tracts, and otherwise used the property much like other rural homestead claimants.

The bankruptcy court acknowledged the traditionally broad and liberal construction given homestead claims in Texas.<sup>27</sup> The court did note, however, a similar Texas policy requiring that "the claimant must reside on part of the property and use the property for purposes of a home" even "though the claimant need not reside on all parcels."<sup>28</sup> Before denying the debtor's homestead claim, the court acknowledged that a present intent to occupy the property, combined with actual preparation toward occupancy, might provide a sufficient basis for a homestead claim. The debtor stated that he had "always planned to build a house" on part of the property but he had made no "preparations toward actual occupancy and use" of a nature that would support a homestead claim.<sup>29</sup>

### 4. Rural Homestead Partially Within a Municipality?

*In re Grisham*<sup>30</sup> is an example of the type of situation that may be affected by the new urban homestead definition in the Property Code, although the end result in this case would likely be the same even if the new definition were applied. The debtors in *Grisham* claimed an eighty-

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24. See *Laster*, 826 S.W.2d, at 130, n.8; see also *Evans v. Mills*, 67 F.2d 840 (5th Cir. 1933) (reversionary interest in mineral estate under property in which lessors had been in uninterrupted possession constituted homestead).

25. *Eskew*, 233 B.R. at 711-12 (the court noted the general rule that a leasehold may support a homestead interest).

26. 233 B.R. 696 (Bankr. N.D. Tex. 1999).

27. *Id.* at 699. "The rule that homestead laws are to be liberally construed to effectuate their beneficent purpose is one of general acceptance." *Id.* (quoting *Woods v. Alvarado State Bank*, 19 S.W.2d 35 (Tex. 1929)).

28. *Brooks* 233 B.R. at 700 (quoting *Riley v. Riley*, 972 S.W.2d 149, 154 (Tex. App.—Texarkana 1998, no pet.)).

29. *Id.*

30. 230 B.R. 529 (Bankr. N.D. Tex. 1998).

acre rural homestead, a portion of which (approximately eleven acres) was located in a municipality. The court acknowledged the well-settled liberal construction given homestead claims in Texas.<sup>31</sup> The court noted that "a person may not have both an urban and a rural homestead,"<sup>32</sup> and the debtors had the burden of establishing the rural nature of their homestead.<sup>33</sup>

Under the old statutory scheme, a homestead was considered rural if the property was not served by municipal utilities and fire and police protection.<sup>34</sup> The court then analyzed various common law factors similar to those in the new statutory scheme.<sup>35</sup> These determinative factors were that the property had a designated city street address on a paved and platted city street; that the property was served by city police and fire; that the property was served by city water and sewer; and that the property had franchised cable television available.<sup>36</sup> Additionally, the property was adjacent to conveniences ranging from a hamburger stand and convenience store to a high school, middle school, and residential subdivision. The court did not determine that the inclusion of a portion of the property within a municipality was by itself determinative, but in weighing the totality of the factors described above, the court denied the rural homestead claim. The court did, however, allow the debtors to exempt one acre of land.<sup>37</sup>

One way in which the new Property Code amendments could have affected the outcome in this case is by the new definition of urban homestead, under which such homesteads may now consist of up to ten acres. Hypothetically, had this case been filed after the effective date of the new amendments, the debtors could have been entitled to exempt ten acres of their property.<sup>38</sup>

## 5. Burial Plots

In addition to the familiar Texas homestead exemption, the Property Code allows a debtor to exempt a burial plot.<sup>39</sup> A single debtor with no dependents claimed four burial plots as exempt in the recent *Preston* case.<sup>40</sup> The court was faced with the task of interpreting recent amendments to this portion of the exemption scheme. An older version of the Property Code provided for an exemption to "one or more lots held for

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31. *Id.* at 531 (citing *In re Bradley*, 960 F.2d 502, 507 (5th Cir. 1992)).

32. *Id.* at 531.

33. *Grisham*, 230 B.R. at 531; *Bradley*, 960 at 507. The rural/urban distinction is an issue of fact. See *In re Crowell*, 138 F.3d 1031, 1033 (5th Cir. 1998).

34. *Grisham*, 230 B.R. at 531 (citing TEX. PROP. CODE ANN. § 41.002(c) (Vernon 1984)).

35. See *id.*

36. See *id.* at 532.

37. *Id.* 533.

38. See TEX. PROP. CODE ANN. § 41.002 (Vernon Supp. 2000) (urban homestead consists of up to ten contiguous acres).

39. A homestead *and one or more lots used for a place of burial of the dead* are exempt from seizure. *Id.* at § 41.001(a) (emphasis added).

40. 233 B.R. 375 (Bankr. E.D. Tex. 1999).

use as a sepulcher of a family or single adult who is not a member of a family."<sup>41</sup> The old statute provided a more narrow and limited burial plot exemption than the new, broader statute, which allows "one or more" lots to be exempted.<sup>42</sup>

The court was conflicted in its efforts to adhere to the plain meaning of the new statute, which does not provide a numerical or per capita limitation, while attempting to abide by its perception of the legislative intent. The court assumed (with no reference to legislative history or other authority) that the legislature intended some reasonable limitation on the exemption. The court noted that the debtor did not explain the need for more than one of the exempted plots,<sup>43</sup> so the court denied an exemption for more than the one lot allowed. As amended, the Property Code does not limit the number of burial plots owned by a debtor. This appears to be a case of first impression, so it is uncertain whether future courts will apply the *Preston* court's interpretation of the "plain meaning" of this statute.

## 6. Annuities

In a 1998 case,<sup>44</sup> the debtors claimed as exempt the proceeds of a structured settlement they received following the death of their two children in an automobile accident. The structured settlement obligation was assigned to a third party, who in turn purchased from an insurance company a "qualified funding asset" as defined by section 130(d) of the Internal Revenue Code.<sup>45</sup>

The debtors claimed their right to future payments under the annuity under article 21.22 of the Texas Insurance Code, which provides a broad exemption of interests in a variety of insurance policies and annuities.<sup>46</sup> The trustee argued that because the annuity arose out of what was originally a debtor-creditor relationship, the annuity was nothing more than a substitute for what would have otherwise been a non-exempt asset of the bankruptcy estate. The bankruptcy court was not convinced, and it enforced the Property Code exemption as written, noting again the strong policy of Texas courts favoring exemptions.<sup>47</sup> Based upon what can be read as an acknowledgment of this policy, together with a literal reading

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41. *Id.* (citing TEX. PROP. CODE ANN. § 41.002 (Vernon 1984)).

42. TEX. PROP. CODE ANN. § 41.001(a) (Vernon Supp. 2000).

43. "[N]o evidence was presented to explain for whom the other plots were being held." *Preston*, 233 B.R. at 377.

44. *In re Alexander*, 227 B.R. 658 (Bankr. N.D. Tex. 1998).

45. I.R.C. § 130(d) (1999).

46. TEX. INS. CODE ANN. Art. 21.22 (Vernon Supp. 2000). The Insurance Code exception effectively produces an unlimited exemption for a broad array of insurance benefits, including cash values and policy proceeds. *Id.* See, e.g., *In re Walden*, 12 F.3d 445 (5th Cir. 1994); *In re Atkins*, 217 B.R. 522 (Bankr. E.D. Tex. 1997); *In re Young*, 166 B.R. 854 (Bankr. E.D. Tex. 1994); *In re Hosek*, 124 B.R. 239 (Bankr. N.D. Tex. 1991).

47. The court commented on this policy by reiterating that

[O]ur exemption laws should be liberally construed in favor of express exemptions, and should never be restricted in their meaning and effect so as to minimize their operation upon the beneficent objects of the statutes. With-

of the Insurance Code, the court allowed the exemption claim.<sup>48</sup>

### 7. *Tools of the Trade—Products Sold to Third Parties (Computer Software)*

The information age met the Property Code in *In re White*,<sup>49</sup> in which the debtors claimed an interest in computer software as an exempt tool of the trade. The debtors created customized software, which they licensed to third party customers. The software in question was licensed to the debtor's current employer.

Superficially, it appeared as though the software was used in the debtors' trade or profession, but (as the court noted) it was actually simply a product sold by the debtors.<sup>50</sup> In addition, even though the debtors were employed by the licensee at the time of the case, the allowance or disallowance of the exemption would have had no impact on that licensee's continued use of the software.<sup>51</sup>

## C. AUTOMATIC STAY AND ADEQUATE PROTECTION

### 1. *Vehicle Repossession*

The debtors in *Baker*<sup>52</sup> were two months in arrears to Nissan when they filed for Chapter 7 bankruptcy. Four days post-petition, without knowledge of the bankruptcy filing, Nissan repossessed the debtor's car. Nissan was thereafter informed of the bankruptcy and the facts indicate that the debtor's counsel requested that Nissan return the vehicle. Two months later Nissan moved for relief from the stay. Curiously, while the motion was pending, Nissan sold the vehicle. Ironically, the bankruptcy court (unaware of the sale) granted relief from the stay some weeks after the sale.<sup>53</sup> The debtors filed an adversary proceeding seeking damages for the stay violation, and the court granted judgment in favor of the debtors for actual and punitive damages and attorney's fees.<sup>54</sup>

The district court affirmed the bankruptcy court's judgment, finding that § 542 of the Bankruptcy Code<sup>55</sup> requires "an affirmative obligation on the creditor to return estate property unless it is of inconsequential value to the estate, and nothing in § 542(a) requires the debtor to provide the creditor with adequate protection as a condition precedent to turno-

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out doubt the exemption would generally be resolved in favor of the claimant.

*Id.* (quoting *Carson v. McFarland*, 206 S.W.2d 130, 132 (Tex. Civ. App.—San Antonio 1947, writ ref'd.)).

48. *Alexander*, 227 B.R. at 661.

49. 234 B.R. 388 (Bankr. W.D. Tex. 1999).

50. *See id.* at 390.

51. Citing *In re Legg*, 164 B.R. 69 (Bankr. N.D. Tex. 1994), the court alluded to the difficulty an employee may have in claiming a tool of a "trade." *White*, 234 B.R. at 390 n.4.

52. *Nissan Motor Acceptance Corp. v. Baker*, 239 B.R. 484 (N.D. Tex. 1999).

53. *See id.* at 487.

54. *See id.* at 486. The bankruptcy court allowed Nissan to fulfill the damage portion of the judgment by providing the debtor with a new pickup.

55. 11 U.S.C. § 542 (1999).

ver.”<sup>56</sup> Moreover, the court noted substantial authority for the proposition that a creditor’s continued retention of estate property after notice of a bankruptcy constitutes an “exercise of control” over property of the estate in violation of the stay.<sup>57</sup>

The creditor argued that it did not willfully violate the stay by retaining the vehicle after notice of the bankruptcy, in part because Bankruptcy Code § 363<sup>58</sup> requires adequate protection of a creditor’s interest in collateral. The court discounted this argument, finding instead that the retention and subsequent sale of the vehicle did constitute a willful violation of the automatic stay. Based on § 362(h),<sup>59</sup> which allows for actual and punitive damages, as well as costs, and attorney’s fees, the court affirmed the bankruptcy court’s judgment.<sup>60</sup>

Readers may recall the facts of *In re Zaber*,<sup>61</sup> in which Chief Bankruptcy Judge McGuire confronted the more conventional quandary of a creditor who repossessed a debtor’s car pre-petition. Although the repossession itself did not violate the stay, Judge McGuire found a stay violation when the creditor subsequently refused to return the vehicle. The creditor in *Zaber* faced a situation in which previous authority supported a possessory lien claimant’s retention of a car, so it is understandable that this creditor raised adequate protection issues. On the other hand, the creditor’s conduct in *Baker*, which occurred primarily post-petition and after notice, remains inexplicable.

## 2. Chapter 13—Adequate Protection in Late Confirmation Districts

The Bankruptcy Code contemplates confirmation of a Chapter 13 plan within a relatively short time after the case has been filed. But in certain districts, local practice has evolved to a point where confirmation of a debtor’s plan does not occur until many months after the filing. This practice is purportedly justified by the fact that some courts prefer to allow the deadline for filing claims to expire. A major drawback to this approach is that although the debtor presumably makes monthly payments to a Chapter 13 trustee, most secured creditors are left without adequate protection payments for a lengthy period pending confirmation. Confirmation also occurs later than contemplated by the Bankruptcy Code.

The Eastern District of Texas is one of these so-called “late confirmation” districts. In *In re Rogers*,<sup>62</sup> Judge Bill Parker addressed the dilemma of creditors left without adequate protection. A creditor with a

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56. *Id.* 489.

57. *See id.* at 488 (citing *In re Zaber*, 223 B.R. 102 (Bankr. N.D. Tex. 1998) (post-petition repossession is unquestionably a violation of the automatic stay)); *see also* Commercial Credit Corp. v. Reed, 154 B.R. 471 (E.D. Tex. 1993).

58. 11 U.S.C. § 363 (1999).

59. 11 U.S.C. § 362(h) (1999).

60. *Baker*, 239 B.R. at 490-91.

61. 223 B.R. 102 (N.D. Tex. 1998).

62. 239 B.R. 883 (Bankr. E.D. Tex. 1999).

security interest in the debtor's automobile moved for relief from the automatic stay, arguing a lack of adequate protection of its interest in the vehicle. In the alternative, the creditor sought interim adequate protection payments. The creditor's situation was aggravated by the debtor's use of the vehicle to make a daily sixty-mile commute to work.

The court reviewed the practical burdens of proof and persuasion in a stay proceeding, noting that although the non-movant (typically the debtor) bears the burden on all issues except the existence of equity in the property, the movant must nevertheless sustain "an initial burden of production or going forward with the evidence to establish that a prima facie case for relief exists before the respondent is obligated to go forward with its proof."<sup>63</sup> In *Rogers*, the court found that the creditor did not establish its prima facie case for relief because it failed to present evidence regarding the debtor's lack of equity. Therefore, the burden of establishing the necessity of an effective reorganization never shifted to the debtor.<sup>64</sup>

The court next addressed the issue of relief from the stay "for cause," including a lack of adequate protection. A creditor establishes its *prima facie* case by proving that it holds a claim secured by a valid, perfected lien, and that a decline in the collateral's value is occurring or threatens to occur due to the existence of the automatic stay. Once the prima facie case is presented, the burden shifts to the debtor to prove that the collateral is not declining in value, or that the secured creditor is otherwise protected.<sup>65</sup>

After conducting an in-depth analysis of adequate protection, the *Rogers* court pointed out the difficulty faced by a secured creditor in a late confirmation district. Specifically, it observed that under this practice, the risk of failure of a Chapter 13 plan is placed entirely upon secured creditors. Under a strict reading of the Bankruptcy Code, not only are payments to the trustee allowed to accrue in its possession, but the "first available funds" are typically reserved for the debtor's counsel.<sup>66</sup> The court next attempted to establish a means by which this burden could be distributed more equally. It ultimately concluded that the debtor would be required to modify her Chapter 13 plan. Following payment of the Chapter 13 trustee's fees, the funds distributed under the confirmed plan would be halved, with one half of the funds to be distributed equally among the creditor and any other parties authorized to share in such a distribution. The other half of the funds would be distributed equally among the debtor's counsel and other similarly situated claimants. This distribution scheme would remain in place until the administrative claims had been paid in full. In the situation where a case is dismissed or converted, the court ordered that disbursements should proceed under a sim-

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63. *Id.* at 886 (citing *In re Kowalsky*, 235 B.R. 590, 594 (Bankr. E.D. Tex. 1999)).

64. *Id.* at 887.

65. *See id.* at 887 (citing *Kowalsky*, 235 B.R. at 595).

66. *Id.* 239 B.R. at 889.

ilar fifty-fifty arrangement rather than having the trustee disburse monies back to the debtor.<sup>67</sup> Continuation of the automatic stay was conditioned on the debtor retaining full coverage insurance on the vehicle, limiting the persons allowed to operate the vehicle, and remaining current on all Chapter 13 plan payments. The court imposed a one-time, ten-day notice and opportunity to cure default. Beyond that, the automatic stay would terminate in the event of the debtor's default.<sup>68</sup>

The author recommends that all Texas practitioners who deal with secured claims in consumer bankruptcies, especially in the Eastern District, become familiar with the opinions in *Rogers* as well as those in the 1999 cases of *In re Kowalsky*<sup>69</sup> and *In re Self*.<sup>70</sup>

#### D. DISCHARGEABILITY

##### 1. Credit Card Debt

No *Annual Survey* bankruptcy law review would be complete without a discussion of yet another credit card issuer attempting to have a credit card debt declared non-dischargeable. The credit card issuer in *In re Akins*<sup>71</sup> solicited the debtor's business based on the debtor's credit rating score provided by a credit bureau used by the issuer. According to the court, none of the information obtained and relied upon by the issuer was received or requested from the debtor.<sup>72</sup> The credit card application contained no warranties or representations, nor did the debtor sign any agreement requiring disclosure of any change in her financial condition, job status, or gross income.

The particular form of the solicitation was an unsolicited "check" from the issuer, which the debtor received at a time when her financial condition had deteriorated. Although the debtor had met the credit limit on her other credit cards, the other issuers failed to report that information to the credit bureau. When deciding to send the unsolicited check, the issuer apparently relied on inaccurate or stale information. This information originated from the credit bureau, and not from the debtor herself.

The issuer attempted to rely on *In re Boydston*,<sup>73</sup> a pre-Bankruptcy Code opinion that (in dicta) allowed "[w]here hopeless insolvency at the time of the purchases makes payment impossible, fraudulent intent may be inferred."<sup>74</sup> But the bankruptcy court found *Akins* distinguishable from *Boydston* because the *Akins* debtor made no false representation to

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67. See *Rogers*, 239 B.R. at 893.

68. See *id.* at 893. The court also found that confirmation of a plan that did not contain the fifty-fifty language described above would constitute an automatic termination of the stay. *Id.*

69. 235 B.R. 590 (Bankr. E.D. Tex. 1999).

70. 239 B.R. 877 (Bankr. E.D. Tex. 1999) (establishing the burden of proof in motions to lift stay).

71. 235 B.R. 866 (Bankr. W.D. Tex. 1999).

72. *Id.* at 869.

73. 520 F.2d 1098 (5th Cir. 1975).

74. *Id.* at 1101; see also *Akins*, 235 B.R. at 872 n.4.

the credit card insurer. To the contrary, she went so far as to disclose to the issuer's representative her problems with making payments on other bills. The debtor also asked the issuer if she could use the check proceeds to pay those bills and in effect consolidate the payments, to which she received an affirmative response. The issuer relied solely on the debtor's credit bureau score in issuing the unsolicited offer of credit. The *Akins* court even adopted Northern District Judge Akard's theory of "commercial entrapment."<sup>75</sup> In conclusion, the court found that the extension of credit to the debtor was the issuer's own fault:

[N]egligent lending practices and the industry's negligent use of a faulty . . . system . . . has been engineered to create the greatest amount of credit for the greatest number of working people in this country with artificially low monthly repayment requirements so that credit card companies can make the greatest amount of interest and profits possible.<sup>76</sup>

Accordingly, the court found that the action was not substantially justified and awarded the debtor attorney's fees.<sup>77</sup>

## 2. Chapter 13 Confirmation—No Partial Surrender of Collateral

In *In re Williams*,<sup>78</sup> a Chapter 13 debtor moved to modify her debt adjustment plan to allow her to surrender a portion of the collateral securing a claim, while at the same time continue to make plan payments on the value of other remaining collateral securing the same claim. The court acknowledged that a debtor could confirm a plan over a secured creditor's objection if the plan proposed a full surrender of all collateral.<sup>79</sup> Alternatively, the debtor could confirm a plan under which all collateral is retained and present value payments are made in accordance with the Bankruptcy Code.<sup>80</sup> The hybrid approach suggested by the debtor was not contemplated by the plain meaning of the statute, especially in the context of satisfying an undersecured creditor's claim, and therefore was not available. The net effect of the *Williams* decision is that at least in the Chapter 13 context, a debtor may not satisfy an undersecured creditor's claim by surrendering a portion of the collateral securing a creditor's claim while making payments under a plan based on the value of the retained collateral.<sup>81</sup>

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75. *Adkins*, 233 B.R. at 872 (quoting *In re McDaniel*, 202 B.R. 74, 79 (Bankr. N.D. Tex. 1996)). See Roger S. Cox, *Bankruptcy and Creditors' Rights*, 50 SMU L. REV. 989, 1007 (1997) for a discussion of *McDaniel*.

76. *Akins*, 233 B.R. at 874.

77. *Id.* at 875-76.

78. 168 F.3d 845 (5th Cir. 1999).

79. See *id.* at 847.

80. See *id.*; see 11 U.S.C. § 1325 (1994) (describing Chapter 13 plan confirmation requirements).

81. The debtor cited numerous cases in which claims were satisfied by a combination of a transfer of goods and payment of cash. But the Fifth Circuit distinguished those cases by pointing out that in these situations, creditors were oversecured, and the partial transfer resulted in a full satisfaction of the debt. See *Williams*, 168 F.3d at 848 (citing First Bran-

E. CROP INSURANCE PROCEEDS—FEDERAL PREEMPTION  
AND STATE LAW

A secured party in *In re Cook*<sup>82</sup> claimed an interest in the proceeds of a debtor's cotton crop insurance indemnity payment. Under federal regulations (which pre-empt state law)<sup>83</sup> a written assignment of the right to receive payment must be filed with the Federal Crop Insurance Corporation (FCIC) to be effective.<sup>84</sup> The secured party had a perfected security interest in the debtor's cotton crop and its proceeds, but no written assignment of the program payment proceeds had been filed. The debtors received the insurance payment and filed for Chapter 7 relief shortly thereafter.

The Fifth Circuit found that the federal statute giving rise to the FCIC prohibited liens on policy proceeds "before payment to the insured."<sup>85</sup> This regulatory scheme did not, however, bar a security interest in the proceeds themselves. Accordingly, once the proceeds came into the debtor's hands, the secured creditor's interest in the insurance became the same as its interest in the crop proceeds.<sup>86</sup>

In *In re Rees*,<sup>87</sup> which preceded the *Cook* decision, Judge John Akard applied a similar analysis and reached the same conclusion. As in *Cook*, the specific assignment provisions in *Rees* dealt with a creditor's right to proceeds before the debtor received them. In *Rees*, however, Texas law governed the secured creditor's rights in the proceeds once they came into the debtor's hands.<sup>88</sup>

IV. OTHER CREDITORS' RIGHTS CASES

A. LIEN FORECLOSURE

1. *No Damages for Loss of Opportunity to Do Business with Potential Purchaser*

In *Peterson v. Black*,<sup>89</sup> the assignee of a note caused a trustee's sale to be conducted following the maker's default. At the sale, the substitute

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don Nat'l Bank v. Kerwin, 996 F.2d 552 (2nd Cir. 1993); *In re Lairmore*, 101 B.R. 681 (Bankr. E.D. Ok. 1988)).

82. 169 F.3d 271 (5th Cir. 1999).

83. *See id.* at 275.

84. *See id.* at 274-75 (stating that "claims for indemnity are not subject to attachment or other legal process 'before payment to the insured'" on account of a debt of the insured).

85. *Id.* at 276.

86. *See id.* at 277. The Fifth Circuit noted that whether the security interest specifically mentioned insurance proceeds was not relevant. Under state law, insurance proceeds are proceeds of that collateral. *See id.*; see TEX. BUS. & COM. CODE ANN. § 9.306(a) (Vernon 1991 & Supp. 2000); Sweetwater PCA v. O'Briant, 764 S.W.2d 230 (Tex. 1988).

87. 216 B.R. 551 (Bankr. N.D. Tex. 1998).

88. *Id.* at 555. *Rees* dealt with proceeds already in the hands of the debtor. As the court noted, "'complete preemption' [of state law] means something less than complete." *Id.* Where federal law stops, state law applies. Thus, Article 9 of the Uniform Commercial Code (UCC) governs proceeds in the debtor's hands.

89. 980 S.W.2d 818 (Tex. App.—San Antonio 1998, no writ).

trustee bid on behalf of the holder. The trustee's deed, however, was not recorded. The debtor sued the substitute trustee and the purchaser, alleging that he had found another purchaser who would have bought land at a higher price than the credit bid at the foreclosure sale. The debtor asserted that since the trustee precluded other purchasers from bidding, a fair sale was not conducted.<sup>90</sup> The debtor sought relief based on the loss of conducting business with a potential purchaser. In one defensive theory, the trustee asserted that the sale had never been completed because the trustee's deed was never recorded. Despite this fact, the appellate court found that the sale was complete.<sup>91</sup> Nevertheless, the court refused to authorize a recovery of damages on the debtor's claimed loss of doing business.<sup>92</sup>

## 2. *Disposition of Collateral*

The case of *SMS Financial, LLC v. Abco Homes, Inc.*<sup>93</sup> provides an example of what can go wrong in a Federal Deposit Insurance Corporation (FDIC) note sale transaction. The FDIC sold, but did not physically deliver, a note to SMS Financial (SMS). SMS later requested a refund, but instead the FDIC sent the note to SMS. Shortly thereafter, SMS sued the maker of the note, arguing that it was the holder of the note through the FDIC's negotiation and delivery, and therefore was the party entitled to enforce it.

The Fifth Circuit interpreted Texas Business and Commerce Code § 3.301 to find that SMS was the holder of the note;<sup>94</sup> SMS became the holder when the FDIC negotiated and delivered the note to it.<sup>95</sup> The court found that a genuine issue of material fact had been raised regarding the commercial reasonableness of the sale of the equipment being used as collateral, reiterating that SMS had the burden of proof on the issue.<sup>96</sup> The maker also asserted that the note was barred by limitations, but the court found that both the general federal statute of limitations<sup>97</sup> and FIRREA<sup>98</sup> applied in this case. The court went on to note that

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90. A trustee or substitute trustee must conduct a sale fairly, "with absolute impartiality," and he may not discourage bidding. *Id.* at 822. Having said that, however, a trustee need not "take affirmative actions beyond that required by the deed of trust," and his "duties are fulfilled by complying with the deed of trust." *Id.* (citing *First State Bank v. Keilman*, 851 S.W.2d 914, 924-25 (Tex. App.—Austin 1990, writ denied)).

91. *See Peterson*, 980 S.W.2d at 822.

92. *Peterson*, 980 S.W.2d at 822-23.

93. 167 F.3d 235 (5th Cir. 1999).

94. TEX. BUS. & COMM. CODE ANN. § 3.301 (Vern. Supp. 1994 & 2000).

95. Under the UCC, SMS became the holder of the note even if delivery of the note was inadvertent. As the holder, SMS was entitled to enforce the note. *See SMS*, 167 F.3d at 239.

96. *See SMS* at 243 (citing *Greathouse v. Charter Nat'l Bank—Southwest*, 851 S.W.2d 173 (Tex. 1992)).

97. 28 U.S.C. § 2415(a) (1994).

98. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. § 1821(d)(14) (1994).

§ 2415, the general statute, actually contains a specific tolling provision.<sup>99</sup>

### 3. *Fraudulent Transfers*

*Bahr v. Kohr*<sup>100</sup> was originally filed under the Uniform Fraudulent Transfer Act (UFTA).<sup>101</sup> In this case, a judgment debtor and his spouse purchased certain real property during their marriage. The debtor conveyed a portion of that property to his spouse as her separate property, and both spouses designated the remaining portion of that property as their homestead. The judgment creditors claimed that this conveyance violated the UFTA.

The court found that the general denial filed by the judgment debtors was sufficient to raise a defense that the property in question was purchased with separate property funds of the non-judgment debtor's spouse. But the court determined that the judgment debtor and his spouse bore the burden of rebutting the presumption that the property was community in nature by clear and convincing evidence, which involves tracing and identifying the specific funds used to purchase the property.<sup>102</sup> Since the debtor and his spouse failed to overcome that presumption by sufficiently clear and convincing evidence, the case was remanded.<sup>103</sup>

## B. FAIR DEBT COLLECTION PRACTICES ACT—AGENTS

Collection practices were at issue in the case of a debtor who purchased a satellite dish and television set from a retail store on credit.<sup>104</sup> The debtor's account was sold to a finance company, which began billing the debtor. Dunning phone calls followed, despite the fact that the debtor no longer owed money on the satellite dish account. The store's wholly-owned finance company turned the account over to a collection agency, which had contracted with the original holder to work as an independent contractor. The new collector began making "harassing and threatening" phone calls, and the debtor finally sued under the Texas Debt Collection Act<sup>105</sup> and the Fair Debt Collection Practices Act.<sup>106</sup>

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99. See *SMS*, 167 F.3d at 240-42. In disposing of this issue, the court relied on *Midstates Resources Corp. v. Farmers Aerial Spraying Service, Inc.*, 914 F. Supp. 1424 (N.D. Tex. 1996), which was the first published case to apply the tolling provisions of the old federal statute to a FIRREA-covered debt. As an aside, the *Midstates* court cited an earlier issue of the *Annual Survey of Texas Law*. *Id.* at 1426 n.3 (citing Roger S. Cox, *Bankruptcy & Creditor's Rights*, 48 SMU L. REV. 875, 408 (1995)).

100. 980 S.W.2d 723 (Tex. App.—San Antonio 1998).

101. TEX. BUS. COM. CODE ANN. § 24.001 (Vernon 1987).

102. See *Bahr*, 980 S.W.2d at 728; see generally, *McKinley v. McKinley*, 496 S.W.2d 540, 543 (Tex. 1973); *McElwee v. McElwee*, 911 S.W.2d 182, 188 (Tex. App.—Houston [1st Dist.] 1995, writ denied).

103. See *Bahr*, 980 S.W.2d at 729-30.

104. See *Morante v. Am. Gen. Fin. Ctr.*, 157 F.3d 1006 (5th Cir. 1998).

105. TEX. REV. CIV. STAT. ANN. Art. 5069-11.01 (Vernon 1987 & Supp. 2000).

106. 15 USC § 1692 et. seq. (1994 & Supp. 1996).

The Fifth Circuit found that the phone calls made by the financing company and the subsequent collector were harassing and threatening to the extent that they supported a jury verdict awarding several thousand dollars in damages.<sup>107</sup> More importantly, the court determined that the finance company controlled most aspects of the relationship with the debtor, including the time and manner of contacts with the debtor, reporting requirements, settlement approval, and initiation of litigation.<sup>108</sup> The court found sufficient evidence that the collector was the finance company's agent, which exposed the finance company to liability for the collector's actions and for exemplary damages under the state statute.<sup>109</sup>

Perhaps even more significant than what the court did is what the court did *not* do. It appears that the facts of this case presented the Fifth Circuit with an opportunity to impose a non-delegable duty on the owner of the debt to comply with the debt collection statute. But the court's in-depth factual analysis of the agency relationship between the creditor and the collector indicates that the court declined to impose any non-delegable duty beyond that which already exists by statute.

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107. *See Morante*, 157 F.3d at 1009-11.

108. *See id.*

109. *See id.*