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Bankruptcy and Creditors' Rights

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BANKRUPTCY AND CREDITORS' RIGHTS

Roger S. Cox*

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I. INTRODUCTION—SCOPE OF ARTICLE

ALTHOUGH this article includes developments in the bankruptcy courts, the author has attempted to limit the reported cases to those involving state law¹ or other developments that

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1. See, e.g., homesteads, exemptions, automatic stay, etc.

directly impact enforcement of the debtor-creditor relationship.² This 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.³

This Survey period, Texas based bankruptcy courts returned to further developments in the area of Texas homesteads, both urban and rural. A series of opinions, including one from the Fifth Circuit, provides a good deal of guidance into the nature and extent of the homestead exemption available to Texas debtors. Those cases are the focus of this year's Survey.

II. LEGISLATIVE DEVELOPMENTS

A. BANKRUPTCY REFORM

During the 2001 legislative session, so-called bankruptcy reform legislation remained an issue. Despite versions having passed both the House and the Senate early in the session, no conference committee met during calendar year 2001. Although it is pure speculation at this point, it remains possible that substantial revisions to the Bankruptcy Code may have been passed by the time this Survey is published; however, one would hope that the "reform" ultimately passed will be in a more workable version than last year's bill.

B. ARTICLE 9

Effective July 1, 2001, Texas joined most other states by implementing the revised Article 9 of the UCC, known in Texas as the Texas Business & Commerce Code.⁴ Although Article 9 is beyond the scope of this article, the creditors' rights practitioner should become familiar with its more significant changes to existing law, especially in the areas of perfection,⁵ which could have an impact on a subsequent debt collection effort or

2. See, e.g., dischargeability, automatic stay, etc.

3. Judge Leif M. Clark provides an extensive and thorough analysis of bankruptcy developments in the Fifth Circuit in the Fifth Circuit Symposium published annually by the Texas Tech Law Review. See Judge Leif M. Clark, *Bankruptcy, Fifth Circuit Symposium*, 32 TEX. TECH L. REV. 667 (2001); 31 TEX. TECH L. REV. 405 (2000); 30 TEX. TECH L. REV. 441 (1999); 29 TEX. TECH L. REV. 355 (1998); 28 TEX. TECH L. REV. 299 (1997); Dean G. Pawlowic, *Banking Law, Fifth Circuit Symposium*, 31 TEX. TECH L. REV. 385 (2000); 30 TEX. TECH L. REV. 425 (1999). 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 (2001); G. Pronske, *Recent Developments*, State Bar of Texas Advanced Business Bankruptcy Course (2001).

4. TEX. BUS. & COMM. CODE ANN. §§ 9.101-.709 (Vernon Supp. 2001).

5. For example, the location for filing a financing statement is now based upon the location of the debtor, rather than the location of the collateral. See, e.g., *id.* § 9.307 (location of debtor). Other changes have been made to allow for "authentication" rather than original signatures. See *id.* § 9.102(7) (definition of "authenticate").

Some commentators have already provided some introductory analysis to the new filing rules. See Terry M. Anderson et al., *Attachment and Perfection of Security Interests Under Revised Article 9: A Nuts and Bolts Primer*, 9 AM. BANKR. INST. L. REV. 179 (2001); see also Donald W. Garland, *Uniform Commercial Code Revised Article 9: Understanding the Changes to Secured Transactions*, 64 TEX. BAR J. 974 (2001).

bankruptcy filing. Perhaps the best compilation of articles devoted to the effect of the revised Article 9 on bankruptcy practice is found in a recent symposium issue of the American Bankruptcy Institute Law Review.⁶

III. BANKRUPTCY CASES

A. HOMESTEADS AND EXEMPTIONS

A number of cases during the Survey period addressed the nature and extent of the Texas homestead. These cases arose in varying factual contexts; however, the common theme emanating from these cases is that, no matter the creativity of the homestead claimant, each family is only entitled to one homestead.

1. *Proceeds of Sale of Homestead*

In *In re Zibman*⁷ the debtors sold their home, placed the proceeds of the sale in an unsegregated bank account, and moved to Massachusetts. A few days later, the debtors filed for Chapter 7 bankruptcy protection, and they claimed as exempt the full amount of the proceeds from the sale of their Houston home. On that same day, however, the debtors moved into a town home in Massachusetts under a six month lease, and they testified that they had no intention of reinvesting the proceeds in another Texas homestead within six months.⁸

The homestead claim was made under Section 41.001(c) of the Texas Property Code, which provides that the proceeds from the sale of a homestead are not subject to seizure for a creditor's claim for six months following the date of the sale.⁹ The theory behind the debtor's exemption claim was, presumably, that courts typically take a "snapshot" view of a debtor's financial condition as reflected on schedules filed effective as of the date of the bankruptcy case. As of the petition date, the debtor still had the proceeds in hand; therefore, that would be the end of the inquiry.

The Fifth Circuit, however, found that the debtors were not entitled to claim the proceeds exemption.¹⁰ While it is true that a "snapshot is

6. See, e.g., G. Ray Warner, *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, 9 AM. BANKR. INST. L. REV. 3 (2001); Steven L. Harris and Charles W. Mooney, Jr., *Revised Article 9 Meets the Bankruptcy Code: Policy and Impact*, id. at 85; C. Scott Pryor, *How Revised Article 9 Will Turn the Trustee's Strong-Arm into a Weak Finger: A Potpourri of Cases*, id. at 229. For an introduction to the changes in filing and perfection rules, see Anderson, *supra* note 5, at 179.

7. 268 F.3d 298 (5th Cir. 2001).

8. *Id.* at 300-01.

9. Section 41.001 provides as follows:

Interest in land exempt from seizure

a. A homestead . . . [is] exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property.

b. * * *

c. The homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale.

TEX. PROP. CODE ANN. § 41.001 (Vernon 2000).

10. *Zibman*, 268 F.3d at 304.

taken,” that snapshot can only consist of the rights that the debtor ultimately had as of that date. As the court says, “the important reminder is that it is the *entire* state law applicable on the filing date that is determinative.”¹¹ The Fifth Circuit held that the lower courts, which allowed the exemption, did not apply the *entire* Texas law that was applicable. The Fifth Circuit added that the lower courts effectively read the six month limitation out of the statute, and “transformed an explicitly limited exemption into a permanent one.”¹²

Presumably, the Fifth Circuit felt that it was implicit in the six month statute that those proceeds would actually be invested within that six month period. Moreover, the court noted that the object of the proceeds exemption was to protect the concept of a homestead, and “not to protect the proceeds, in and of themselves.”¹³

As noted above, the debtors made no effort to reinvest the proceeds in another homestead. To the contrary, they moved from Texas and entered into a long term lease in another state. Therefore, but for the intervention of the bankruptcy, the proceeds would have lost their exempt character under state law. That being the “entire” law applicable to the proceeds, the Fifth Circuit reasoned, the debtors were not entitled to the exemption claim.

2. *One Homestead—Even While Separated*

*In re Dawson*¹⁴ involved not only multiple tracts of land, but important lessons regarding the timing of a bankruptcy filing and homestead claim during the pendency of a divorce. In *Dawson*, the debtor and his soon to be ex-wife lived in a home that was the wife’s separate property prior to marriage. The parties separated and the debtor moved into a small apartment complex, which he owned as his separate property.¹⁵

The wife filed for divorce in January 2000, a final decree was signed on April 13, 2001, which became final on May 14, 2001. The decree awarded the single family residence to the wife and ordered the apartment complex to be sold with the proceeds divided evenly between the debtor and the ex-wife.

During the pendency of the divorce, the debtor filed a petition under Chapter 13. Again, at the time the bankruptcy was filed, the parties were still married, but they were living apart. The wife objected to the homestead claim, asserting that the single family residence was the only homestead, which precluded the debtor from claiming another property as an urban homestead during the pendency of the divorce.

The court’s analysis began with the fundamental principle that “Texas

11. *Id.*

12. *Id.*

13. *Id.* at 305 (quoting *In re England*, 975 F.2d 1168, 1174-75 (5th Cir. 1992)).

14. 266 B.R. 355 (Bankr. N.D. Tex. 2001).

15. Apparently, this apartment complex was claimed by the debtor as his homestead prior to the marriage. *Id.* at 357.

law allows one homestead for a family.”¹⁶ Additionally, the homestead may be the separate property of one of the spouses or their community property, “but the wife cannot have one homestead and the husband another.”¹⁷

Assuming the family was entitled to only one homestead, then, in order for the husband to claim the other property as homestead, there would have had to have been an abandonment. The court found, however, that the debtor could not unilaterally abandon or change the homestead by himself.¹⁸ Accordingly, the court found that the debtor could not claim a separate homestead from that already established by the family until a final decree of divorce was entered and the familial relationship actually terminated.¹⁹

3. Rural Homestead—Non-Contiguous Tracts

Turning to rural homesteads,²⁰ it is important to note that the limitation to one homestead does not necessarily mean that all of the tracts of a rural homestead need be contiguous. In *In re Murray*,²¹ the debtor owned three tracts of land, two of which were contiguous and the other detached. A 33 acre tract and a 15 acre tract were contiguous to each other, but a third tract of 147 acres was about a half mile from the other properties.²² As of the filing of the case, the debtor lived in a mobile home on the 33 acre tract, and he was continuing to grow hay on those tracts in order to supplement his income and barter for other goods. He also cut wood from all three properties, in particular, the non-contiguous tract. The debtor and his wife also used all three tracts for various activities including gardening, fishing, and “recreational and aesthetic activities

16. *Id.* at 358 (citing *In re Claflin*, 761 F.2d 1088, 1092 (5th Cir. 1985) (stating that a wife cannot have one homestead and the husband another)). The Texas Government Code also provides some statutory definitions of “family.” See TEX. GOV. CODE ANN. §§ 573.022, 573.024 (Vernon 2001); see also Texas Family Code § 71.003 (Vernon Supp. 2002).

17. *In re Dawson*, 266 B.R. at 358 (citing *In re Cumpton*, 30 B.R. 49, 51 (Bankr. N.D. Tex. 1983)).

18. *In re Dawson*, 266 B.R. at 358.

19. *Id.* at 359. A practice note: the opinion is silent on this issue; however, one wonders whether it would have been beneficial for the debtor simply to dismiss and refile after the divorce became final. In that event, the debtor should have been entitled to his own homestead.

20. The Texas Property Code provides for a 10 acre urban homestead and up to a 200 acre rural homestead. See TEX. PROP. CODE ANN. §41.002 (Vernon Supp. 2002).

21. 260 B.R. 815 (Bankr. E.D. Tex. 2001).

22. The rural homestead “for a family” may consist of up to 200 acres, while a homestead for a single, adult person may not exceed 100 acres:

(b) if used for the purposes of a rural home, the homestead shall consist of:

(1) for a family, not more than 200 acres, which may be in one or more parcels, with the improvements thereon; or

(2) for a single adult person, not otherwise entitled to a homestead, not more than 100 acres, which may be in one or more parcels, with the improvements thereon.

TEX. PROP. CODE ANN. § 41.002(b).

such as bird watching and picnicking.”²³

In short the court required the debtor to establish four things: (1) the tracts are rural in nature; (2) the debtor qualifies as the head of a family (because he claims more than 100 acres); (3) the debtor demonstrates “overt acts of homestead usage consistent with a rural home;” and (4) the debtor has the intent to claim the three tracts as homestead.²⁴

The 100 acre issue was complicated by the fact that the debtor and his spouse had executed a premarital agreement under which the debtor’s wife specifically waived her homestead rights, as well as limited the debtor’s obligation to provide financial support to her. The court noted that the family relation under Texas law is one of status and not merely of contract, and “any desire to keep assets separate does not necessarily defeat the existence of a family or prohibit the head of that family from claiming a homestead.”²⁵ Moreover, as noted in the earlier case, a family may claim only one homestead. With these concepts in mind, the court found that the debtors had chosen the three tracts to claim as their homestead.

Interestingly, the court noted, with apparent approval (and no nod to modern society), that Texas case law has long held that “the husband is the head of the household,” and that his declaration of a homestead would bind the wife and the rest of the family. Thus, the court apparently concluded that the male debtor’s declaration would control over any contrary decision of his wife.²⁶ This was buttressed by the fact that the spouse lived on the same tracts as Murray, “uses utilities paid for by Murray, burns the wood chopped by Murray, and likely eats the food bought by Murray.”²⁷

Having found that Murray was the head of the household, the court then had to determine whether the three tracts were used for purposes of a rural home. The court did not require a strict economic or profit/loss test, but applied a broader approach, looking for use consistent with that of a rural home.²⁸

That rather permissive approach, however, was not the end of the inquiry. The court still had to determine whether the non-contiguous tract was part of this rural homestead. The apparent issue was whether the detached tract contributed to the “comfort, enjoyment, or convenience of the residents or the family.”²⁹ Although the opinion indicates that the court was not entirely comfortable with the even more liberal view found in some cases, the court nevertheless held that because the debtor had

23. *Murray*, 260 B.R. at 820.

24. *Id.* at 823.

25. *Id.* at 825.

26. *Id.* at 825 n.36.

27. *Id.* at 827.

28. An earlier opinion cited in *Murray* held that the “‘use of the land for shelter and protection, comfort, convenience, and enjoyment of the home’ could constitute support for purposes of the rural homestead.” *Murray*, 260 B.R. at 829 (quoting *In re Mitchell*, 132 B.R. 553 (Bankr. W.D. Tex. 1991)).

29. *Id.* at 830.

farmed and cut wood from the separate tract and also irrigated the land and "built a duck blind" for that area, such use indicated that the land belonged as part of his homestead. Accordingly, all three tracts were found to constitute Murray's rural homestead.³⁰

4. Rural Homestead—Separate Tracts But Not Rented Property

*In re Webb*³¹ provides a useful contrast to the analysis and holding in *Murray*. In *Webb*, Chapter 13 debtors claimed a rural homestead, in which they attempted to include three additional tracts of land on which three rental houses were located. The court touched upon the same requirements that were analyzed more in depth in *Murray*, that is, that the non-contiguous tracts must be used for purposes of the rural home.³² In *Webb*, the debtors used the other tracts for no reason other than the generation of income as rental property. Although the generation of rental income is arguably for the support of the family, the court found that the mere use of rental proceeds as income did not constitute "support" for purposes of a home.³³

5. Rural Homestead—No Rural "Business" Homestead

Another limitation on the rural homestead (and a distinction from its urban counterpart) is that property utilized in the operation of a business is not suitable for a rural homestead claim. In *In re Perry*,³⁴ Judge Leif Clark provides a detailed analysis of how a court distinguishes between an urban and rural homestead.

In *Perry*, the debtor owned a 26 acre tract adjacent to a 59 acre tract. Upon filing bankruptcy, the debtor claimed both tracts as one rural homestead. The court was faced with two issues: whether the debtors could claim the original 26 acre tract as homestead notwithstanding a

30. *Id.* at 831. The opinion did not address this, but it appeared that one of the properties was contiguous to the debtor's home tract. Perhaps if the debtor used that adjacent house as storage, a work area, or for other uses connected to the house, that tract could have been saved.

31. 263 B.R. 788 (Bankr. W.D. Tex. 2001).

32. *See id.* at 791-92. The *Webb* court framed the issue in the more simplistic but equally useful question of whether the non-contiguous tracts were used "for the purposes of a home." *Id.* (citing *Kocke v. Conquest*, 35 S.W.2d 673, 678 (Tex. 1931)).

33. *Id.* at 795-96. The court recognized that over the historical development of the rural homestead exemption, the generation of some rental income, such as by way of a share-cropping arrangement with a tenant might not defeat the rural homestead claim. The court cited *Youngblood v. Youngblood*, 76 S.W.2d 759 (Tex. Comm'n App. 1934, opinion adopted) noting that homestead claimants leased an adjacent 99 acre tract to their son-in-law and then to their son on a share-cropping basis. Some of those crops were actually used by the claimants in kind. Moreover, the two tracts in *Youngblood* were largely contiguous but for an unfenced public road that separated those tracts. *Youngblood* is an example of a situation that might very well still support a homestead claim of non-contiguous tracts, even when some rental income is being generated. In *Webb*, however, the separate tracts appeared to be no more or less than rent houses that were not used in connection with the family's rural home.

34. 267 B.R. 759 (Bankr. W.D. Tex. 2001).

prior abandonment to a family owned corporation,³⁵ and whether the adjacent 59 acre tract also qualified as a rural homestead.

The court began the inquiry with the basic proposition that the initial burden of proof in establishing a homestead is on the claimant.³⁶ Generally, once that burden has been met, the burden then shifts to the party seeking to disturb the homestead claim.³⁷ Essentially, there is a presumption that the homestead continues until it is terminated or abandoned, and again, the burden proving termination or abandonment is on the party making that claim.³⁸

After disposing of the issue regarding earlier abandonment,³⁹ the first inquiry faced by the court was whether the homestead was rural or urban. The court addressed the interplay between the traditional test developed in the common law and a relatively new statutory scheme found in the Property Code.⁴⁰ The court concluded that it must first address the statutory factor to determine whether the property qualifies as "urban." If it does not, then the property is rural in nature, and that ends the inquiry. On the other hand, if the property initially qualifies as "urban" under the statute, then the court would return to the more traditional test.⁴¹

Regarding the two-pronged statutory test, Judge Clark says it best:

The first element asks whether the property is located within the limits of a municipality or its extraterritorial jurisdiction or a platted subdivision. The second element asks two questions: (1) whether the property is served by municipal police protection, paid or volunteer fire protection; and (2) whether a municipality provides the property with three of the following services: (i) electric, (ii) natural gas, (iii) sewer, (iv) storm sewer, and (v) water. § 41.002(c)(2). If the property fails under either the (c)(1) test *or* one of the two inquiries under (c)(2), the property will be deemed rural and the court's analysis will be at an end. If it does not fail either test, only then must the court proceed to the "traditional" test.⁴²

35. *Id.* at 761-62. The facts are somewhat more complex. In particular, the 26 acre tract had previously been conveyed to a family owned corporation, which had previously obtained a loan secured by that tract, purportedly as what was then non-homestead property. Later, that corporation went out of business, and the debtors re-claimed that property as their homestead.

36. *Id.* at 764 (citing *In re Moody*, 77 B.R. 580, 592 (Bankr. S.D. Tex. 1987)); *Pace v. McEwen*, 617 S.W.2d 816, 818 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ).

37. *Perry*, 267 B.R. at 764.

38. *Id.*

39. *Id.* at 761-62.

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

41. The so-called traditional test includes factors such as the "location of the land in relation to limits of a municipality; the situs of the lot in question; the existence of municipal utilities and services; the use of the lot and adjacent property; and the presence of platted streets, blocks," etc. *Perry*, 267 B.R. at 766 (citing *In re Crowell*, 138 F.3d 1031, 1034 (5th Cir. 1998)); see also *U.S. v. Blakeman*, 997 F.2d 1084, 1091 (5th Cir. 1992) (statutory test not the exclusive test). The *Perry* court notes a continuing reluctance to rely upon the statutory test as the exclusive test. See *In re Bradley*, 960 F.2d 502 (5th Cir. 1992), *cert. den'd subnom*, *Commonwealth Land Title Ins. Co. v. Bradley*, 507 U.S. 971 (1993).

42. *Perry*, 267 B.R. at 767 (emphasis added) (citations omitted).

In *Perry*, the property was not located within a city limits or extra territorial jurisdiction or a platted subdivision. Therefore, the property was not considered urban under the statute, and there was no need to resort to the traditional test. Therefore, the 59 acre tract was held to constitute a rural homestead.

The 26 acre tract presented a different problem, however, because of the conduct of a business on that tract. The court cited substantial authority for what has become a well-established principle—"a rural homestead cannot 'encompass a business homestead' and indeed, the operation of a business on part of a rural homestead forfeits the homestead protection *on that part of the property*."⁴³ Because the 26 acre tract was used as a mobile home park, which also included some year-round tenants, it constituted the operation of a business.⁴⁴

The *Perry* opinion also provides some perspective on the impact of renting a portion of the rural homestead. Specifically, the court points out that mere renting of the property, absent some other facts, does not in and of itself constitute "operation of a business" on the rural homestead.⁴⁵

6. *Personal Property Exemptions—Wild Card Exemption Trumps Garnishment*

On the subject of personal property exemptions, *In re Benson*⁴⁶ provides an example of the interplay between the post-judgment remedy of garnishment and the availability of personal property exemptions under the Bankruptcy Code. In *Benson*, the holder of a judgment served a writ of garnishment on the judgment debtor's bank, which trapped just over \$8,000.00. Before the bank's answer date, the debtor filed for Chapter 7 relief. The debtor claimed that amount of money as exempt under the so-called wild card portion of the Bankruptcy Code exemptions.⁴⁷ After a

43. *Id.* at 768 (emphasis added by *Perry* court) (citing *In re Bradley*, 960 F.2d at 506, n.6).

44. *Perry*, 267 B.R. at 759, 769.

45. *Id.* (citing *Orr v. Orr*, 226 S.W.2d 172, 176 (Tex. Civ. App.—Amarillo 1948, no writ)). According to *Perry*, the *Orr* court would address the following factors in determining whether the renting of property constituted a business:

- (1) Whether the owner had other income or means of living and had other businesses or professions;
- (2) Whether the owner spent all of his or her time, together with the hired help, in operating the rented property;
- (3) Whether the owner used all of the land and improvements thereon for the renting of the property;
- (4) Whether the owner used all of the proceeds from the renting of the property over and above his or her living expenses and the necessary operating expenses to pay taxes, repair and further the premises.

Perry, 267 B.R. at 769 (citing *Orr*, 226 S.W.2d at 176).

46. 262 B.R. 371 (Bankr. N.D. Tex. 2001).

47. *Id.* at 374. See 11 U.S.C. § 522(d)(5) (2001). This section allows a debtor claiming under the Bankruptcy Code (as opposed to state exemptions) to exempt up to a certain amount of any unused portion of other enumerated exemptions. In this case, this allowed the debtor to claim money in a demand deposit account as exempt. This is not available under the Texas statute. See TEX. PROP. CODE ANN. § 42.002 (Vernon Supp. 2002).

thorough analysis of the development of garnishment under Texas law,⁴⁸ the court determined that the garnishment was stayed by the bankruptcy filing,⁴⁹ which deprived the state court of the ability to enforce the garnishment by what would have been an execution on the garnishment. Additionally, the court found that the garnishment was effectively a judicial lien, fixed against an interest of the debtor, which impaired an exemption to which the debtor would have otherwise been entitled.⁵⁰ Because the garnishment was a judicial lien, the lien was subject to avoidance under Section 522(f)(1)(A) of the Bankruptcy Code.⁵¹ Accordingly, because of the exemption claim and the court's analysis that the garnishment constituted a judicial lien, the garnishment was avoided.⁵²

B. DISCHARGEABILITY

1. Vicarious Liability For Partner's Actions

In *In re M.M. Winkler & Associates*,⁵³ the Fifth Circuit found that under Mississippi state partnership law, a partner was vicariously liable for a fraud carried out by another partner in the course of the partnership business. One of the partners who was apparently innocent of any direct wrongdoing sought relief under Chapter 7 of the Bankruptcy Code; however, the Fifth Circuit found that under the concept of vicarious general partnership liability, the debt was also non-dischargeable as to that partner, regardless of whether that partner actually received any benefit from the fraud.⁵⁴

Although this case dealt with a Mississippi partnership and Mississippi partnership law, it is important because of the court's "plain meaning" approach to the concept of vicarious liability under principles of general partnership law. The court relied on two Supreme Court opinions to support its holding, and under Texas law, general partnerships also give rise to vicarious (civil) liability for general partners.⁵⁵ There may be a conflict among the Circuits arising out of this opinion, however, so it is impossible

48. In general, garnishment is governed by Chapter 63 of the Texas Civil Practice and Remedies Code and Rules 657, *et seq.* of the Texas Rules of Civil Procedure.

49. *Benson*, 262 B.R. at 377-78 (citing *Baytown State Bank v. Nimmons*, 904 S.W.2d 902 (Tex. App.—Houston [1st Dist.] 1995, no writ)).

50. *Id.* at 378-79 (citing *In re Henderson*, 18 F.3d 1305 (5th Cir. 1994)).

51. Section 522(f)(1) allows for avoidance of a judicial lien. See 11 U.S.C. § 522(c) & 522(f)(1)(A).

52. As a practical matter, a debtor seeking to claim a substantial equity interest in a Texas homestead would not be able to achieve this result. The Texas exemption statutes contain no similar counterpart to the "wild card" exemption in the Bankruptcy Code. Compare TEX. PROP. CODE ANN. §§ 41.001, 41.002, 42.001, 42.002 (Vernon Supp. 2002) with 11 U.S.C. § 522(d).

53. *Deodati v. M.M. Winkler & Assoc.*, 239 F.3d 746 (5th Cir. 2001).

54. *Id.* at 751-52.

55. See *Strang v. Bradner*, 114 U.S. 555 (1885); *Cohen v. De la Cruz*, 523 U.S. 213 (1998). See also TEX. REV. CIV. STAT. ANN. art. 6132b-3.04 (Vernon Supp. 2002) ("[A]ll partners are jointly and severally liable for all debts and obligations of the partnership unless otherwise agreed by the claimant or provided by law"); see generally *Smith v. Waynan*, 224 S.W.2d 211 (Tex. 1949); see also *Remington v. U.S.*, 210 F.3d 281 (5th Cir. 2000); but see *Darnell v. Martin*, 740 S.W.2d 15 (Tex. App.—El Paso 1987, writ den'd).

to tell whether the Supreme Court would grant certiorari, and, if so, what the outcome would be. Similarly, predicting an outcome under Texas state law would be pure speculation; however, even though the result is quite harsh, it is arguably a plain meaning application of the concept of pure vicarious liability in a civil context.⁵⁶

2. Credit Card Debt—Implied Representation (*Mercer*, *Cont'd*)

In the area of dischargeability of credit card debt, the saga of *In re Mercer*⁵⁷ concluded with an *en banc* opinion out of the Fifth Circuit. The *en banc* decision provided a lengthy and detailed analysis of the use of credit cards in the context of the ordinary fraud exception to discharge.⁵⁸ In short, the most significant development of this opinion was that the Fifth Circuit held that each use of the pre-approved credit card by the debtor constituted an implied representation by the debtor of her intent to repay any credit extended.⁵⁹ The implied representation occurs “at card-use, *not* at card-issuance.”⁶⁰ Moreover, “there is *no* statutory basis for distinguishing between cards obtained at the debtor’s initiative and those obtained in response to a solicitation (pre-approved).”⁶¹

The court also found that the creditor “actually relied” as a matter of law on the debtor’s implied representations.⁶² The case was remanded, however, for a determination regarding the falsity of the debtor’s representations, the debtor’s intent to deceive the creditor, and whether the creditor’s reliance was justifiable.⁶³ Although, as stated, the opinion was quite lengthy, overruled some prior precedent, and provided a lengthy and detailed analysis of the whole issue of credit card dischargeability, it is difficult to comment much beyond the issues discussed above because of the fact-intensive nature of what will be faced by the *Mercer* court on remand (and other bankruptcy courts in the future). There was also no bright line rule coming out of the *Mercer* case other than the fact that we now know, at least in the Fifth Circuit, that the implied representation theory applies and, in that context, there is little distinction applicable to pre-approved credit cards.

(holding that the criminal conviction of one partner did not give rise to contribution claim against non-culpable partner).

56. *But see Darnell*, 740 S.W.2d at 15 (holding that the criminal conviction and its consequences were personal to culpable partner but not chargeable to other partner without knowledge).

57. 246 F.3d 391 (5th Cir. 2001).

58. *See* 11 U.S.C. § 523(a)(2)(A). This section excepts from discharge any debt for an extension of credit obtained by “false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s . . . financial condition.”

59. *Mercer*, 246 F.3d at 404.

60. *Id.*

61. *Id.* at 402-03. The court continued, “Accordingly, although this case involves a pre-approved card, the standard we adopt—common-law fraud—is *not* so confined.” (emphasis provided by court). “On the other hand, a card’s pre-approval *may* be relevant as to whether the initial reliance was justifiable.” *Id.*

62. *Id.* at 391.

63. *Id.* at 425.

3. Collateral Estoppel Following Arbitration

In *In re O'Neill*,⁶⁴ a bankruptcy court again was faced with the decision whether to apply the principle of collateral estoppel in dischargeability litigation. In *O'Neill*, however, the issues that were to be precluded from re-litigation arose out of an arbitration rather than a trial. Moreover, the arbitration award had not been confirmed by a trial court.

In general, collateral estoppel, also known as issue preclusion, applies in dischargeability litigation.⁶⁵ The arbitration issue was not entirely a matter of first impression, however, because as the *O'Neill* court noted, a Texas bankruptcy court, applying California law, had previously applied collateral estoppel effect to an arbitration.⁶⁶

Finding that the Texas collateral estoppel issues were satisfied by the prior arbitration,⁶⁷ and finding that the case was “fully and fairly litigated” in light of prior Fifth Circuit authority,⁶⁸ the court found that the arbitration award would hold, and the parties were collaterally estopped from re-litigating the issues already decided in the arbitration.

C. CHAPTER 13 PRACTICE—VALUATION

In the post-*Rash* world, readers of the Survey will recall the development of property valuation in a Chapter 13 context through the saga of *In re Rash*,⁶⁹ which in effect required application of a replacement cost approach to property that is being retained by a debtor in a reorganization context, specifically a Chapter 13 plan. In *In re Longbine*,⁷⁰ the court found that a vehicle to be retained by a Chapter 13 debtor should be retained as of the petition date, as opposed to the date of a confirmation hearing.⁷¹

64. 260 B.R. 122 (Bankr. E.D. Tex. 2001).

65. *Id.* at 126 (citing *Grogan v. Garner*, 498 U.S. 279, 284 (1991)); *see also In re Davis*, 3 F.3d 113, 114 (5th Cir. 1993).

66. *See In re Marx*, 171 B.R. 218 (Bankr. N.D. Tex. 1994).

67. The issues are whether the facts sought to be litigated in the second action were fully and fairly litigated in the prior action, whether the facts were essential to the judgment in the first action, and whether the parties were cast as actual adversaries. *O'Neill*, 260 B.R. at 126-27.

68. *See In re Pancake*, 106 F.3d 1242 (5th Cir. 1997).

69. 520 U.S. 953 (1997). This case came out of the Fifth Circuit, which had previously withdrawn an earlier opinion and substituted it with an *en banc* opinion. *See In re Rash*, 31 F.3d 325 (5th Cir. 1994), *modified on denial of rehearing*, 62 F.3d 685 (1995), *modified on rehearing en banc*, 90 F.3d 1036 (1996), *cert granted*, 117 S. Ct. 758 (1997). The *en banc* opinion was analyzed, and to some extent criticized, in an earlier edition of the Survey. *See Roger S. Cox, Bankruptcy and Creditors' Rights, Annual Survey of Texas Law*, 50 SMU L. REV. 989, 993 (1997). That analysis included a substantial review of the dissent to the *en banc* opinion. That dissent (and this author's analysis) turned out to be much more consistent with the Supreme Court's ultimate ruling than what was found in the *en banc* opinion.

70. 256 B.R. 470 (Bankr. S.D. Tex. 2000).

71. Theoretically, the vehicle could have been filed as of the date of filing the case, the effective date of the plan, and the actual date of confirmation. The court adopted another bankruptcy court's analysis in *In re Kennedy*, 177 B.R. 967 (Bankr. S.D. Ala. 1995); however, the court disagreed with that court's conclusion. In effect, because it was the debtor's use of the property, which continued from the date of confirmation, it made the most sense to value that collateral as of the date of the filing of the case.

IV. OTHER CREDITORS' RIGHTS CASES

A. NOTE PURCHASERS AND ASSIGNEES—LIMITATIONS

1. *Promissory Notes*

In *Holy Cross Church of God in Christ v. Wolf*,⁷² the Texas Supreme Court addressed the issue of whether the federal six year statute of limitations applied for the benefit of a note purchaser when the note had not yet matured at the time of a bank's receivership. The opinion also clarified when a note is accelerated and, therefore, when a cause of action on a note accrues.

In *Wolf*, the borrower was in default under a note; however, the FDIC did not accelerate the note. The FDIC then sold the note, and the new holder of the note sent the borrower a notice of default and intent to accelerate. Two notices of acceleration followed, both of which indicated dates for a possible non-judicial foreclosure sale. The foreclosure never actually occurred, the church did not resume making payments, and the note was sold to a third party. The new holder ultimately conducted a trustee's sale, but the borrower sued for a declaratory judgment claiming the foreclosure was void because of limitations.⁷³

The note holder agreed that limitations began to run as of the date of the first notice of acceleration; however, as an assignee of the FDIC, the holder argued that the six year statute of limitations applied.

The court of appeals did not reach the limitations issue; rather, it found a fact issue regarding when the cause of action on the note accrued. The supreme court dispensed with that issue by simply reiterating the requirement that acceleration of a note requires two acts: (1) notice of intent to accelerate and (2) notice of acceleration.⁷⁴ Notably, the court of appeals, relying on an earlier opinion from the Corpus Christi Court of Appeals, indicated that acceleration cannot be fully exercised without actually taking steps toward foreclosure.⁷⁵ The Texas Supreme Court acknowledged that some authority to that effect existed; however, those cases were expressly disapproved of by the Court, and it made clear that acceleration requires only a clear and unequivocal notice.⁷⁶

With the acceleration issue resolved, the court then turned to limitations. In short, the court, following *Cadle Co. v. 1007 Joint Venture*,⁷⁷ found that the federal six year statute applies only when the note has already matured as of the time of a bank receivership. In a case where the

72. 44 S.W.3d 562 (Tex. 2001).

73. *Id.* at 565.

74. *Id.* at 566 (citing *Shumway v. Horizon Credit Corp.*, 801 S.W.2d 890, 892 (Tex. 1991)).

75. *Id.* at 569 (citing *Swaboda v. Wilshire Credit Corp.*, 975 S.W.2d 770 (Tex. App.—Corpus Christi 1998, pet. den'd)).

76. *Id.* at 570. To hold, as the court of appeals did here, that acceleration does not occur and thus an action does not accrue until a foreclosure posting or sale takes place would, in essence, mean the foreclosure posting or sale would be the triggering event bringing about the right to hold a foreclosure sale. This result is nonsensical.

77. 82 F.3d 102, 105 (5th Cir. 1996).

note is current, or it has not otherwise matured or been accelerated, the state law statute will apparently apply to the assignee.⁷⁸

The court recognized its earlier holding in *Jackson v. Thweatt*,⁷⁹ in which it held that the FDIC's six year statute of limitations applied to an assignee. The court also recognized substantial other authority to this effect,⁸⁰ and reiterated the principle that an assignee generally stands in the shoes of its assignor. The court appeared, however, to contradict itself for what can only be described as policy reasons consistent with those earlier stated by the Fifth Circuit in the *Cadle Co.* case.⁸¹

2. Effect of Judgment on Limitations Against Lien Debt

In *National Asset Placement Corp. v. Western Securities*,⁸² the assignee reached a similar fate, although for different reasons. In this case, the FDIC was the holder of a note secured by a deed of trust lien. The note matured January 1, 1989, which means the six year statute would have expired January 1, 1995.⁸³ The note, however, was reduced to judgment on January 3, 1994. The FDIC's assignee argued, therefore, that it had at least six years following the date of the judgment, rather than six years following the original maturity of the note, within which to initiate a foreclosure of the underlying deed of trust lien.

Consistent with earlier authority, the Court of Appeals concluded that the "acknowledgment of debt" provision of the general federal statute of limitations applied to a FIRREA based claim, which then left the court to determine whether the agreed judgment on the note would constitute a written acknowledgment, thereby extending limitations. The court held that upon the entry of the judgment, the FDIC's cause of action no longer existed, therefore, it was impossible for limitations to accrue again. Thus, the purchaser was left with the remedy of collecting on that judgment. Continuing along that same line, the court found that because the foreclosure right was not itself a cause of action, the concept of an acknowledgment of debt did not apply to that remedy.⁸⁴

The opinion was not clear with respect to what recitations, if any, were contained within the judgment. In this situation, a practitioner may wish

78. *Wolf*, 44 S.W.3d at 573-74.

79. 883 S.W.2d 171 (Tex. 1994).

80. See e.g., *FDIC v. Bledsoe*, 989 F.2d 805, 810 (5th Cir. 1993); *Cadle Co. II v. Lewis*, 864 P.2d 718, 724 (Kan. 1993).

81. *Wolf*, 44 S.W.3d at 572. In following the Fifth Circuit, the court explained:

The court recognized the policies behind extending the six-year period to transferees, but noted that this "reasoning loses force with a note performing when the FDIC transfers it; because such a note is not in default, it has value to a prospective transferee and no limitation period is running."

Id. (citing *Cadle Co.*, 82 F.3d at 105-06). See also *Beckley Capital Ltd. v. DiGeronimo*, 184 F.3d 52, 58 (1st Cir. 1999).

82. 49 S.W.3d 420 (Tex. App.—San Antonio 2001, no writ).

83. This case apparently came down before *Beckley*, so it is not clear whether the six year statute or the four year statute would have applied in light of that case. That issue was not determinative, however, in the *Western Securities* case.

84. *Western Sec.*, 49 S.W.3d at 424-25.

to include language in an agreed judgment to the effect that the underlying deed of trust lien is renewed for a set period of time, and better yet, obtain a written renewal and extension agreement that complies with the real property limitations statute found in the Civil Practice and Remedies Code.⁸⁵ Reading the opinion in *Western Securities* literally, this may not suffice, but this would appear to be a more practical solution to what the case turned into a potentially impossible situation.

85. See TEX. PROP. CODE ANN. § 16.036 (Vernon Supp. 2002). This statute requires extension of a real estate lien debt to be in writing, signed by the debtor, and recorded in the county in which the real property is located.

