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Bankruptcy and Creditors' Rights

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I. INTRODUCTION-SCOPE OF ARTICLE

This article is limited to developments involving state law, enforcement of the debtor-creditor relationship in bankruptcy, and cases that might not otherwise be addressed in a conventional bankruptcy survey. This is not an exhaustive survey of bankruptcy developments, but rather an update for the Texas based debtor-creditor practitioner.1

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1. For other surveys that focus exclusively on bankruptcy law developments, see J. Westbrook & E. Warren, Recent Developments, University of Texas School of Law Bankruptcy Conference (2003) (providing national survey, with supplement containing Texas and Fifth Circuit case summaries); G. Fronske, Recent Developments, State Bar of Texas Advanced Business Bankruptcy Course (2004); see also Alan S. Trust, 2004 Legal Perspective—Bankruptcy, 68 Tex. B. J. 26 (Jan. 2005).
II. BANKRUPTCY IN THE SUPREME COURT

A. INTEREST RATE ON SECURED CLAIMS IN CHAPTER 13

In In re Till, a plurality of a divided Supreme Court addressed the appropriate interest rate to be applied to a secured claim in a Chapter 13 "cram down" scenario. To some degree, the plurality fashioned its own (partial) solution, of which the full effect is unknown. Therefore, it is necessary to review both the plurality's rationale and the concerns raised in the dissent.

In the bankruptcy court, the debtors proposed a "prime-plus" or "formula" rate, which combined the then national prime rate of 8% with a risk factor of 1.5%, for a total 9.5% rate. The secured creditor sought its contract rate of 21%, which was the rate it generally charged on so-called "sub-prime" loans. The debtors offered the testimony of an economics professor who admitted that he had "limited familiarity with the sub-prime auto lending market" but described the debtors' suggested formula rate as "very reasonable" because Chapter 13 plans are "supposed to be financially feasible." With little or no empirical evidence, the professor surmised that the creditor's exposure was "fairly limited because [petitioners] are under the supervision of the court."4

The bankruptcy court apparently adopted the professor's rationale, and it imposed the debtors' suggested rate. The district court reversed, however, and the Seventh Circuit endorsed a slightly modified version of the district court's "coerced" or "forced" loan approach. In effect, the Seventh Circuit held that the contract rate should serve as the starting point absent evidence to the contrary.5

The Supreme Court identified three general approaches: the "coerced loan," "presumptive contract rate,"6 and the "cost of funds." The Court was critical of each approach and noted that they were complicated, required significant evidentiary costs, and essentially tilted toward the interest of the affected creditor. Continuing on what can only be described as a policy-based analysis, the Court adopted its "formula" approach, which it "has none of these defects."7 The Court deemed the commercial prime rate as a starting point because "starting from a concededly low estimate and adjusting upward places the evidentiary burden squarely on the creditors, who are likely to have reader access to any information

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3. Id. at 1957.
4. Id.
5. Id. at 1957-58; see In re Till, 301 F.3d 583, 592-93 (7th Cir. 2002). The Seventh Circuit further held that the original contract rate should "serve as a presumptive [cram down] rate," which either party could challenge with evidence that a higher or lower rate should apply. Id.
6. The presumptive contract rate used by the Seventh Circuit in Till, had also been approved by the Fifth Circuit. See In re Smithwick, 121 F.3d 211, 214 (5th Cir. 1997); see also In re Showtime Farms, Inc., 267 B.R. 541 (Bankr. E.D. Tex. 2000) (discussing interest rate on deed of trust note in Chapter 12).
absent from the debtor’s filing . . . .”

Finally, the Court argued that its “formula” approach would entail “a straightforward, familiar, and objective inquiry . . . [minimizing] the need for potentially costly additional evidentiary proceedings.” The Court further posited that a “prime-plus” approach “depends only on the state of financial markets, the circumstances of the bankruptcy estate, and the characteristics of the loan, not on the creditor’s circumstances or its prior . . . [relationship] with the debtor.” The Court concluded that “the prime-plus or formula rate best comports with the purposes of the Bankruptcy Code.”

Critically, however, the plurality did not address the appropriate scale for a risk adjustment, and it provided little guidance for courts faced with applying this new judge-made approach. Thus, despite the seemingly objective nature of the plurality’s formula approach, a very subjective part of the formula was left unresolved. At no point in its analysis did the plurality provide the statutory source for its reasoning, and the Bankruptcy Code certainly does not express which party ought to bear the burden on this issue. This simply seemed to be what the plurality thought was the best policy.

Four justices, with Justice Scalia writing, dissented, pointing out many flaws in the plurality decision. First, the dissent noted that beginning with a rate that is admittedly too low and requiring the judge to determine an appropriate upward adjustment will “systematically undercompensate secured creditors for the true risks of default.”

The dissent also exposed the na"ıve, if not totally unrealistic, rationale of the debtors’ expert that was adopted by the plurality. The rationale held that Chapter 13 debtors are somehow a substantially lower credit risk than sub-prime borrowers as a whole. The dissent noted the evidence before the lower court that the default rate for confirmed Chapter 13 plans is, at best, 37%. Observing that the debtors’ expert admitted his limited familiarity with the auto-lending market and his lack of experience with default rates or costs of collection in that market, the dissent stated that “it is impossible to view the 1.5% figure as anything other than a smallish number picked out of a hat.”

8. Id. at 1961 (emphasis in original). In a footnote, the court added: “We note that, if the creditor could somehow be certain a debtor would complete his plan, the prime rate would be adequate to compensate any secured creditors forced to accept cramdown loans.” Id. at 1961 n.18.
9. Id. at 1961.
10. Id.
11. Id. at 1962.
12. See id.
13. Id. at 1968 (Scalia, J., dissenting).
14. Id. at 1969 (Scalia, J., dissenting). The dissent also noted that the actual rate of plan failure is most likely much higher than the 37% figure, with studies suggesting a failure rate perhaps as high as 60%. Id. n.1 (Scalia, J., dissenting).
15. Id. at 1973-74 (Scalia, J., dissenting).
Policy issues aside, the most problematic aspect of the plurality's formula approach is that while one component of it is certainly objective, the other, and perhaps more important component (the upward adjustment) remains totally subjective; courts are given little guidance either by statute or by the plurality on how to apply that formula. As the dissent noted, the plurality begins with a number that, "while objective and easily ascertainable, is indisputably too low."16 It then adds a risk premium that "is neither objective nor easily ascertainable."17 Noting that risk premiums could be substantially greater than the prime rate itself if properly computed, the dissent observed that "the prime rate becomes the objective tail wagging a dog of unknown size."18

The plurality mentioned several risk factors. The only ones that seem to be specifically approved, however, include the circumstances of the estate, the nature of the security and its depreciation, the duration and feasibility of the plan, and the probability of plan failure. The "creditor’s circumstances or its prior interactions with the debtor" are no longer considered risk factors.19

In summary, Till provides little guidance to the bankruptcy courts, and at least one commentator questions its precedential value.20 Although Till provides a convenient (albeit incomplete) starting point, it provides very little guidance thereafter and fails to resolve this issue. In the long term, the only permanent solution can come from Congress. Meanwhile, courts and practitioners are each left to their own devices, presumably on a case-by-case basis, with procedural devices such as standing orders and operating guidelines even called into question.21

Creative debtor’s counsel, for example, may simply file a prime rate plan that, in the absence of a secured creditor’s objection, could be confirmed. In the absence of standing orders or court-imposed guidelines (which, if they survived Till, will vary among jurisdictions) creditors must proceed with the formality of objecting to every plan until appropriate precedent is established. Plan feasibility and the rate of depreciation of collateral are two issues that may now need to be litigated that much more often in the post-Till environment.22

16. Id. at 1972 ( Scalia, J., dissenting).
17. Id.
18. Id. at 1973 ( Scalia, J., dissenting).
19. Id. at 1961. Again, the court does not cite to the Bankruptcy Code to support this contention.
22. See id. For other commentary on the possible future impact of Till, see generally James J. Haller, What Till v. SCS Credit Corporation Means for Your Chapter 13 Clients, 92 ILL. B.J. 478 (2004); Ronald Greenspan & Cynthia Nelson, "Untill" We Meet Again—Why the Till Decision May Not Be the Last Word on Cramdown Interest Rates, 23 AM. BANKR. INST. J. 48 (2005).
B. SIXTY-DAY DISCHARGE OBJECTION DEADLINE

NOT JURISDICTIONAL

In Kontrick v. Ryan, the Court addressed Bankruptcy Rule 4004(a), which governs the time within which to file an objection to a debtor's discharge in a Chapter 7 bankruptcy. In Kontrick, which was addressed in last year's Texas Survey issue, the Supreme Court ruled that the time limits in Bankruptcy Rule 4004 are not jurisdictional. Rather, they are to be considered affirmative defenses that must be raised in a timely responsive pleading.

C. OTHER PENDING MATTERS—IRA EXEMPTION?

The United States Supreme Court granted certiorari in Rousey v. Jacoway, a case on the applicability of the Bankruptcy Code exemption for certain retirement plans to an IRA account. The Eighth Circuit in In re Rousey found that the exemption did not apply, even though the debtor's IRA was a rollover from a pension plan.

This case will most likely be decided before the publication date of this survey.

III. BANKRUPTCY AND HOMESTEAD ISSUES IN THE FIFTH CIRCUIT

A. TIMING OF VALUATION OF SECURED CLAIMS

In In re Stembridge, the Fifth Circuit addressed collateral valuation in Chapter 13 cases from two perspectives—the timing and the method of determining the value of property securing a claim in a Chapter 13 case.

The Fifth Circuit stated the timing issue as follows: "at what point in time should a secured asset be valued for the confirmation of a cram down plan?" The court held that the property should be valued as of the time the bankruptcy was filed. This conclusion was the result of the court's analysis of the concept of adequate protection for the secured creditor's claim that entitles the secured creditor to the present value of...
its claim at the institution of the automatic stay.\textsuperscript{30}

\textit{Stembridge} also addressed the proper method of valuation. This issue was partly settled under \textit{Associates Commercial Corp. v. Rash}.\textsuperscript{31} In \textit{Rash}, the United States Supreme Court held that, in a Chapter 13 context, section 506(a) of the Bankruptcy Code requires a replacement-value standard to determine the amount of an allowed secured claim.\textsuperscript{32} The bankruptcy court in \textit{Stembridge}, however, used what was essentially a trade-in valuation. The Fifth Circuit acknowledged that bankruptcy courts still retain some discretion in determining the replacement value. Given the evidence before the lower court, however, the Fifth Circuit found that the bankruptcy court erred in disregarding a full-replacement-cost valuation.\textsuperscript{33}

As a result of \textit{Stembridge}, the Fifth Circuit values depreciable property securing claims in Chapter 13 cases based upon full replacement value of the property as of the date of the bankruptcy filing.

\section{Foreclosure Sales in Violation of Automatic Stay—Bona Fide Purchasers}

In \textit{In re Cueva},\textsuperscript{34} a real property foreclosure sale occurred some hours after notice of a bankruptcy filing had been faxed to the lender's counsel. Apparently, lender's counsel did not notify the substitute trustee, and the sale went forward. Two purchasers working together were the successful bidders; each agreed to purchase an undivided one-half interest in the property. The purchasers also signed a "Purchaser's Acknowledgment . . . that the sale was subject to bankruptcy by the debtor."\textsuperscript{35}

After learning of the bankruptcy filing, the lender reinstated the debt and returned funds to the foreclosing lawyers. One of the purchasers, despite learning of the bankruptcy, purchased the other one-half interest about five months after the sale.

The purchaser then brought an adversary proceeding seeking a declaration that the post-bankruptcy foreclosure sale was valid and not violative of the automatic stay. The bankruptcy court awarded the buyer an undivided one-half interest in the property based upon his status as a purported good faith purchaser without notice of the bankruptcy at the time of the sale. The court concluded that, although the sale violated § 362, the purchaser did not have notice of the bankruptcy and therefore was a good faith purchaser. The other one-half interest was awarded to the debtor on grounds that the sale to the other original purchaser was void.

\begin{thebibliography}{9}
\bibitem{30} Id. at 387; \textit{see also} \textit{In re Longbine}, 256 B.R. 470, 475 (Bankr. S.D. Tex. 2000).
\bibitem{31} 520 U.S. 953 (1997).
\bibitem{32} Id. at 965.
\bibitem{33} \textit{Stembridge}, 394 F.3d at 386. ("Had the bankruptcy court determined that the replacement value was best captured by the Trade Value, we would find no error. However, the bankruptcy court explicitly premised the Trade Value on the foreclosure value of the vehicle, contrary to \textit{Rash}'s holding.").
\bibitem{34} 371 F.3d 232 (5th Cir. 2004).
\bibitem{35} Id. at 234.
\end{thebibliography}
because of his knowledge of the bankruptcy at the time of the sale. 36

The Fifth Circuit affirmed the district court's reversal of the bankruptcy court, finding that the sale in violation of the automatic stay was invalid, regardless of whether the creditor acted with knowledge of the bankruptcy. 37 In the Fifth Circuit, sales in violation of the stay are voidable and not necessarily void. Therefore, the Fifth Circuit noted that bankruptcy courts may grant retroactive annulment or modification of the stay. In Cueva, however, unlike an earlier Fifth Circuit case, no party requested such retroactive relief, and no such relief was granted. 38

The Fifth Circuit also held that a "bona fide purchaser defense" was not a defense to a claim that a foreclosure sale violated the automatic stay. Rather, the Fifth Circuit held that such a defense, which arises under § 549(c) of the Bankruptcy Code, was not applicable to a sale in violation of the stay. 39

C. CHAPTER 7 DISCHARGE

The Fifth Circuit addressed the right to a Chapter 7 discharge in at least three different cases. Unfortunately, each of these opinions were unpublished at time of publication for the Texas Survey. Given the importance of guidance from the Fifth Circuit on this issue, however, they are addressed below.

In In re Mitchell, 40 the Fifth Circuit reversed a bankruptcy court's findings of whether Chapter 7 debtors made a false oath or account in violation of § 727(a)(4)(A). 41 The court found that the debtor's failure to amend schedules or take other action to correct errors and omissions constituted a "reckless disregard for the truth," which resulted in a denial of their discharge under § 727(a)(4). 42 The court was apparently struck by the fact that the errors and omissions did not consist of a single, isolated

36. Id. at 235-36.
37. Id. at 239.
38. Id. at 236; see Jones v. Garcia, 63 F.3d 411, 412 (5th Cir. 1995) (retroactive relief from stay granted to validate a voidable, but not void, sale); see also In re Calder, 907 F.2d 953, 956 (10th Cir. 1990).
39. In re Cueva, 371 F.3d at 238 ("In short, § 549(c) is not an exception to the automatic stay imposed by § 362, and there is no authority to support [the purchaser's] position to the contrary.").
40. 102 Fed. Appx. 860 (5th Cir. 2004).
41. Section 727(a)(4) provides that a Chapter 7 debtor will receive a discharge, unless:
   The debtor knowingly and fraudulently, in or in connection with the case –
   (A) made a false oath or account;
   (B) presented or used a false claim;
   (C) ***
   (D) withheld from an officer of the estate entitled to possession under this
title, any recorded information, including books, documents, records, and
papers, relating to the debtor's property or financial affairs.
11 U.S.C. § 727(a)(4) (2004). This is a common basis for denying a discharge under § 727. Other common grounds include the conveyance or concealment of property with the intent to hinder, delay, or defraud a creditor within a year prior to the bankruptcy and the failure to explain the loss of assets or deficiency of assets to meet a debtor's liabilities, 11 U.S.C § 727(a)(2), (5) (2004).
42. In re Mitchell, 102 Fed. Appx. at 862. According to the Fifth Circuit:
mistake; rather, the court found that the debtors filed their schedules with a flagrant disregard for the truth. The magnitude of all errors, combined with the debtors' apparent disregard for the obligations of absolute honesty in the bankruptcy process, proved too much for the Fifth Circuit to allow.\footnote{43}

\textit{In re Andrews}\footnote{44} provides somewhat of a contrast. In Andrews, a number of assets were transferred out of a debtor's name before the petition filing because of the family's concern about the debtor's mental and physical health and his ability to avoid the loss of those assets. The Fifth Circuit found that this was a legitimate concern, and the transfers were accomplished without the requisite intent under § 727(a)(2).\footnote{45}

In \textit{In re Womble},\footnote{46} a discharge was denied under § 727(a)(3), which provides that a discharge may be denied for failure to maintain adequate financial records or a failure to explain the pre-petition loss of assets.\footnote{47} In Womble, the creditor satisfied its initial burden of establishing the failure to preserve adequate financial records, shifting the burden to Womble to justify that failure.\footnote{48}

The court found that the debtor was relatively sophisticated and should have maintained adequate financial records. More importantly, it ap-

\begin{quote}
The Mitchell's made the following errors and omissions in their bankruptcy filings: (1) they provided only half a month's income in response to a question that demanded a full month's income; (2) they initially listed a life insurance policy as having no cash value and a face value of $15,000, though it actually had a cash value of approximately $3,500 and a face value of $100,000; (3) they omitted multiple payments made to creditors within 90 days of bankruptcy; (4) in their initial filing, they did not list a counterclaim against Cadle as an asset even though they listed Cadle's claim against them as a liability; (5) they failed to list Mr. Mitchell's substantial vintage-car refurbishing tools in their initial schedules, and their final amended schedules did not include all of the tools and undervalued the remainder; and (6) they omitted a set of Wedgewood china.
\end{quote}

\textit{Id.} at 862-63. The court cited numerous cases where a debtor's cavalier attitude or failure to fully address the necessity of accuracy in their schedules supported a denial of their discharge. \textit{Id. at} 863 n.3; see e.g., \textit{In re Hatton}, 204 B.R. 477, 485 (Bankr. E.D. Va. 1997) (saying a mere "glance over" of a debtor's schedules constituted a reckless disregard for the truth); \textit{In re Gonday}, 27 B.R. 428, 433 (Bankr. M.D. La. 1983) ("Individually, any one answer may have been the result of an innocent mistake. However, the cumulative effect of all the falsehoods together evidences a pattern of reckless and cavalier disregard for the truth . . . ."). For another Fifth Circuit opinion during the survey period, see \textit{In re Lopez}, 111 Fed. Appx. 725 (5th Cir. 2004) (discussing debtor/lawyer who failed to schedule contingent fees and other received fees).

43. \textit{Id.} at 862-63.
44. 98 Fed. Appx. 290 (5th Cir. 2004).
45. \textit{Id.} Section 727 specifically requires that the transfer be done with the "intent to hinder, delay, or defraud a creditor or an officer of the estate." In the absence of that intent, the discharge should be granted. 11 U.S.C. § 727(a)(2) (2004).
46. 108 Fed. Appx. 993 (5th Cir. 2004).
48. The level of the debtor's sophistication and extent of business activities is an issue. The court added: "The justification inquiry should include the education, experience, and sophistication of the debtor; the volume of the debtor's business; the complexity of the debtor's business; the amount of credit extended to the debtor in his business; and any other circumstances that should be considered in the interest of justice." \textit{Womble}, 108 Fed. Appx. at 996 (citing Meridien Bank v. Alten, 958 F.2d 1226, 1231 (3d Cir. 1992)).
peared that Womble controlled various business entities that engaged in numerous transfers. Although Womble apparently had records of what amounted to cash flow in and out of his estate, he had no records establishing the basis for such transfers, and he apparently failed to file tax returns for certain of those business entities for some years.  

IV. BANKRUPTCY COURT CASES

A. RURAL HOMESTEAD—“CONSERVATION RESERVE PROGRAM” PROPERTY

In *In re Baker,* the debtor claimed her undivided one-third interest in a 161-acre tract as a rural homestead. The property was not contiguous with the five acre tract on which her actual home was situated. The 161-acre tract was formerly used by the debtor as grazing land for cattle; however, it had been placed in the Conservation Reserve Program (“CRP”). According to the debtor, her twenty-one-year old son still lived with her, and he occasionally hunted on the 161-acre tract. Just before her bankruptcy was filed, however, the debtor entered into a contract for sale covering the entire 161-acre tract. As of the bankruptcy, however, the sale was not completed.

A creditor objected to the homestead claims and argued that the placement of the 161-acre tract in the CRP combined with the debtor’s subsequent contract for sale divested the land of its homestead protection. The creditor’s position was based primarily upon a series of cases holding that non-contiguous tracts on which rent houses are located may deprive the property of its rural homestead character. Those opinions, however, are premised upon the conclusion that mere collection of rent without a present right of possession defeats the homestead claim. Judge Jones found those cases distinguishable. In a situation involving the CRP, the debtor is indeed paid for taking land out of cultivation. The debtor, however, is not precluded from other common uses of the land, and she is still entitled to full possession and control of the property.

Additionally, the mere execution of a contract for sale did not deprive the debtor of her homestead claim. Because the homestead was established in the first place, it was presumed to continue until there was proof of abandonment. Execution of a contract for sale contingent upon third party financing did not divest the land of its homestead protection. Ac-

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49. *Id.* During the survey period, a number of other cases were centered on this issue. See e.g., *In re Geller,* 314 B.R. 800, 807 (Bankr. D.N.D. 2004) (in saying piano and other assets not listed; debtors simply “perused” schedules); *In re Mantra,* 314 B.R. 723, 731 (Bankr. N.D. Ill. 2004) (covering undocumented gambling losses); *In re McNamara,* 310 B.R. 664, 668 (Bankr. D. Conn. 2004) (“double or nothing” wager on assets to have been turned over to ex-wife); *In re Reed,* 310 B.R. 363, 368 (Bankr. N.D. Ohio 2004) (saying so-called “bad habits” was an inadequate explanation).


51. *Id.* at 862.

52. *Id.* at 863 (citing *In re Webb,* 263 B.R. 788 (Bankr. W.D. Tex. 2001)).

53. *Id.* at 863.
cordingly, the debtor's homestead claim was upheld.\(^{54}\)

**B. House(boat) is Not a Home(stead)**

Texas courts have long attempted to liberally construe homestead claims in favor of the claimant. In an apparent case of first impression, however, this liberal construction did not extend to such a claim in a movable houseboat. In *In re Norris*,\(^{55}\) the debtors listed a street address in northeast San Antonio on their schedules and claimed a 68-foot Chris Craft boat as a homestead. The bankruptcy court upheld the trustee's objection, and the district court affirmed.

The district court based its opinion primarily upon its construction of both the homestead statute and earlier authority that generally refers to interests in *land*. Even earlier cases dealing with manufactured homes generally addressed structures that could be placed upon or fixed to land.\(^{56}\) The court also found authoritative support from other states, including Florida. In the end, the court determined that the boat, "by virtue of its self-powered mobility, is a moveable chattel, not a permanent residence entitled to homestead protection."\(^{57}\)

**C. Objections to Discharge**

In addition to *In re Mitchell*, discussed above, another case provides a different perspective on objections to a debtor's discharge under § 727. In *In re Lee*,\(^{58}\) Judge Leif Clark addressed the limits of conduct that a debtor may engage in while maintaining the right to a discharge. Judge Clark's opinion provides a thorough analysis of various sub-sections of § 724, but the case is perhaps most helpful in the context of the debtors' pre-bankruptcy planning debt against their exempt homestead.

In *Lee*, the debtors sold a business and expected that they would not continue to realize the proceeds of that sale. They owned a homestead, but it appeared that continuing to make the mortgage payment would be difficult. They were able to generate cash proceeds from certain non-exempt assets, a substantial portion of which were used to pay down the debt against their homestead. After effectively converting some non-exempt assets into an investment in their exempt homestead, the Lees filed for Chapter 7 bankruptcy. A creditor filed an adversary proceeding objecting to the Lees' discharge, alleging, among other things, that the pre-

\(^{54}\) *Id.* at 863-64 ("Homesteads are to be liberally construed."). *See In re Perry*, 345 F.3d 303 (5th Cir. 2003); *see also* Painewebber, Inc. v. Murray, 260 B.R. 815, 830-32 (Bankr. E.D. Tex. 2001) (holding that non-contiguous land on which debtor chopped wood, built a duck blind, irrigated, farmed, and used for walking, picnicking, growing hay, and hunting constituted a rural homestead).


\(^{56}\) *Id.* at 250. *See* Capitol Aggregates, Inc. v. Walker, 448 S.W.2d 830, 837 (Tex. Civ. App.—Austin 1969, *writ ref'd n.r.e.*); Cullers v. James, 1 S.W. 314 (Tex. 1886).

\(^{57}\) Norris, 316 B.R. at 251 (basing this conclusion partly on the case of *In re Hacker*, 260 B.R. 542 (Bankr. M.D. Fla. 2000)).

bankruptcy transfers ultimately reducing the debtors' homestead mortgage violated § 727(a)(2)'s prohibition against fraudulent transfers.\textsuperscript{59} The court found that the debtors clearly "chose to maximize the value of their exempt property by selling non-exempt property and using the proceeds to pay off liens on their exempt [homestead]."\textsuperscript{60} The debtors also were aware that there was a good chance they would have lost their homestead considering their age and bleak prospects for future income. "Thus, they were likely not only to be rendered penniless by the pending lawsuits, but also destitute (and homeless) through the loss of their homestead to eventual foreclosure."\textsuperscript{61} The court noted that with the advice of counsel the debtors clearly took actions to maximize their exemptions, paying off one creditor at the expense of others.\textsuperscript{62}

In an effort to apply a consistent standard to pre-bankruptcy planning to maximize otherwise legitimate exemptions, the court reviewed oftencited Fifth Circuit cases addressing this issue. The court, however, was more persuaded by an Arizona bankruptcy case (that analyzed the Fifth Circuit cases).\textsuperscript{63} The Arizona case opines that the best rule does not penalize pre-bankruptcy exemption planning per se; rather, it restricts the application of § 727(a)(2) to situations "in which there is extensive evidence of fraudulent intent, apart from the intent to maximize one's exemptions."\textsuperscript{64} The court acknowledged that the seemingly inconsistent Fifth Circuit decisions were based upon somewhat unique facts. The court also noted the Fifth Circuit's statement in Reed that

\textbf{[w]hile pre-bankruptcy conversion of non-exempt into exempt assets is frequently motivated by the intent to put those assets beyond the reach of creditors, which is, after all, the function of an exemption, evidence of actual intent to defraud creditors is required to support a finding sufficient to deny a discharge.}\textsuperscript{65}

In the end, the court found that the Lees' pre-bankruptcy planning was not motivated by an actual intent to defraud their creditors, and the debtors were properly granted their discharge.\textsuperscript{66} This is clearly a sound deci-

\textsuperscript{59} Id. at 473-74. Section 727(a)(2)(A) provides that a bankruptcy court may deny a debtor's discharge upon showing that "the debtor, with the intent to hinder, delay, or defraud a creditor or an officer of the estate . . . has transferred . . . or has permitted to be transferred . . . property of the debtor, within one year before the date of the filing of the petition . . ." 11 U.S.C. § 727(a)(2)(A) (2004). See also \textit{In re Dennis}, 330 F.3d 696, 701 (5th Cir. 2003).

\textsuperscript{60} Lee, 309 B.R. at 481.

\textsuperscript{61} Id. at 482.

\textsuperscript{62} Id.

\textsuperscript{63} Id. The court was persuaded by \textit{In re Crater}, 286 B.R. 756 (Bankr. D. Ariz. 2002). The court noted the somewhat inconsistent results among the three Fifth Circuit cases mentioned in its opinion. \textit{Crater}, 286 B.R. at 769-70; see, e.g., \textit{In re Swift}, 3 F.3d 929 (5th Cir. 1993); \textit{In re Bowyer}, 932 F.2d 1100 (5th Cir. 1991); First Tex. Sav. Ass'n v. Reed (\textit{In re Reed}), 700 F.2d 986 (5th Cir. 1983).

\textsuperscript{64} Lee, 309 B.R. at 482 (emphasis added) (citing \textit{Crater}, 286 B.R. at 771). See also \textit{Reed}, 700 F.2d at 991.

\textsuperscript{65} Lee, 309 B.R. at 483 (quoting \textit{Reed}, 700 F.2d at 991 (emphasis added by the Lee court)).

\textsuperscript{66} Id. at 486-87.
sion—had Congress intended to prohibit maximizing one's exemptions, appropriate provisions could have been included in the Bankruptcy Code, especially under sections 523 or 727. There is no such prohibition in the Code, and in the absence of clear fraud or other improper activity, legitimate pre-bankruptcy exemption planning should not, by itself, place an otherwise honest debtor's discharge at risk.

D. Arbitration Clauses and the Claims Objection Process

In In re Mirant Corp., the bankruptcy court addressed the conflicting policies of the enforceability of commercial arbitration clauses and the unique power of the bankruptcy court to adjudicate objections to claims. The case turned partly upon what has become known as the National Gypsum test, which essentially looks to the underlying nature of the proceeding before the bankruptcy court—that is, "whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration ... would conflict with the purposes of the Code."

Under the National Gypsum test, if a proceeding does not derive exclusively from the Code, then a bankruptcy court would abstain and allow the parties to arbitrate. On the other hand, the court may deny arbitration if the matter arises directly from the Code and arbitration would conflict with its purpose.

In Mirant, the court found that the allowance, disallowance, or estimation of claims are core proceedings; it was "Congress's intent to leave quantification of a claim to the bankruptcy court." Therefore, the court found that when the claim objection process was implicated, the arbitration clause would not be enforced, and the bankruptcy court would be the proper forum to adjudicate the claim.

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69. In re Nat'l Gypsum Co., 118 F.3d 1056, 1067 (5th Cir. 1997).
70. Id. at 1069.
71. Mirant, 316 B.R. at 239.
72. Id. at 239-40. The court continued:

  The allowance, disallowance and estimation of claims against Debtors are core proceedings pursuant to 28 U.S.C.A. §157(b)(2)(B). Section 502(b) of the Code also evidences Congress's intent to leave quantification of a claim to the bankruptcy court when a party in interest objects to the claim. This procedure for liquidation of claims against a bankruptcy estate and their allowance and disallowance is at the very heart of the bankruptcy court's function and purpose. This court does not therefore read Nat'l Gypsum as empowering parties to use an arbitration clause to divest the bankruptcy court of its generally pervasive authority to control quantification of claims merely because the substance of a claim objection is rooted in state law.

Id.; see also In re UAL Corp., 310 B.R. 373, 377 (Bankr. N.D. Ill. 2004) ("It has long been recognized that one of the essential, 'core' functions of bankruptcy is the allowance or disallowance of claims against the debtor's estate, without regard to the source of the claim.").
V. OTHER CREDITORS' RIGHTS CASES

A. CONTRACTUAL JURY WAIVERS

In re Prudential Insurance Co. of America\textsuperscript{73} arose as a suit for rescission of a commercial lease. There are, however, significant implications for practitioners addressing loan documentation, as well as enforcement of loan documents and other contracts. In Prudential, the parties executed a commercial lease that included a contractual waiver of trial by jury. When the tenant and its guarantors sued for rescission and damages, they demanded a jury trial. The landlord moved to quash the demand, which the trial court denied. The landlord obtained mandamus relief to enforce of the jury waiver as written.\textsuperscript{74}

The tenant argued that a contract to waive a trial by jury is contrary to public policy derived from both the state constitution and rules of civil procedure. The court, however, was more convinced by concepts such as freedom of contract and the enforcement of arbitration clauses, forum selection clauses, and the like.\textsuperscript{75}

The Texas Supreme Court also noted that numerous other states and at least one Texas Court of Appeals had already considered the issue.\textsuperscript{76} Finally, the tenant/guarantors also asserted the lack of conspicuousness, noting that the waiver was in the fifty-third paragraph of a sixty-seven paragraph document and far from the signature line. They also argued that at least one of the parties had not actually read the contract. The court concluded, however, that if the contractual provision otherwise met the elements of a knowing and voluntary waiver, it would be enforceable.

This has obvious implications for the practitioner. It appears that in light of Prudential and the authorities cited within, contractual jury waivers will be enforced in the vast majority of circumstances. This seems to include such waivers in promissory notes, deeds of trust, security agreements, and other loan documents.

B. ATTORNEYS' FEES IN COLLECTION CASES

Although not necessarily a new development, at least two cases during the survey period dealt with the award of attorneys' fees in collection scenarios—specifically, attorneys' fees that exceeded the amount in controversy. In Sibley v. RMA Partners,\textsuperscript{77} the trial court awarded $82,748.50 in attorneys' fees incurred in the enforcement of two notes, the total payoff of which was approximately $43,000. The First District Court of Ap-
peals affirmed the trial court's award of attorneys' fees based upon the trial court's consideration of "the nature and complexity of the case, the amount in controversy, the amount of time and effort required, and the expertise of counsel in arriving at a reasonable amount as attorneys' fees." 78

Although the court acknowledged that the attorneys' fees seemed excessive in comparison to the amount owed, the court emphasized that such a comparison is but one of the factors that the trial court could have considered. 79 The Sibley court also acknowledged that a contractual attorneys' fees provision would take priority over Chapter 38 of the Civil Practice & Remedies Code, which generally requires presentment of a claim before attorney's fees may be awarded under that statute. 80

A similar result was reached in Cordova v. Southwestern Bell Yellow Pages, Inc. 81 In Cordova, over $20,000 in attorneys' fees were awarded on a $7,092 claim. 82 Although attorneys' fees "must bear some reasonable relationship to the amount in controversy," the Cordova court also acknowledged that the amount of damages is but one of many factors to be considered. 83

Cordova involved a counterclaim in which the fees awarded to the plaintiff included those incurred in defending the counterclaim. The court addressed the issue of segregation of fees. Because the plaintiff had to overcome the defendant's counterclaims in order to prevail on its underlying debt collection, the court did not require segregation and affirmed the award of fees despite the overlap in developing the case and defending the counterclaim. 84

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78. Id. at 458 (quoting Stamp-Ad, Inc. v. Barton Raben, Inc., 915 S.W.2d 932, 937 (Tex. App.—Houston [1st Dist.] 1996, no writ)).
79. Id. at 459. See Flint & Assoc. v. Intercontinental Pipe & Steel, Inc., 739 S.W.2d 622, 626 (Tex. App.—Dallas 1987, writ denied) (approving attorneys' fee award of $162,000 when actual damages were under $25,000).
81. 148 S.W.3d 441 (Tex. App.—El Paso 2004, no pet.).
82. Id. at 444.
83. Id. at 448; see also Murcco Agency, Inc. v. Ryan, 800 S.W.2d 600, 602 (Tex. App.—Dallas 1990, no writ) (upholding a $92,000 fee on $28,000 claim).

According to Cordova, the following factors are considered by Texas courts:
(1) the time and labor involved, the novelty and difficulty of the questions involved, and the skill required to perform the legal services properly;
(2) the likelihood that the acceptance of the particular employment will preclude other employment by the lawyer;
(3) the fee customarily charged in the locality for similar legal services;
(4) the amount involved and the results obtained;
(5) the time limitations imposed by the client or the circumstances;
(6) the nature and length of the professional relationship with the client;
(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
(8) whether the fee is fixed or contingent on results obtained or uncertainty of collection before the legal services have been rendered.

Cordova, 148 S.W.3d at 448 (citing Acad. Corp. v. Interior Buildout & Turnkey Constr., Inc., 21 S.W.3d 732, 741 (Tex. App.—Houston [14th Dist.] 2000, no pet.)).
84. Cordova, 148 S.W.3d at 447-49.
VI. FAIR DEBT COLLECTION PRACTICES ACT

During the survey period, the Fifth Circuit Court of Appeals addressed two cases regarding activities governed by the Fair Debt Collection Practices Act ("FDCPA"), which governs consumer debt collection. In *Goswami v. American Collections Enterprise, Inc.*, the debt collector's letter contained a half-inch-thick blue bar across the entire envelope, and read "Priority Letter." The letter itself contained a similar blue bar and the "Priority Letter" marking as a header. Additionally, the letter contained a sub-heading entitled "Settlement Offer & Amnesty," which represented that the debt collector had a limited period of time (30 days) to settle the unpaid balance at a stated discount. In fact, the creditor had authorized the debt collector to give such a discount at any time, not just for the 30 day period referenced in the letter.

The Fifth Circuit addressed two issues. First, it addressed whether the use of the "Priority Letter" marking violated the FDCPA's prohibition against certain markings on debt-collection-letter envelopes; second, it addressed whether the language in the letter regarding the limited settlement period was false or misleading and in violation of the FDCPA.

The court found that the simple marking of a "Priority Letter" did not violate the FDCPA's prohibition against using "any language or symbol, other than the debt collector's address, on any envelope when communicating with a consumer . . . ." The Fifth Circuit found the FDCPA to be ambiguous on this issue, so it turned to legislative history and Federal Trade Commission interpretations. It noted that, according to the FTC, a debt collector does not violate the section in question by using words or notations that do not suggest the purpose of the communication. Because the phrase "Priority Letter" was somewhat benign and similar to the other "harmless words or symbols" previously approved by the FTC, the court held that such printed language does not violate the FDCPA.

The body of the letter of itself, however, "trigger[ed] greater concern." The court found that the debt collector's statement that the discounted settlement was available "only during the next thirty days" was a false or misleading statement, considering the standing authority actually

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86. 377 F.3d 488 (5th Cir. 2004).

87. *Id.* at 492-94. The FDCPA provides that a debt collector "may not use unfair or unconscionable means to collect or attempt to collect any debt." The statute then provides a list of examples of violations, including the following:

88. *Goswami, 377 F.3d at 495.*
granted to the debt collector.\textsuperscript{89} Although the court agreed with the general policy encouraging settlement offers, such a policy would not allow the use of false or misleading statements in the process. Therefore, the court found the debt collector’s “deception” actionable under the FDCPA and “not excused because it is part of a debt collector’s settlement offer.”\textsuperscript{90}

The implications of this finding are obvious. Lawyers have long used a variety of techniques to initiate and continue settlement discussions, including limited disclosure of the nature and extent of a client’s settlement authority. By this holding, however, a “debt collector” may no longer conceal or misrepresent actual settlement authority in attempting to settle a debt under the FDCPA.

In \textit{Owsley v. Coldata, Inc.},\textsuperscript{91} the court issued a \textit{per curiam} opinion regarding a debt collector’s statement in a letter to the effect that an account was “scheduled to be returned to [the creditor] who may [among other things] . . . secure advice of counsel regarding appropriate steps to be taken to enforce payment.”\textsuperscript{92} The debtor contended that the letter violated section 1962e(10) of the FDCPA\textsuperscript{93} because it created a false impression that the debtor’s account would be turned over to a lawyer for legal action. The court noted that the letter did not imply that a lawsuit was imminent or that the debt collector had “any say in whether legal action would be taken.”\textsuperscript{94} To the contrary, the letter indicated a number of different actions the creditor could take. The Fifth Circuit affirmed the trial court’s summary judgment in favor of the debt collector.

This opinion is worth noting primarily because it is indicative of the standard used by the Fifth Circuit in addressing FDCPA claims. As the court stated: “We have not decided whether to view collection notices from the standpoint of the ‘least sophisticated consumer’ or the ‘un sophisticated consumer.’ [T]he difference between the standards is \textit{de minimus} at most.”\textsuperscript{95} In \textit{Owsley}, the court simply concluded that it did not believe that a recipient of Coldata’s letter “with any degree of sophistication” would believe that legal action was imminent.\textsuperscript{96}

\begin{footnotes}
\footnotetext{89}{\textit{Id.} at 495.}
\footnotetext{90}{\textit{Id.} at 496.}
\footnotetext{91}{104 Fed. Appx. 994 (5th Cir. 2004).}
\footnotetext{92}{\textit{Id.} at 995.}
\footnotetext{93}{15 U.S.C. § 1692e(1) (1998) (providing that a debt collector may not use a false, misleading, or deceptive representation in collecting a debt covered by the FDCPA).}
\footnotetext{94}{\textit{Owsley}, 104 Fed. Appx. at 995.}
\footnotetext{95}{\textit{Id.} (quoting Peter v. G.C. Servs., 310 F.3d 344, 348 n.1 (5th Cir. 2002)).}
\footnotetext{96}{\textit{Id.}; see Gammon v. G.C. Servs., 27 F.3d 1254, 1257 (7th Cir. 1994).}
\end{footnotes}