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CREDITOR AND CONSUMER RIGHTS

by

Vernon O. Teofan* and Jeanne E. O'Neill**

THIS Article addresses notable developments under Texas law in the areas of creditor and consumer rights during the period November 1988 through October 1989. During the Survey period the Texas Legislature enacted provisions limiting oral agreements pertaining to loans in excess of \$50,000,¹ established a statutory definition of "rural homestead",² and invalidated the filing of UCC-1 financing statements under a debtor's trade name or assumed name.³ In addition, the Texas courts rendered significant decisions dealing with usury, exemptions, and foreclosure.

I. LEGISLATIVE DEVELOPMENTS

A. Oral Agreements Limited

The Texas Legislature amended the Texas Business and Commerce Code effective September 1, 1989, to add a new section 26.02 restricting the use of oral agreements pertaining to loans by financial institutions.⁴ The amendment renders a loan agreement exceeding \$50,000 in value unenforceable unless it is in writing and is signed by each obligor. In addition, the amendment provides that such a loan agreement may not be modified orally prior to or contemporaneously with the execution of the written contract.

A financial institution claiming the benefits of the amendment must incorporate into the loan documents a conspicuous notice disclaiming the existence and validity of contradictory oral understandings between the parties.⁵ In light of the apparent discrepancy between the language of the statute and the broader suggested notice language, the enforceability of subsequent oral modifications to the written agreement is unclear.

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1. TEX. BUS. & COM. CODE ANN. 26.02 (Vernon Supp. 1990).

2. TEX. PROP. CODE ANN. 41.002(c) (Vernon Supp. 1990).

3. TEX. BUS. & COM. CODE ANN. 9.402(g) (Vernon Supp. 1990).

4. *Id.* 26.02.

5. The notice must be "boldface, capitalized, underlined or otherwise set out from surrounding written material so as to be conspicuous." *Id.* 26.02(e). The notice must substantially conform with the following language: "This written loan agreement represents the final agreement between the parties and may not be contradicted by evidence of prior, contemporaneous, or subsequent oral agreements of the parties. There are no unwritten oral agreements between the parties." (emphasis added; footnote omitted) *Id.*

B. Rural Homestead Definition

Effective August 28, 1989, the Texas Legislature amended the Property Code by adding a new subsection (c) to section 41.002, which provides that "[a] homestead is considered to be rural if, at the time the [homestead] designation is made, the property is not served by municipal utilities and fire and police protection."⁶ By negative implication, a homestead receiving these municipal services will apparently be deemed urban.⁷ The ramifications of the homestead classification are significant: rural homesteads are exempt up to 200 acres for a family and 100 acres for a single adult, without regard to value, whereas urban homesteads are exempt only up to one acre.⁸

The legislature apparently intended to reduce the uncertainty surrounding urban and rural homestead characterizations by overriding existing case law.⁹ Although not expressly stated, it appears that the homestead "designation" could be either voluntary or involuntary. A voluntary designation provides record notice¹⁰ while an involuntary designation aids the enforcement of a judgment debt.¹¹ If a voluntary designation falls within section 41.002(c)'s purview, a timely designation arguably preserves a homestead's character as rural even if the homestead subsequently receives municipal services.¹² It would appear that the property must still be used for the purpose of a rural homestead in order to qualify for the rural homestead exemption.¹³

C. Tradename Filings

The Texas Legislature amended section 9.402(g) of the Texas Business and Commerce Code to invalidate the filing of a UCC-1 Financing Statement filed solely under a debtor's trade name or assumed name, except where the debtor's legal name and assumed or trade name are nearly indistinguishable.¹⁴ The amendment is effective with respect to financing state-

6. TEX. PROP. CODE ANN. 41.002(c) (Vernon Supp. 1990). The statute does not define the terms "municipal utilities" or "designation." Hence, the classification of a property is unclear where some, but not all of the services are provided, or where such services are available but declined by the property owner.

7. *Id.* 41.002.

8. *Id.* 41.002(a), (b).

9. Under existing case law, the urban or rural nature of the property is a fact issue to be determined by a jury. *Kimmev v. Goddrum*, 346 S.W.2d 901 (Tex. Civ. App.—Waco 1961, writ ref'd n.r.e.).

10. TEX. PROP. CODE ANN. 41.005 (Vernon Supp. 1990).

11. *Id.* 41.021-.023.

12. Under prior law, the determination of rural or urban homestead was made at the time a judgment creditor attempted to levy, not when the property was acquired or designated to homestead usage; thus, over time, urbanization in many instances altered the character of the property. *Lauchieimer & Sons v. Saunders*, 97 Tex. 137, 76 S.W. 750 (1903).

13. See *In re Spencer*, — Bankr. — (Case No. 88-12138) (Bankr., W.D. Tex., June 19, 1989); *In re Moellerdorf*, — Bankr. — (Case No. 88-51896-C) (Bankr., W.D. Tex., Jan. 16, 1989).

14. TEX. BUS. & COM. CODE ANN. 9.402(g) (Vernon Supp. 1990). As amended, the statute provides:

A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds

ments filed after August 31, 1989.¹⁵ Under prior law, a trade name filing sometimes effectively perfected a security interest in personal property where creditors generally knew the debtor under the trade name.¹⁶

II. JUDICIAL DEVELOPMENTS

A. Exemptions

During the survey period, several bankruptcy courts considered challenges to the 1987 Property Code amendment exempting retirement plans from attachment by creditors.¹⁷ Although all the courts focused primarily on preemption of the exemption by the Employee Retirement Security Income Act of 1974 (ERISA), they reached widely disparate results.¹⁸

In the case of *In re Dyke*,¹⁹ a doctor, relying on the exemption, sought to exempt approximately \$1,170,000 in retirement funds from his bankruptcy estate.²⁰ The bankruptcy court determined that the state statute "related" to ERISA so as to invalidate the statute under the doctrine of federal preemption.²¹ Accordingly, the retirement funds in *Dyke* remained the property of the bankruptcy estate to be distributed to creditors.²²

To the contrary, the bankruptcy court in *In re Volpe*²³ held the relation of the Texas exemption statute to ERISA "too tenuous, remote or peripheral to 'relate' within the intendment of [ERISA]." Judge Kelly criticized the U.S. Supreme Court's holding in *MacKey v. Lanier Collection Agency & Service*,²⁵ upon which the *Dyke* court relied, stating that "the Supreme Court

other trade names or the names of partners. Filing under a trade name or assumed name alone shall not be sufficient to perfect a security interest unless the trade name or assumed name is so similar to the debtor's legal name that the trade name or assumed name filing would be discovered in a search of the filing officer's records

15. *Id.*

16. *See, e.g.,* *McBee v. Nat'l Bank*, 714 F.2d 1316 (5th Cir. 1983), *cert. denied*, 484 U.S. 848 (1987).

17. TEX. PROP. CODE ANN. 42.0021 (Vernon Supp. 1990). Effective September 1, 1987, 42.0021(a) exempts "a person's right to the assets held in . . . any stock bonus, pension, profit-sharing, or similar plan, including a retirement plan for self-employed individuals . . . unless the plan, contract, or account does not qualify under the applicable provisions of the Internal Revenue Code of 1986."

18. The Employment Retirement Income Security Act of 1974 (ERISA) provides that its provisions "shall supersede any and all state laws insofar as they may now or hereafter relate to any employee benefit plan [covered by this statute]." 29 U.S.C. 1144(a) (1982).

19. 99 Bankr. 343 (Bankr., S.D. Tex. 1989).

20. The debtor claimed the Texas exemption under 11 U.S.C. 522 (1988), which permits debtors to elect state exemptions in bankruptcy.

21. *Dyke*, 99 Bankr. at 352. The court cited *Mackey v. Lanier Collections Agency & Serv.*, 108 S. Ct. 2182 (1988) to support an expansive interpretation of the preemption provision. In *Mackey*, the Court determined that "[a] law 'relates to' an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan 'The preemption provision . . . displace[s] all state laws that fall within its sphere, even including state laws that are consistent with [ERISA].'" *Id.* at 2185 (citations omitted; emphasis in original).

22. *See* 11 U.S.C. 541 (1988).

23. 100 Bankr. 840 (Bankr., W.D. Tex. 1989).

24. *Id.* at 854-55.

25. 108 S. Ct. 2182 (1988).

fell victim to the allure of a well-turned phrase."²⁶ According to the *Volpe* court, a fundamental distinction exists between a state law that makes reference to ERISA, as opposed to a state law making substantive reference to ERISA for purposes of preemption. The court in *Volpe* allowed the debtor, also a doctor, to retain \$478,753 in profit-sharing and individual retirement accounts free of creditor claims.

The bankruptcy court in *In re Laxson*²⁷ upheld the exemption of a debtor's individual retirement accounts totalling less than \$40,000. The *Laxson* court conceded that ERISA arguably preempted the Texas statute, but determined that preemption was limited to the extent that ERISA regulated the exempt assets. Since individual retirement accounts are not governed by ERISA, preemption did not apply to the debtor's individual retirement accounts.²⁸

The court reaffirmed, in part, *In re Komet* (Komet II).²⁹ The bankruptcy court reaffirmed, in part, its prior ruling³⁰ that ERISA preempted the Texas exemption for qualified retirement plans. The *Komet II* court, however, upheld the debtor's claim that the plans were exempt under Bankruptcy Code section 522(b)(2)(A)³¹ by virtue of ERISA's antialienation provision.³² In so holding, the *Komet II* court rejected long established precedent interpreting the Fifth Circuit Court of Appeal's decision in *In re Goff*.³³

Although the Texas Legislature enacted no direct response to the judiciary's challenge to the retirement plan exemption, the legislature did enact a savings clause seeking to minimize the effect of nonbankruptcy federal preemption on bankruptcy cases.³⁴

B. Usury

In *Hardwick v. Austin Gallery of Oriental Rugs, Inc.*³⁵ the Austin court of appeals determined that a charge of interest in excess of the contract rate is per se usurious, even when the rate charged is below the applicable statutory interest ceiling.³⁶ The dispute in *Hardwick* arose under a real estate note providing for interest at ten percent per annum and an additional ten percent

26. 100 Bankr. at 848.

27. 102 Bankr. 85 (Bankr. N.D. Tex. 1989).

28. 29 U.S.C. 1003(a), 1002(2)(A) (1982) and 29 C.F.R. 2510.3-2(d)(1) (1989) make clear that independent retirement accounts are not covered by ERISA.

29. 104 Bankr. 799 (Bankr. W.D. Tex 1989).

30. *Komet I* 93 B.R. 498.

31. 11 U.S.C. 522(b)(2)(A) (1988) exempts "any property that is exempt under Federal [nonbankruptcy] law or state or local law."

32. 104 Bankr. at 805, citing 29 U.S.C. 1056(d) (1982) & Supp. 1986).

33. 706 F.2d 574 (5th Cir. 1983).

34. The clause reads:

If [the exemption for retirement plans] is declared invalid . . . in whole or in part or in certain circumstances, as applied to a person who has not brought a proceeding under title 11, United States Code, [the exemption] remains in effect, to the maximum extent permitted by law, as to any person who has filed that type of proceeding. TEX. PROP. CODE ANN. 41.002(e) (Vernon Supp. 1990).

35. 779 S.W.2d 438, 445 (Tex. App.—Austin 1989, writ requested).

36. See TEX. REV. CIV. STAT. ANN. arts. 5069-1.01 to -1.12 (Vernon 1987 & Supp. 1990).

of the unpaid principal balance as attorney's fees upon default. The corporate borrower contracted to sell the property securing the note, and the lender demanded payment of the ten percent penalty as a condition of releasing the lien. The lender claimed that past late payments triggered the attorney's fee provision.

The appellate court noted that, absent a contrary statutory provision, the general usury limit in effect at the time of the loan's inception was ten percent per annum.³⁷ Although corporations were, and still are, authorized to agree and stipulate to interest rates in excess of the general usury limit,³⁸ the *Hardwick* court noted that enforcement of the penalty provision was authorized neither by the note nor the deed of trust, and hence, fell outside the article 1302-2.09 exception to the general usury limit.³⁹ Accordingly, the court held the payoff demand to be usurious.⁴⁰

As of this writing, writ is pending in the *Hardwick* case. The *Hardwick* decision is in direct conflict with the court of appeals decision in *Butler v Holt*,⁴¹ where the San Antonio court of appeals held a charge under the statutory ceiling to be nonusurious, even though the rate exceeded the contractual limit. In *Butler* the Supreme Court initially granted and recently withdrew a writ of error.⁴²

*Fischer v. Westinghouse Credit*⁴³ involved the application of an interest spreading clause to a late charge imposed by the lender on a past due interest installment. The debt arose under a limited partnership investor note pledged to secure a loan from Westinghouse to the partnership. The partnership's obligations were further secured by a surety bond issued in favor of Westinghouse.

Upon Fischer's failure to remit a \$3,357 interest installment, Westinghouse submitted a proof of loss to the surety. Westinghouse assigned the note to the surety, who, in turn, reimbursed Westinghouse in the sum of \$5,438.03, which included the \$3,357 installment and a late charge of \$2,081.03. Thereafter, the surety accelerated the note and made demand upon Fischer.

Notwithstanding the assignment, Westinghouse subsequently accepted payment of the \$3,357 installment from Fischer and de-accelerated and re-

37. *Id.* art. 5069-1.02 (Vernon 1987). Effective in 1981, the Texas Legislature enacted a provision authorizing parties to contract, in writing, for a higher rate of interest, usually eighteen percent, subsequent to the making of a loan. *Id.* art. 5069-1.04. Where the parties have no agreement as to interest, the applicable usury ceiling is six percent per annum. *Id.* art. 5069-1.03.

38. *Id.* art. 1302-2.09.

39. *Id.*

40. 779 S.W.2d at 445. The court also determined that, although *Hardwick* honestly believed he was entitled to the additional ten percent, the charge was "intentional"; thus *Hardwick* could not rely upon "bona fide error" as a defense to usury. 779 S.W.2d at 443; see TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (Vernon 1987).

41. 741 S.W.2d 169, 175-76 (Tex. App.—San Antonio 1987, writ granted, order withdrawn; denied, *reh's granted in part on other grounds*, 732 S.W.2d 958 (Tex. App.—San Antonio 1987).

42. *Id.*

43. 760 S.W.2d 802, 807 (Tex. App.—Dallas 1988, no writ).

assigned the note from the surety back to itself. After the surety sought to collect the late fee, Fischer commenced an action against the lender and the surety for usury. Each of the parties moved for summary judgment, and the trial court ruled in favor of the lender and surety on the usury claim.

On appeal, the court affirmed the denial of Fischer's summary judgment motion.⁴⁴ The court of appeals next rejected the lender's argument that the late charge should be spread over the entire unpaid principal balance, over the full term of the loan.⁴⁵ The late charge at issue was, apparently, computed as interest on the past-due installment, accruing daily, rather than as a one-time charge. The court held that the past-due installment should be treated as a separate loan for usury purposes and that the late charge should be deemed to be the interest charged on that loan, spread over the time the installment remained unpaid.⁴⁶ The appellate court remanded the usury claim against the lender to the trial court but affirmed the summary judgment as to the surety.⁴⁷

In *Woodcrest Associates, Ltd. v. Commonwealth Mortgage Corp.*⁴⁸ the court considered a usury claim based upon an acceleration letter sent by the lender's attorney. The dispute arose from the lender's efforts to obtain possession of an apartment complex securing the loan. The attorney's letter demanded payment of a specific sum, but referred to the borrower's obligations under the underlying contract, which contained a savings clause.⁴⁹ The court held that the letter incorporated the savings clause by reference, and absent evidence that the lender intended to violate the usury law, the savings clause would be given effect to restrict the demand to the maximum amount allowed by law.⁵⁰

In *Sunbelt Service Corp. v. Vandenburg*,⁵¹ the court of appeals reversed a summary judgment in favor of the general partner of two partnership borrowers who had asserted a usury counterclaim against a lender suing on partnership notes assumed by the general partner.⁵² The general partner relied upon the "Alamo Lumber" doctrine that a borrower's assumption of the debts of a third party as a condition of making a new loan requires the lender to include the debt assumed in its interest calculations.⁵³ The appellate court distinguished the instant case on the grounds that a general partner is liable for the partnerships' debts as a matter of law, thus the assumption was not of a third party's debt, and the usury claim could not be

44. *Id.* at 806. In his pleadings, Fischer conceded that the note was accelerated at the time of demand, and argued that the demand was "tainted" by the subsequent de-acceleration.

45. *Id.* at 807.

46. *Id.*

47. *Id.*

48. 775 S.W.2d 434 (Tex. App.—Dallas 1989, no writ).

49. The documents stated that interest "contracted for, chargeable, or receivable . . . in connection with this loan transaction shall under no circumstances exceed the maximum amount of interest permitted by applicable law." *Id.* at 438.

50. *Id.* at 439.

51. 774 S.W.2d 815 (Tex. App.—El Paso 1989, writ denied).

52. *Id.* at 818.

53. *Alamo Lumber Co. v. Gould*, 661 S.W.2d 926, 928 (Tex. 1983).

sustained.⁵⁴

C. Foreclosures and Guarantor Liability

In *Van Brunt v. BancTexas Quorum*⁵⁵ the Dallas court of appeals denied a secured creditor's deficiency claim against the guarantor based upon non-compliance with the notice provisions governing private sales of collateral,⁵⁶ notwithstanding that the defective private sale yielded significantly more than the prior, properly noticed public sale. In *Van Brunt*, the secured party initially conducted a public sale of collateral upon proper notice and announced its reservation of right to reject any and all bids. At the sale, which the guarantor attended, the highest bid for the collateral was \$40,000. Subsequently, the secured party rejected the \$40,000 bid and negotiated a private sale of the collateral for the sum of \$55,000 without further notice to the guarantor.

In the ensuing deficiency suit, the guarantor argued that the private sale violated section 9.504,⁵⁷ thereby voiding his liability under the guaranty. The trial court found the notice to be sufficient and entered judgment for the secured creditor.

On appeal, the *Van Brunt* court noted that section 9.504⁵⁸ required the secured party to provide reasonable notice of the private sale to the guarantor. The court declined to assume that the guarantor was not harmed by the failure to give adequate notice of the sale. Accordingly, the appellate court reversed the lower court's ruling and entered a take-nothing judgment.⁵⁹

54. 774 S.W.2d at 817.

55. No. 05-87-01165-cv (Tex. App.—Dallas, Aug. 15, 1989) (not yet reported).

56. TEX. BUS. & COM. CODE ANN. 9.504 (Vernon Supp. 1990).

57. No. 05-87-01165-cv (Tex. App.—Dallas, Aug. 15, 1989) (not yet reported), slip op. at 17.

58. *Id.*

59. *Id.*

