Bankruptcy and Creditors' Rights

Roger S. Cox

Recommended Citation
Roger S. Cox, Bankruptcy and Creditors' Rights, 54 SMU L. Rev. 1141 (2001)
https://scholar.smu.edu/smulr/vol54/iss3/4

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

Roger S. Cox*

I. INTRODUCTION-SCOPE OF ARTICLE ................. 1142
II. LEGISLATIVE DEVELOPMENTS ......................... 1142
   A. Bankruptcy Code and Other Federal Statutes .... 1142
      1. Bankruptcy Reform .................................. 1142
   B. State Law—Home Equity Loans ...................... 1143
III. BANKRUPTCY CASES .................................. 1143
   A. Supreme Court Developments ....................... 1143
      1. State Law Governs Establishment of Bankruptcy
         Claims ............................................ 1143
      2. Staking to Surcharge Collateral .................... 1144
   B. Homesteads and Exemptions ......................... 1145
      1. Use of Proceeds of Non-Exempt Property .......... 1145
      2. Exemptions Denied For Constantly Amending
         Schedules ........................................ 1146
   C. Automatic Stay and Adequate Protection .......... 1147
      1. Time for Filing Complaint ......................... 1147
      2. Standing to File a Dischargeability Complaint .. 1148
      3. Credit Card Debt .................................. 1149
      4. Conversion of Collateral ........................... 1151
   D. Chapter 13 Practice ................................ 1152
IV. BANKRUPTCY DEVELOPMENTS IN THE STATE COURTS ............ 1155
   A. Bankruptcy in State Courts Generally ............ 1155
   B. Effect of Discharge on Pending State Court Claim .... 1156
   C. Other Implications of the Automatic Stay ......... 1158
      1. Cases Filed by the Debtor ........................ 1158
      2. Suits Against Multiple Defendants, One of Whom is
         a Debtor ........................................ 1158
      3. Voluntary Dismissal or Non-Suit Affected by
         Automatic Stay? ................................ 1159
V. OTHER CREDITORS’ RIGHTS CASES .................... 1159
   A. Proper Default Judgment Procedure ................ 1159

* Shareholder, Sanders Baker, P.C., Amarillo, Texas. Board Certified in Business
  Bankruptcy Law and Commercial Real Estate Law, Texas Board of Legal Specialization.
  The author gratefully acknowledges the contributions of Stephanie Sherwood, Legal Assistant
  with Sanders Baker, P.C., for her able assistance in research support and manuscript
  preparation.
ALTHOUGH this article includes developments in the bankruptcy courts, the author has attempted to limit the reported cases to those involving state law or other developments that directly impact enforcement of the debtor-creditor relationship. 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.

In recent years, many developments in the bankruptcy courts have arisen out of consumer cases. This year was no exception, so this article devotes a section to developments in Chapter 13 practice. Many of these cases deal more with Bankruptcy Code issues than Texas law; however, familiarity with Chapter 13 practice is ever more crucial to any debtor-creditor practitioner.

II. LEGISLATIVE DEVELOPMENTS

A. Bankruptcy Code and Other Federal Statutes

1. Bankruptcy Reform

During the 2000 legislative session, so called bankruptcy reform legislation remained an issue. Despite versions having passed both the House and the Senate in late 1999, no final legislation emerged from either house until the last hours of the 2000 session. The Senate passed the con-
ference version of the bill, but it faced a White House veto. It is pure speculation at this point, but the reader should assume 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 the current bill.

B. STATE LAW—HOME EQUITY LOANS

There was no legislative session during the Survey period, so there are no Texas legislative developments to report. That said, readers should be on the lookout for possible revisions to the home equity laws in light of the Texas Supreme Court's holding in *Stringer v. Cendant Mortgage Corp.*, which is discussed elsewhere in this Survey.

III. BANKRUPTCY CASES

A. SUPREME COURT DEVELOPMENTS

1. State Law Governs Establishment of Bankruptcy Claims

In *Raleigh v. Illinois Department of Revenue*, the Supreme Court addressed this issue: "[W]ho bears the burden of proof on a tax claim in bankruptcy court when the substantive law creating the tax obligation puts the burden on the taxpayer (in this case, the trustee in bankruptcy)." In other words, does underlying substantive (typically, state) law govern the establishment of a claim, or is there special treatment to be afforded certain claims (i.e., tax claims) in bankruptcy?

The basic facts are that the president of a defunct company was alleged to be liable for an unpaid tax claim as a responsible controlled person. Under Illinois law, the burden of proof in a challenge to such a claim lies with the taxpayer. In this case, the individual taxpayer's bankruptcy trustee assumed the position of the taxpayer and urged for a variety of reasons analyzed by the court and summarized below, that the burden of proof should have been borne by the taxing entity. There was apparently a split among the circuit courts on this issue, and critically, the Fifth Circuit had previously held that in a bankruptcy context, the burden should shift to the tax entity.

In upholding the underlying state law, the court started with this basic proposition: "[c]reditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code." In citing numerous prior Supreme Court cases, the Court continued, "the 'basic federal rule' in bankruptcy is that state law governs the

---

4. 23 S.W.3d 353 (Tex. 2000) (notice requirements regarding use of home equity proceeds to pay third party creditors).
6. *Id.* at 16.
7. *See In re Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993).
substance of claims [citation omitted] Congress having 'generally left the
determination of property rights in the assets of a bankrupt's estate to
state law.' 9 Given that guiding principle, what role does the burden of
proof play in the substantive establishment of a claim? According to the
Court, "given its importance to the outcome of cases, we have long held
the burden of proof to be a 'substantive' aspect of a claim." 10 Critically,
the Court added, "tax law is no candidate for exception from this general
rule. . . ." 11 Regarding the burden of proof, the court also noted that the
bankruptcy court establishes certain burdens of proof in particular situations,
such as seeking relief from the automatic stay, and other unique
procedural settings. 12

The absence of any special burden of proof regarding tax claims in the
bankruptcy court indicated that Congress intended that this issue be left
to substantive law. With the burden of proof having been found to consti-
tute a part of the underlying substantive claim, there was no statutory
basis for shifting that burden, and the Supreme Court likewise refused to
invoke equitable remedies such as "equitable subordination" 13 to vary
from the plain meaning of the Code.

Thus, the finding of Raleigh is a reiteration that underlying substantive
law governs the establishment of a valid claim, with the burden of proof a
substantive part of that claim. There is no special treatment for tax
claims, which would indicate that the prior Fifth Circuit ruling in Placid
Oil 14 is effectively overruled.

2. Standing to Surcharge Collateral

In Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A., 15
an administrative claimant in a Chapter 11 case, which was subsequently
converted to a Chapter 7, sought to surcharge a secured creditor's collat-
eral to recover its administrative claim. In essence, the issue before the
Supreme Court was whether a non-trustee party had standing to assert
this right, which arises out of section 506(c). That section allows the trus-
tee to surcharge certain collateral for the "reasonable, necessary costs

9. Id. (citing Butner v. United States, 440 U.S. 48, 55 (1979)). "Unless some federal
interest requires a different result, there is no reason why [the state] interests should be
analyzed differently simply because an interested party is involved in a bankruptcy
proceeding."

10. Raleigh v. III. Dep't of Revenue, 530 U.S. 11, 20 (2000). "That is, the burden of
proof is an essential element of the claim itself; one who asserts a claim is entitled to
the burden of proof that comes with it." Id.

11. Id. The Court also discussed the various rationales for imposing the burden of
proof on the taxpayer. Id.

12. See, e.g., 11 U.S.C. § 362(g) (allocation of burden of proof on certain issues upon
filing of a motion for relief from the automatic stay). See also discussion in Raleigh, 530
U.S. at 19.

13. Raleigh, 530 U.S. at 20 (citing 11 U.S.C. § 510(c) (equitable subordination of
claims among various creditors)).


and expenses of preserving, or disposing of such property. . . ." The Court concluded that the administrative claimant lacked such standing.

The Court was required to construe the express terms of the statute, which empowered a specific party (the trustee) to exercise this right. Additionally, the trustee's unique role in bankruptcy administration buttressed the apparent exclusivity found in the plain language of the statute. It was not specifically addressed in the statute, but in a Chapter 11, the debtor is typically empowered with the duties and responsibilities of a "debtor in possession," which is analogous to a trustee. That was not the issue in this case, because the party seeking to surcharge the collateral was an administrative claimant, and not the debtor or debtor in possession. The debtor in possession's avoidance powers, however, come from a specific provision in the Bankruptcy Code, which the administrative claimant in Union Planters Bank lacked.

B. Homesteads and Exemptions

1. Use of Proceeds of Non-Exempt Property

The Texas Property Code denies an exemption claim in personal property acquired with the proceeds of non-exempt property, when accomplished with the intent to defraud, delay, or hinder a creditor; however, Texas statutory law is silent when those proceeds are used to acquire or pay for an interest in the debtor's homestead (i.e., real property).

This was put to the test in In re Coates, in which the debtors participated in a variety of ill conceived actions pre-petition. In short, when faced with impending financial difficulties, the debtors first transferred, for no consideration, a promissory note and some non-exempt real estate to their accountant. Later, the note was sold for $80,000 and those proceeds were deposited in the debtors' bank account. Ultimately, the debtors made a number of disbursements from those funds, including paying off liens against two vehicles and paying off the mortgage against their home. The debtors were also apparently receiving legal counseling from one or more lawyers over the course of these transactions.

16. 11 U.S.C. § 506(c). The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim. Id.
17. Union Planters Bank, 530 U.S. at 6. The Court observed:
   First, a situation in which a statute authorizes specific action and designates a particular party empowered to take it is surely among the least appropriate in which to presume non-exclusivity... Second, the fact that the sole party named—the trustee—has a unique role in bankruptcy proceedings makes it entirely plausible that Congress would provide a power to him and not to others.
18. Id. at 7. 11 U.S.C. § 1107 ("subject to... limitations... debtor in possession shall have all the rights... powers... functions and duties... of a trustee serving in a case under this chapter").
21. From the opinion, it appears that the note was transferred to one of the payees. There were no details given of that transaction. Id. at 904 n.4.
The debtors filed Chapter 7 bankruptcy, which was also fraught with problems. Initially, they omitted a number of transactions from their statement of financial affairs, and most importantly, they did not mention the transfer of the note for the $80,000. The Chapter 7 trustee objected to their exemption claims as to the two motor vehicles and homestead, liens against which were paid off with a portion of the note proceeds.

With respect to the subject matter generally, the court acknowledged legislative history prior to the enactment of the Bankruptcy Code in which these types of transfers were not necessarily disfavored. The court noted, however, that the Bankruptcy Code was ultimately enacted with no specific provision in place. With the debtors claiming under the state exemption scheme, however, the court acknowledged the more restrictive approach when there are state law provisions denying exemptions because of fraudulent conduct. This was ultimately dispositive in Coates.

Specifically, the court found that in light of the specific Texas Property Code prohibition, the personal property exemption claims were denied to the extent of the pre-petition payments, and the trustee was awarded a lien against those two vehicles in the amounts paid.

Under Texas law, however, there was no statutory counterpart regarding the homestead. Although a homestead claim could be set aside when the homestead was acquired with “the fruits of a fraud,” simply using non-exempt proceeds to pay off a homestead lien was not subject to the same prohibition. Therefore, the homestead claim was allowed.

2. Exemptions Denied for Constantly Amending Schedules

In In re Park, Judge Donald Sharp denied all exemptions claimed by a debtor who had apparently amended his schedules numerous times throughout the development of his Chapter 7 proceeding. Most of the schedule amendments involved his schedule C exemption claims, which started out reflecting only his homestead. As of the date of his creditors’ meeting, the debtor amended his schedules to reflect the homestead and a substantial amount of personal property. The schedules were also amended numerous times after that, including a fourth and fifth

22. Id. at 905.
23. Id.
24. The trustee was effectively surrogated to the interests of the prior lienholders. Id. at 906 (citing § Tex. Prop. Code § 42.004(a)).
25. Id. at 906-07. The court relied, in part, on In re Reed, 700 F.2d 986 (5th Cir. 1983), which originally arose in the same bankruptcy court. Judge Akard mentioned that at the trial court level, his predecessor denied that debtor’s discharge for engaging in similar acts, including selling substantial non-exempt assets and using proceeds to pay down homestead liens. The Coates opinion does not mention anything about whether the discharge of these debtors was challenged.
27. See id. 839-40.
amended set of schedules after a trial.\textsuperscript{28}

Generally, exemption claims are liberally allowed, as are good faith amendments to a debtor’s schedules.\textsuperscript{29} Even the mere presence of numerous amendments alone will not necessarily limit a debtor’s exemption claims.\textsuperscript{30} That said, a debtor nevertheless had “a positive duty to disclose for the benefit of one’s creditors all of one’s interest in property rights . . . the obligation is strict and the law requires such schedules to be complete and accurate as possible.”\textsuperscript{31} This duty has been described as “paramount,” and a debtor’s failure to meet this obligation strikes “at the heart of the bankruptcy system.”\textsuperscript{32}

In \textit{Park}, the court could not find any level of accuracy or truth to the debtor’s schedules, which appeared “as a constantly shifting landscape.”\textsuperscript{33} The court therefore concluded that the debtor’s non-compliance with the Bankruptcy Code’s mandated disclosure requirement could only result in disallowance of the debtor’s exemption claims.\textsuperscript{34} Additionally, because of related non-disclosure applicable to other assets of the debtor, the debtor’s discharge was also revoked.\textsuperscript{35}

\section*{C. Automatic Stay and Adequate Protection}

\subsection*{1. Time for Filing Complaint}

In \textit{In re Dunlap},\textsuperscript{36} the Fifth Circuit revisited the issue of the timeliness of the filing of a complaint to determine dischargeability, which must be filed within sixty days following the date first set for the Section 341 meeting of creditors. The unique twist in \textit{Dunlap} was provided by the dismissal and subsequent reinstatement of the case.\textsuperscript{37} After reinstatement, a new date for the first meeting of creditors was set, along with a corresponding bar date for non-dischargeability complaints. Additionally,

\textsuperscript{28} Id. In a footnote, the court also concluded that the last amendments fell under the restrictions applicable to amendment of pleadings as governed by the Federal Rules of Civil Procedure. \textit{Id.} at \textsuperscript{1}840 n.3.

\textsuperscript{29} See generally \textit{In re Stone}, 10 F.3d 285, 291 (5th Cir. 1994) (noting that late amendment to schedules is allowed after inadvertent omissions). \textit{But see In re Smith}, 21 F.3d 660, 663-64 (5th Cir. 1994) (applying \textit{Stone} factors, omission was not inadvertent, creditor was prejudiced, etc.—amendment not allowed and claim of creditor omitted from mailing matrix was not discharged).

\textsuperscript{30} \textit{See Park}, 246 B.R. at 841 n.9 (citing \textit{In re Fournier}, 169 B.R. 282 (Bankr. D. Conn. 1994) (noting that amended exemption claims are generally allowed absent bad faith, concealment, or prejudice to creditors)).

\textsuperscript{31} \textit{In re Park}, 246 B.R. 837, 841-42 (Bankr. E.D. Tex. 2000).

\textsuperscript{32} \textit{Id.} at 842 (citing \textit{In re Mohring}, 142 B.R. 389, 394 (Bankr. E.D. Ca. 1992)).

\textsuperscript{33} \textit{Park}, 246 B.R. at 841.

\textsuperscript{34} \textit{Id.} at 844. The court also noted that untimely filed schedules may waive a debtor’s exemption claim unless the untimely filing is permitted by the bankruptcy court, which is typically granted under a fairly liberal standard. \textit{Id.} at 844 n.15.

\textsuperscript{35} \textit{Id.} at 839 n.2.

\textsuperscript{36} 217 F.3d. 311 (5th Cir. 2000).

\textsuperscript{37} The debtor filed a motion to dismiss, and the court entered an order without a hearing. The court subsequently reinstated the case and directed the debtor to reset his motion to dismiss for a hearing. Because of a clerical error, the order vacating the dismissal was not entered until three months after the dismissal.
the debtor purportedly rescheduled the first meeting and issued a notice to that effect. Both dates were docketed by the Bankruptcy Court, but no formal notice was provided.

Two creditors filed complaints to determine dischargeability well after what would have been the bar date following the date first set for the first scheduled meeting, but within the time set by the clerk following the reinstatement. The issue before the Fifth Circuit, however, was how to determine the bar date for filing a non-dischargeability complaint after a bankruptcy court has dismissed, and then reinstated, the case. The court declined to impose any kind of equitable tolling rule; however, the court found that the reinstatement and the clerk’s re-setting of the Section 341 meeting was effectively the new “first date set,” and therefore, the bar date ran sixty days following that new “first date.” The court acknowledged that a tolling rule would avoid the need for prophylactic or preventative filings, but at the expense of the certainty provided by the fixed sixty day filing period. Therefore, the holding of this case is most likely limited to the unusual circumstance of a new “first date” after a dismissal and reinstatement.

2. Standing to File a Dischargeability Complaint

In In re Davis, the Fifth Circuit addressed whether the personal representative of a decedent’s estate had standing to file a non-dischargeability complaint. Under state law, the plaintiff administrator was the only person under the Texas Wrongful Death statute to bring a state court action, because none of the children or parents of the deceased (the real parties in interest) filed within the three month period provided under state law.

After the debtor’s Chapter 7 filing, the administrator filed a complaint to determine the dischargeability of certain debts owing the wrongful death beneficiaries. The debtor filed a motion for summary judgment, alleging that the administrator lacked standing to bring the complaint, arguing that the personal representative was not a “creditor to whom payment is owed” because she was not the real party to whom any such claim would ultimately be payable.

The district court withdrew the bankruptcy reference and the district court subsequently granted the debtor a summary judgment on this issue. The Fifth Circuit reversed, however, finding that as a personal represen-

38. One complaint was filed March 31, 1998, and the other on April 2, 1998. Id.
39. Id. at 317.
40. Id.
41. 194 F.3d 570 (5th Cir. 1999).
42. Texas law provides that a wrongful death action is for the exclusive benefit of the surviving spouse, children, and parents of the deceased; however, if none of those individuals file suit within three months, the personal representative of the decedent’s estate is required to file the action. TEX. CIV. PRAC. & REM. CODE ANN. § 71.004 (Vernon 1997).
43. The action was based on the debtor’s alleged willful and malicious acts under section 523(a)(6).
44. Davis, 194 F.3d at 573; see also 11 U.S.C. § 523(c)(1).
tative of the deceased, she had effectively been granted a claim and the right to payment against the debtor under state law. Therefore, even though she was acting in a representative capacity, the administrator was a creditor with standing to object to the dischargeability of the wrongful death claim.45

3. Credit Card Debt

At least three cases during the Survey period rejected attempts by credit card companies to have credit incurred following pre-approved credit solicitations declared non-dischargeable. In In re Mercer,46 the Fifth Circuit found that a debtor who had received a pre-approved credit card did not commit the elements of fraud necessary to establish non-dischargeability. Not only could the lender not establish the basic elements of fraud,47 the lender was likewise unable to establish its own "justifiable reliance" on any representations made by the debtor.48

While the Fifth Circuit acknowledged that the creditor does not have a duty to investigate the debtor to show justifiable reliance, the court concluded that in accepting an unsolicited, pre-approved credit card, the debtor essentially made no representation at all.49 Most importantly for Texas practitioners, the court noted that to find a fraudulent misrepresentation by the debtor in this context, the Fifth Circuit would have to apply the so-called "implied representation theory" to this scenario, which the court declined to do.50

45. Id. at 574. The opinion provided a lengthy analysis of persons and entities that in their representative capacity, had standing to assert a claim or cause of action, although not the person ultimately entitled to payment. Accordingly, the persons or entities with "statutory authority to prosecute and collect a claim against the debtor, even if other persons are entitled to ultimate payment on the claim" are creditors under the Bankruptcy Code. Id. at 576-77. See, e.g., Nathanson v. Nat'l Labor Relations Board, 344 U.S. 25, 27 (holding that NLRB is the public agent to enforce the National Labor Relations Act); Securities and Exchange Commission v. Kane, 212 B.R. 697, 700 (Bankr. D. Mass. 1997) (holding that the SEC can bring actions to have securities fraud claims declared non-dischargeable); In re Taibbi, 213 B.R. 261, 267 (Bankr. E.D. NY 1997) (holding that county consumer protection agency had standing to sue). Under Texas law, the personal representative of the decedent's estate has exclusive standing, after three months, to prosecute wrongful death claims, even though the statutorily defined persons outlined in footnote 42 are the ultimate beneficiaries of those claims. TEX. CIV. PRAC. & REM. CODE ANN. § 71.004 (Vernon 1997).

46. 211 F.3d 214 (5th Cir. 2000).
47. Id. at 216.
48. Mercer, 211 F.3d at 216-17.
49. Id. at 217.
50. Id. at 218. Under the implied representation theory, the credit card holder purportedly makes a representation that he or she intends to pay each time he incurs a debt, much like the representation that money received as a cash advance from an ATM implies a promise to repay that money. L.A. Capital Fed. Credit Union v. Melancon, 223 B.R. 300, 311 (Bankr. M.D. La. 1998). Again, the Fifth Circuit declined to apply this principle, stat-
Judge Barbara Houser reached a similar result in *In re Kuntz* and *In re Rich*, in which the court provided an in-depth, fact-intensive analyses of yet two more unsolicited credit card scenarios. Like the Fifth Circuit, the court declined to apply the implied representation theory, concluding "that use of a credit card to incur debt does not necessarily involve a representation as a matter of fact or law." The court provides additional analysis of the use of the implied representation theory, even noting divergent views on that theory found in the various concurring opinions in *In re Mercer*.

*Kuntz* is important because it provides additional analysis regarding the debtor's intent to deceive the lender, specifically whether a debtor's hopeless insolvency may give rise to an inference of fraudulent intent. In short, the court applied a "totality of the circumstances test," and found that the debtor's hopeless insolvency did satisfy the intent requirement of section 523(a)(2)(A). That said, the court nevertheless concluded that the lender did not reasonably rely on any representations by the debtor, and found the debt dischargeable.

In a case tried prior to *Kuntz*, which resulted in an opinion issued the same day as *Kuntz*, Judge Houser reached a similar conclusion. In *In re Rich*, the same creditor attempted to have another pre-approved credit card discharged. "We conclude that we should apply a rule that favors the debtor, at least in the pre-approved credit card context, and we decline to apply the implied representation theory."

---

53. The court narrowed the case to five issues:
1. Whether the debtor made a false representation to the lender;
2. Whether the debtor made representations with the intent to deceive;
3. Whether the lender actually and justifiably relied on any misrepresentation;
4. Whether the lender was substantially justified in filing the adversary proceeding; and
5. Whether certain special circumstances exist to make an award of cost and reasonable attorneys' fees unjust.

54. Id. at 701.
55. See id. at 704 n.5.
56. Id. at 706 (citing *In re Boydston*, 520 F.2d 1098, 1101 (5th Cir. 1975)).
57. The factors identified by the court include:
1. The length of time between the charges made and the bankruptcy filing;
2. Whether an attorney was consulted about bankruptcy before the charges were incurred;
3. The number and amount of charges and sudden changes in the debtor's buying habits;
4. The debtor's financial condition and whether debtor was employed;
5. Whether the charges exceeded the credit limit;
6. Whether multiple charges were made on the same day;
7. Debtor's financial sophistication; and
8. Whether purchases were for luxuries.

58. Id. at 708. The court noted the creditor's reliance on what is commonly known in the industry as the FICO score (Fair Isaac Company methodology) to evaluate potential and existing cardholders. Id. at 708, 702.
card debt declared non-dischargeable. The facts were somewhat similar to those in Mercer and Kuntz, so they will not be recited here. Like Kuntz, however, Rich is must read for any creditor whose claim is based on a pre-approved credit card. In addition to the rejection of the implied representation theory, Kuntz and Rich are both important because Judge Houser found that even recognizing the split of authority on the implied representation theory, the lender failed to meet its burden of proof regarding the reliance element. Therefore, it was not substantially justified in filing either adversary proceeding, and the debtors were awarded their attorneys’ fees in defending the proceedings.60

4. Conversion of Collateral

In In re Grisham,61 Judge Stephen Felsenthal addressed the classic issue of whether the unauthorized sale of collateral could give rise to a non-dischargeable claim. In Grisham, two partners, who ultimately became Chapter 7 debtors, operated a partnership that owned and grazed cattle. They had a long term relationship with their lender; however, in the final year of that relationship, the bank alleged that a substantial portion of their cattle herd had been sold without the bank’s knowledge or consent. The individuals, along with their spouses, ultimately filed for Chapter 7 protection.

The creditor whose claim had been secured by the cattle filed an adversary proceeding to determine dischargeability under three subsections of Section 523(a), alleging common fraud,62 fraud, or defalcation in a fiduciary capacity,63 and willful and malicious injury.64 The court easily dismissed the common fraud and fiduciary fraud allegations, finding, respectively, that there was no misrepresentation at the time of the last renewal of the loan,65 and that there was no express or implied trust relationship.66

With those claims dismissed, the court addressed willful and malicious injury. To find the unauthorized sale of collateral non-dischargeable, the court would have to find that the injury was willful, or in other words “a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury.”67 In that regard, the creditor must establish “either an objective certainty of harm or a subjective motive to cause harm.”68 Finally, assuming the injury was committed willfully, the injury must also

60. Kuntz, 249 B.R. at 709; Rich, 249 B.R. at 720.
63. Id. § 523(a)(4).
64. Id. § 523(a)(6).
65. In a fraud context, the critical time of injury is the time of the loan or renewal, not the debtor’s subsequent conduct.
66. The court found that there was no express or implied trust relationship arising out of the security agreement or the bank’s status as a secured creditor. Grisham, 245 B.R. at 71.
67. Id. at 71 (citing Kawaauhau v. Geiger, 523 U.S. 57 (1998)).
68. Id. (citing In re Miller, 156 F.3d 598, 603 (5th Cir. 1998)).
be “malicious,” that is, “without just cause or excuse.” In sum, the court framed the issue as whether the debtors deliberately or intentionally injured the bank in unauthorized collateral sales, and if so, whether the debtors had cause or excuse for their actions.

After a fact intensive inquiry, the court concluded that a substantial portion of the bank’s collateral (cattle) had been sold without the bank’s knowledge or consent. Although the debtors paid down interest on the note, no principal reductions were made following the cattle sales. The debtors argued that proceeds were placed in their account with the bank; however, the court concluded that any such deposits, if made, fell far short of principal reduction or even replenishment of the bank’s collateral. Finding no express authorization for the cattle sales, and given the debtors’ failure to account for the disposition of a substantial amount of the proceeds, the court found a willful and malicious injury, rendering the claim non-dischargeable.

Notably, in addition to the section 523 complaint, the bank took the somewhat unusual step of pressing a complaint under section 727(a)(2), which denies a discharge to a debtor who within one year before filing, transfers property with an intent to hinder, delay, or defraud creditors. Because of the debtor’s failure to account for a substantial amount of the proceeds, the court found that the unauthorized cattle sales not only amounted to a non-dischargeable willful and malicious injury, but also hindered the bank in a Section 727 context. Accordingly, the individual debtors who were principals of the cattle company were denied their discharge.

D. Chapter 13 Practice

1. Wholly Unsecured Claims Against Debtor’s Residence

It is axiomatic that a claim secured by a lien against the debtor’s principal residence cannot be modified in a Chapter 13 plan. This so-called anti-modification provision is codified at section 1322(b) of the Bankruptcy Code, and the typical practice is that any payment arrearage is cured in the plan, but the debtor stays current on post-petition payments coming due under the mortgage.

---


70. “They have not accounted for the remainder and yet did not use the remainder to replenish the collateral or pay the principal of the note.” Id. at 73-74.

71. Id. at 74-75. The Section 727 claim, however, was dismissed as to the spouses.

72. The section reads in pertinent part:

   (b) Subject to subsections (a) and (c) of this section, the plan may –

     (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

This principle typically applies to creditors whose claims are fully or partially secured by the debtor’s residence.\textsuperscript{73} What happens, however, when the claim is secured by the residence, but there is no equity or value for that creditor’s claim? In \textit{In re Bartee},\textsuperscript{74} the Fifth Circuit held that such a claim is essentially unsecured. Because of its unsecured nature, the anti-modification clause would not apply.

In \textit{Bartee}, the creditor was a homeowner’s association with an inferior lien against the residence arising out of unpaid homeowner’s association dues, and its lien was inferior to a prior lien that was equal to or greater than the value of the underlying real property. The Fifth Circuit began its analysis under Section 506(a) of the Bankruptcy Code, which defined secured and unsecured liens.\textsuperscript{75} Recognizing an apparent split in authority on the applicability of the anti-modification provision to wholly unsecured claims,\textsuperscript{76} the court found that under a classic Bankruptcy Code analysis, the claim is essentially unsecured, and therefore the anti-modification provision would not apply.

The debtor advanced a second argument under a relatively narrow exception to the anti-modification provision. In section 1322(c)(2), certain short term debts secured by the residence are excluded from the anti-modification provision.\textsuperscript{77} The court easily rejected that claim, because the nature of the property assessment was not the kind of claim contemplated by the statute, which was designed to address short term contractual payment obligations that matured before the final plan payment date.\textsuperscript{78}

2. Discrimination in Treatment of Co-Signed Debts

During the Survey period, the Fifth Circuit twice rejected attempts by Chapter 13 debtors to provide for extremely favorable treatment of co-signed debts in their Chapter 13 plans. The debtors in \textit{In re Chacon}\textsuperscript{79} attempted to confirm a plan providing that a debt cosigned by the debtor’s father would have priority over all other unsecured claims. Its effect would have been that the cosigned debt would be paid in full, with a high rate of interest, before other claims could be paid. Again recognizing a split in authority,\textsuperscript{80} the court found that the prohibition against un-
fair discrimination found in the statute would apply to a Chapter 13 plan.\textsuperscript{81} Even recognizing that "differences in treatment are not discriminatory if they rationally further a legitimate interest of the debtor and do not disproportionately benefit the cosigner," the court found that a proposal to pay the cosigned debt in full, with interest, before any distributions whatsoever rose to the level of unfair discrimination.\textsuperscript{82}

The same court reached a similar conclusion in \textit{In re Ramirez},\textsuperscript{83} which likewise proposed to pay a cosigned debt in full, with 12% interest, before distribution to unsecured creditors. The pertinent facts were essentially identical with the \textit{Chacon} case, so the court simply cited \textit{Chacon} and affirmed a bankruptcy court order denying confirmation of that plan.\textsuperscript{84}

3. \textit{Property of the Estate—Pre-Conversion Wages}

Another practical reality of Chapter 13 cases is that many wind up converted to cases under Chapter 7. In \textit{In re Stamm},\textsuperscript{85} the Fifth Circuit addressed the practical quandary of what happens to the debtor's wages (a portion of which has presumably been paid over to the Chapter 13 trustee) upon conversion? The Fifth Circuit found that monies paid over from the debtor's wages to the Chapter 13 trustee that are subsequently distributed to the Chapter 7 trustee were not part of the Chapter 7 estate.

According to the Fifth Circuit, this question was resolved by the 1994 Property Code amendments, which specifically provided that upon conversion from Chapter 13 to Chapter 7, property of the estate consists of "the property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion."\textsuperscript{86} In other words, wages that were earned after the filing of the Chapter 13 do not fall within that statutory definition and therefore are not property of the estate upon conversion.\textsuperscript{87}

4. \textit{Chapter 13 Debtor's Standing to Assert Avoidance Actions}

In \textit{In re Stangel},\textsuperscript{88} the debtor filed an adversary proceeding against the

\textsuperscript{81} As quoted in the opinion, the statute allows a plan to "designate a class or classes of unsecured claims . . . but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims." 11 U.S.C. §1322(b)(1). \textit{Id.} at 726.

\textsuperscript{82} \textit{Id.} at 726-27.

\textsuperscript{83} 204 F.3d 595 (5th Cir. 2000).

\textsuperscript{84} \textit{Id.} at 596. In \textit{Ramirez}, Judge Benavides authored a concurring opinion, expressing somewhat different reasoning than the analysis that was stated in the \textit{Chacon} case. \textit{Id.} at 596-97 (Benavides, J. specially concurring).

\textsuperscript{85} 222 F.3d 216 (5th Cir. 2000).

\textsuperscript{86} \textit{Id.} at 217 (emphasis added) (citing 11 U.S.C. § 348(f)(1)).

\textsuperscript{87} \textit{Id.} at 217-18. According to the Fifth Circuit, the statutory amendment and this holding should clarify some confusion that arose under prior versions of the statute and prior opinions. \textit{Id.} at 217 (citing \textit{In re Baker}, 154 F.3d 534, 536 (5th Cir. 1998)); \textit{In re Sandoval}, 103 F.3d 20, 23 (5th Cir. 1997).

\textsuperscript{88} 219 F.3d 498 (5th Cir. 2000).
Internal Revenue Service ("IRS") seeking to avoid an IRS tax lien. The adversary proceeding was filed under section 545 of the Bankruptcy Code, which empowers a trustee to avoid certain statutory liens on property of the debtor. The Fifth Circuit found that the debtor had no standing because of the specific language of Section 545, which allocates this avoidance power specifically to the trustee.\(^8\)

This case should come as no surprise, because unlike a Chapter 11 debtor in possession, a Chapter 13 debtor is not analogous to a trustee, which was noted in a different context in the Union Planters Bank case discussed above.\(^9\) Additionally, the Fifth Circuit had previously reached a similar conclusion in deciding that a Chapter 13 debtor lacked the avoidance powers under section 544 of the Bankruptcy Code.\(^9\) Thus, the adversary proceeding was dismissed due to the debtor’s lack of standing.

**IV. BANKRUPTCY DEVELOPMENTS IN THE STATE COURTS**

**A. Bankruptcy in State Courts Generally**

The Survey period saw an unusual number of state court cases in which the bankruptcy of one or more of the parties impacted the outcome of the case. Some of those cases are discussed in more detail below.

A common thread that runs through many of the state court cases, which differs slightly from holdings in the Fifth Circuit, is the state courts’ view of actions taken in violation of the automatic stay. The Fifth Circuit has steadfastly held that actions taken in violation of the automatic stay are **voidable** rather than **void**.\(^9\) The majority of Texas courts, however, generally find actions taken in violation of the stay to be **void**.\(^9\) At least one state court during the Survey period adhered to this view, acknowledging the persuasive, but non-binding effect of the Fifth Circuit.\(^9\) That same court, however, agreed with the Fifth Circuit that it is possible for a bankruptcy court to retroactively **annul** a stay,\(^9\) but that same court adhered to the more restricted view that termination or modification of the stay (as opposed to annulment) does not retroactively validate actions

---

89. *Id.* at 500 (citing 11 U.S.C. § 545, which reads in part: “the trustee may avoid the fixing of a statutory lien on property of the debtor . . .”). See also 11 U.S.C. § 545.


91. *See In re Hamilton, 125 F.3d 292 (5th Cir. 1997).* As discussed in *Stangel,* the *Hamilton* court reasoned that a Chapter 13 debtor lacks standing to pursue a section 544 avoidance; however, section 1303 allows the debtor certain specified rights of a trustee under section 363. The *Hamilton* court did conclude, however, that the debtor’s suit met the requirements of section 522(h), which allows a debtor to avoid certain non-purchase money liens on otherwise exempt property. Section 522(h), however, is a substantially different type of avoidance power than that found under sections 544 or 545.

92. *In re Jones,* 63 F.3d 411, 412, (5th Cir. 1995) (actions in violation of the stay are **voidable** because the court has the power to annul the stay retroactively); *Sikes v. Global Marine,* Inc., 881 F.2d 176, 178 (5th Cir. 1989).


95. *Id.* at 39 (citing Goswami v. Metro. S&L Ass’n, 751 S.W.2d 487, 489 (Tex. 1988)). *See also Jones,* 63 F.3d at 412.
B. Effect of Discharge on Pending State Court Claim

At least two courts struggled with the concept of what constituted a claim, which would have been discharged in bankruptcy. In Glass v. Prclin, a plaintiff brought suit for damages arising out of the purchase of a house. Before the case was tried, the defendant filed a Chapter 7 bankruptcy in Utah, and the plaintiff was scheduled as an unsecured creditor. The plaintiff filed a proof of claim in the defendant’s bankruptcy. No creditor objected to the debtor’s discharge (or for that matter, to the dischargeability of this particular debt) so the debtor/defendant obtained a discharge in her Utah bankruptcy. The state court case continued to trial. The trial court awarded the plaintiff the house in controversy, and the debtor/defendant appealed.

The debtor/defendant first alleged that the state court had no jurisdiction because the suit was nothing more than an attempt to impose a claim against the debtor, a matter over which the bankruptcy court had exclusive jurisdiction. The court found, however, that the suit was not really one to determine whether the plaintiff had a claim; rather, the state court action was one to recover property or damages. Therefore, the court of appeals refused to hold that the state court lacked jurisdiction.

That said, the court found that because a part of the claim involved an attempt to impose personal liability, the discharge effectively barred the recovery. This was clearly the correct result; however, the court reached its conclusion only after a tortured and unnecessary analysis. In short, this was a claim for fraud, which should have been asserted in the bankruptcy court, and dischargeability of the claim could have been litigated under section 523. Additionally, the court did not address whether continuing to pursue this state court claim after the discharge violated the post-discharge injunction found at section 524 of the Bankruptcy Code.

In this writer’s view, if the court was correct in finding that the debtor’s discharge barred the claim, then the post-discharge injunction should have also barred proceeding with the lawsuit itself.

Similarly, the Waco Court of Appeals found in Janis v. Associates Home Equity Services, Inc., that a suit for a right of recission was effectively an equitable claim that constituted a “debt” discharged by a Chap-

96. Sensitive Care, Inc., 28 S.W.2d at 39 (citing Nautical Landings Marina, Inc. v. First Nat’l Bank, 791 S.W.2d 293, 296 (Tex. App.—Corpus Christi 1990, writ denied)).
97. 3 S.W.3d 135 (Tex. App.—Amarillo 1999, pet. denied).
98. Id. at 136.
99. Id. The court did not explain how a suit for damages is not essentially a “claim” for bankruptcy purposes.
100. The court noted that although this was a suit to recover property, the plaintiff did not have a specific lien or mortgage against the house, thus it was in the nature of a monetary claim, and not a purely an in rem proceeding. Id. at 139-40.
101. Section 524 of the Bankruptcy Code bars pursuit of discharged claims following the entry of a discharge. 11 U.S.C. § 524(a)(3).
102. 29 S.W.3d 244 (Tex. App. – Waco 2000, pet. granted).
ter 7 bankruptcy. Accordingly, that court found that certain claims were discharged and barred by the section 524 post-discharge injunction.\footnote{103}{Id. at 249.}

Unfortunately, a closer reading of Janis reveals that this case may fall under the maxim that “bad facts make bad law.” The item on which recission was sought was a mistakenly delivered release of lien, which was sent to the debtor/borrower in anticipation of a restructuring of a debt secured by real property. The release was mistakenly delivered to the borrower, together with the original note, marked paid. The borrower refused to acknowledge the mistake, so the lender filed suit seeking a declaratory judgment acknowledging the mistake and canceling the release of lien. Shortly thereafter, the borrower filed for Chapter 7 bankruptcy. Although the lender sought relief from the stay to proceed with the state court case, no written order was entered, and the debtor received a discharge. Therefore, the motion to lift the stay was found to be moot.

After the discharge, Associates filed a new suit seeking no monetary relief, but rather, a declaratory judgment that the delivery of the note and release were a mistake and judicial foreclosure of the lien.\footnote{104}{Id. at 247.}

As mentioned, the court of appeals found that the suit for recission was effectively a “claim,” which was discharged. In throwing the baby out with the bath water, however, the effect of this holding was that the creditor lost what had been a perfected interest in property, which was the result of what was clearly a mistake from which state law typically grants relief.\footnote{105}{As the Janis court stated, “Recission is an equitable remedy that operates to set aside a contract that is legally valid but is marred by fraud, mistake, or for some other reason, the court must set it aside to avoid unjust enrichment.” Humphrey v. Camelot Ret. Cmty., 893 S.W.2d 55, 59 (Tex. App.—Corpus Christi 1994, no writ); Country Cubbard, Inc. v. Tex Star Corp., 570 S.W.2d 70, 73 (Tex. Civ. App.—Dallas 1978, writ ref’d n.r.e.).}

This equitable relief could have been granted on what would have amounted to an \textit{in rem} basis, effectively reinstating the lien, without granting the creditor any monetary relief against the debtor personally. Arguably, this could have been accomplished without violating the post-discharge injunction; however, the court of appeals did not see the situation that way. The net effect of this holding is that the debtor used his Chapter 7 bankruptcy discharge in an offensive way to become unjustly enriched as a result of a unilateral mistake by the lender.

Fortunately, as of this writing, the Texas Supreme Court has granted review in Janis, so this holding could be subject to further disposition. Assuming that the court of appeals’ decision stands, it should be read narrowly and applied to its unique set of facts.\footnote{106}{Other than seeking relief from the stay, the opinion did not indicate what other procedures, if any, the lender attempted either pre- or post-petition. For example, it is unclear whether a notice of lis pendens was on record as of the bankruptcy or whether the creditor attempted to remove the state court case to bankruptcy court.}
C. OTHER IMPLICATIONS OF THE AUTOMATIC STAY

1. Cases Filed by the Debtor

It is well settled that the automatic stay of section 362 forbids the commencement of or continuation of action against the debtor. What about cases filed by the debtor, and against another party? In *Montgomery Ward & Co., Inc. v. Denton County Appraisal District*, *107* Montgomery Ward filed suit in state court to compel a reassessment of its personal property for ad valorem tax purposes. While that suit was pending, Montgomery Ward sought relief under Chapter 11. While the Chapter 11 was pending, the state court case was dismissed for lack of prosecution. Montgomery Ward appealed on two grounds: whether the dismissal order violated the automatic stay and whether, under non-bankruptcy procedural grounds, the dismissal deprived Montgomery Ward of due process. *108*

Quite simply, the court found that the language of section 362 precludes only suits against the debtor, and it does not have any application to claims filed by the debtor. Thus, the tax dispute initiated by the debtor was not stayed. Because it was not stayed, the debtor apparently had the obligation to pursue the case under applicable state law and procedure. Therefore, the case was subject to dismissal for want of prosecution. *109*

2. Suits Against Multiple Defendants, One of Whom is a Debtor

In an opinion that as of this writing was unpublished, the Texas Supreme Court addressed the issue of the effect of the automatic stay on multi-party cases when one, but not all defendants are in bankruptcy. In *In re Southwestern Bell Telephone Co.*, *110* the Texas Supreme Court preliminarily found that an order transferring venue, entered while one of a number of defendants was in bankruptcy, was valid as to all of the non-debtor defendants. *111* Presumably, the court was referring to Chapter 7 and Chapter 11 cases, and not Chapter 13, which provides a co-debtor stay with respect to certain consumer debts. Assuming this opinion stands, the court also addressed a point, which often causes confusion in multi-party state court cases. Specifically, the court recognized numerous holdings that “an express severance is not required for the proceedings to


*108* The state court found that the dismissal did not violate the debtor's due process rights, because although the debtor arguably did not receive advance notice of the court’s intent to dismiss, the debtor acknowledged having received the order, or at least having had actual notice of the dismissal within the time to file a motion to reinstate. Thus, the appellate court disposed of the due process argument.

*109* *Id.* at 829-30. This case is apparently consistent with an earlier holding of the Fifth Circuit. See *McMillan v. Mbank Ft. Worth, N.A.*, 4 F.3d 362, 366 (5th Cir. 1993).

*110* 35 S.W.3d 602 (Tex. 2000).

*111* *Id.* at 603. According to the Texas Supreme Court: “When a defendant files a bankruptcy petition, an automatic stay goes into effect and abates any judicial proceeding against that party.” *See 11 U.S.C. § 362(a).* However, the stay only operates against the debtor, and does not operate against non-debtors or even co-debtors, co-tortfeasors, or co-defendants.
continue against the co-debtor.\textsuperscript{112} In a state law context, the net effect of the holding was that the order transferring venue was valid as to the non-debtor party, and a subsequent order entered by the court purporting to set that order aside was void because the trial court had lost jurisdiction as to the non-debtor parties. In the bankruptcy context, the supreme court found that as to the debtor, the prior order was void and not voidable.\textsuperscript{113}

3. \textit{Voluntary Dismissal or Non-Suit Affected By Automatic Stay?}

In \textit{Darr v. Altman},\textsuperscript{114} the 14th Court of Appeals addressed the issue of whether the voluntary dismissal of or non-suit of a suit against a bankruptcy debtor violates the automatic stay. Apparently, according to that court, the majority rule in the Texas courts is that it does not.\textsuperscript{115} The court accordingly found that a dismissal of a bankruptcy debtor was not void, but rather a final, appealable judgment.\textsuperscript{116} The reader is cautioned, however, that not all courts are in agreement on this issue, perhaps even the Fifth Circuit.\textsuperscript{117}

\section*{V. OTHER CREDITORS' RIGHTS CASES}

\subsection*{A. Proper Default Judgment Procedure}

The procedure for obtaining a default judgment in a suit on a note is quite simple; however, a recent case out of the Amarillo Court of Appeals indicates that there are no shortcuts. In \textit{Arenivar v. Providian National Bank},\textsuperscript{118} the creditor filed suit on a note. The petition contained general allegations that the debt was not paid as agreed, and it even alleged a specific amount of principal plus unpaid interest. The plaintiff did not, however, attach copies of the note or any other agreement to the petition.\textsuperscript{119} The creditor apparently forwarded to the court coordinator a motion for entry of a default judgment, together with “supporting docu-
There was no evidentiary hearing, however, conducted in connection with the default judgment. The court entered a monetary judgment based on the debtor's default. The debtor filed a motion for new trial and on appeal asserted that the trial court erred in failing to conduct an evidentiary hearing on damages.

Of course, upon a defendant's default, all allegations of fact contained in the petition are deemed admitted, with the exception of damages. Even with liability established, the issue then becomes whether the amount of damages are liquidated, which occurs "if the amount of damages caused by the defendant can be accurately calculated from (1) the factual, as opposed to conclusory, allegations in the petition, and (2) an instrument in writing." Crucially, the court noted that a claim can seem to be liquidated but in actuality be unliquidated because of pleading allegations that actually require proof for resolution.

In short, with no documentation attached to the petition, the court found that the damages were effectively unliquidated. Therefore, it was error for the court to fail to conduct an evidentiary hearing. Accordingly, the court affirmed the default judgment as to liability but remanded the case for an evidentiary hearing on damages and attorneys' fees.

The moral of Arenavar is that one should not take the pleading and proof requirements for granted, even in a simple suit on a note. Failure to attach the note or other loan documentation to the petition can prove fatal in a summary judgment context without an evidentiary hearing. The better practice is to (a) attach the loan documents to the petition; (b) plead damages with specificity if anticipating a default judgment without an evidentiary hearing; and (c) attach the proof necessary to establish attorneys' fees, which may typically require an evidentiary hearing even if damages are liquidated.

B. FEDERAL PREEMPTION—SUITS BY FOREIGN BANKS

In In re Hibernia National Bank, an out of state bank filed suit on a note against a Texas borrower. The borrower filed a plea in abatement. The documentation apparently included an affidavit by an agent of the plaintiff, which stated the amount due, together with an affidavit of plaintiff's counsel regarding the reasonable and necessary attorneys' fees. Id.

Id. (citing Tex. Commerce Bank, N.A. v. New, 3 S.W.3d 515, 516-17 (Tex. 1999)).

Id. (citing Pentes Design, Inc. v. Perez, 84 S.W.2d 75, 79 (Tex. App.—Corpus Christi 1992, writ denied) (emphasis added)).


Id.

Most notes provide for recovery of "reasonable" attorneys' fees, which would require expert testimony. A court may also take judicial notice of reasonable attorneys' fees, which was apparently not invoked in Arenavar. TEX. CIV. PRAC. & REM. CODE ANN. § 38.004 (Vernon 2000) (court may take judicial notice of usual and customary attorneys' fees).

21 S.W.3d 908 (Tex. App.—Corpus Christi 2000, no pet.).
which was granted by the trial court. This matter was brought to the appellate court by a writ of mandamus.

The debtor’s efforts to fend off the case because of the bank’s foreign status were unsuccessful for two reasons. First, very specific federal law provides that national banks have power “to sue and be sued, complain and defend, in any court of law or equity, as fully as natural persons.”128 Additionally, the United States Supreme Court has previously indicated that national banks “are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the bank’s functions.”129 Accordingly, the court of appeals found that as to foreign national banks, the statutory provision quoted above effectively preempted any state law prohibiting foreign corporations from doing business in Texas.130

Additionally, the court may not have even had to rely on the federal preemption, because the Texas Business Corporation Act specifically excludes most actions to collect debts from the concept of “transacting business” in Texas. Specifically, in its laundry list of exceptions from the definition of “transacting business,” the action of “securing or collecting debts due . . . or enforcing any rights in property securing the same,” does not constitute transacting business.131 Thus, the mandamus was issued, and the foreign bank was properly allowed to continue its suit to collect the debt.

C. DEED OF TRUST FORECLOSURE

1. Oral Announcement of “Sold” Means Sold

In Key v. Pierce,132 a substitute trustee bid $55,068, apparently as a credit bid on behalf of the lender. Pierce, a real estate investor, bid $55,069. The bid was accepted by the trustee, and Pierce was given thirty minutes to return with the money. While Pierce was gone, the trustee was told (incorrectly) that the mortgagors had filed bankruptcy. When Pierce returned with a cashier’s check in the correct amount, the trustee refused to accept the money because of the apparent bankruptcy filing by the mortgagors. Ultimately, it was discovered that the mortgagors had not filed bankruptcy.

Apparently, the property was reposted for sale the following month. At that sale, Pierce re-tendered his $55,069 to the trustee, but the trustee had

128. Id. at 909 (citing 12 U.S.C. § 24 (West 1989)).
131. Hibernia Nat’l Bank, 21 S.W.3d at 910 (citing TEX. REV. CIV. STAT. ANN. art. 8.01B(8) (Vernon Supp. 2000)). On this issue, this was not a case of first impression. See Paskett v. FDIC, 785 S.W.2d 172, 173 (Tex. App.—Houston [14th Dist.] 1990, writ dism’d w.o.j.).
been authorized to substantially outbid Pierce. The lender was announced as the high bidder at this second sale. The lender was deeded the property and subsequently sold it to an unrelated third party, who moved into the property and designated it as their homestead.

Pierce filed suit seeking a declaratory judgment to the effect that he was the successful bidder, and therefore equitable owner of the property. The defendants defended based on the statute of frauds.

The dispositive issue regarding ownership of the property was the trustee's misplaced reliance on the statute of frauds in the context of the trustee's sale, which concluded at the trustee's announcement of "sold." In short, the trial court found, and the appellate court affirmed, that the notice of sale, read together with the underlying deed of trust, provided a sufficient written memorandum of the terms of the sale, especially when considered in connection with the tendered check. Effectively, the sale was complete as of the announcement, and the existing documents (the deed of trust and notice of sale) provided sufficient writings reflecting the essential terms of the sale. Accordingly, Pierce was granted summary judgment, and the subsequent deeds executed at the second sale and on subsequent disposition by the lender were declared void.

D. LIEN PRIORITIES—MOTOR VEHICLE CERTIFICATES OF TITLE

In Bank One Texas, N.A. v. Arcadia Financial, Ltd., an automobile dealer's floor plan lender sought declaratory judgment that its security interest in the dealer's inventory was not cut off by subsequent sales of the vehicles without title transfers. Bank One, the inventory lender, had a perfected security interest in the dealer's inventory, and it also took physical possession of certificates of title. Nine persons apparently bought vehicles, purportedly in the ordinary course of business, financed by Arcadia Financial. The dealer, however, did not transfer the certificates of title to the buyers.

The district court found, and the Fifth Circuit affirmed, that Arcadia, as the purported purchase money lender for the vehicle buyers, was on notice of Bank One's security interest because Bank One's inventory financing statements were apparently filed with the secretary of state. Even though the alleged buyers were given physical possession of the vehicles, the sales were not complete nor in the ordinary course of business because the transfer of the certificates of title never took place. Spe-

133. Pierce also sought damages under the Deceptive Trade Practices Act ("DTPA") and a constructive trust based on fraud and unconscionable conduct.

134. Id. at 708. Again, note that the initial claim was for a declaratory judgment and not for breach of contract, which may have had an impact on the context in which the statute of frauds really applied.

135. Id. at 707-08.

136. 219 F.3d 494 (5th Cir. 2000). This was a diversity case, so the Fifth Circuit applied Texas law. Id. at 498 n.4 (citing Erie R.R. Co. v. Thompkins, 304 U.S. 64 (1938)).

137. The certificates of title remained in Bank One's possession.

138. Id. at 497.
cifically, the Certificate of Title Act provides that a sale does not occur "unless the owner designated in the certificate of title transfers the certificate of title at the time of the sale." Crucially, a footnote to the Fifth Circuit opinion provides that even though the Certificate of Title Act defers to Article 9, earlier Texas opinions found that requiring a certificate transfer in order to complete a sale does not conflict with Article 9. Because a sale never effectively occurred, the buyers acquired no real interest in the vehicles, and they could not grant Arcadia a security interest.

E. Note Purchasers and Assignees

1. Guaranty Agreements

Two cases from the Survey period are indicative of the assignability of the original rights of a payee of a note and/or the beneficiary of a guaranty agreement. First, in *Boyd v. Diversified Financial Systems*, the purchaser of a note from the FDIC brought suit on a guaranty agreement. Specifically, the FDIC was appointed receiver of a failed bank, and approximately four years after the insolvency, the FDIC sold the note and any "collateral documents" which included in the assignment any guarantees, to the note purchaser. The note was endorsed by the FDIC, in its corporate capacity to the purchaser. Factually, the guarantor admitted signing the note and the guaranty agreement.

The debtor asserted numerous defenses and attempts to avoid liability, including an assertion that copies of the note and guaranty (which he had admitted signing) were inadmissible as hearsay. The court found, however, that the copies were admissible. This was distinguished from an earlier opinion on which the guarantor relied, which excluded certain summary documents (and not copies of the actual documents themselves) as hearsay. The guarantor also claimed that the plaintiff was not the holder of the note, because the endorsement came from FDIC corporate rather than FDIC as receiver for the failed bank. The court also disposed of this question based on existing Fifth Circuit authority, the effect of which was that "the FDIC was without question the holder of the note." The guarantor even claimed, unsuccessfully, that the plaintiff was not the holder of the underlying note because it did not have actual

---

140. *Arcadia*, 219 F.3d at 497 n.3. See also *Pfluger*, 620 S.W.2d 739, 741 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e).
141. *Arcadia*, 219 F.3d at 498. "A third party's perfected security interest is not interrupted when a purported buyer attempts to purchase an automobile without receiving title as required to complete a sale under the Certificate of Title Act." *Id.*
142. 1 S.W.3d 888 (Tex. App.—Dallas 1999, no pet.).
143. *Id.* at 890.
144. *Id.* at 891 (distinguishing Sholdra v. Bluebonnet Sav. Bank, 858 S.W.2d 533 (Tex. App.—Ft. Worth 1993, writ denied)).
145. *Id.* at 892 (citing FDIC v. Patel, 46 F.3d 482 (5th Cir. 1995)).
possession. Rather, possession was kept in a vault of one of the plaintiff's investors.

Regarding the guaranty itself, the guarantor argued that the plaintiff was not the actual owner of the guaranty, relying on an earlier case out of the Dallas court. That earlier case was distinguishable because the original guaranty in *Boyd* was clearly in existence and had been assigned by the FDIC. Ultimately, the guarantor asserted what amounted to an "impairment of collateral" defense, based on an alleged failure to perfect a security interest that would have secured the underlying debt. The court found, however, that the debtor specifically waived this defense in the guaranty agreement, which waiver was enforceable. Similarly, in *Cadle Co. v. Regency Homes, Inc.*, the debtor and guarantor took a similar tack in response to a suit filed by another note purchaser based on a promissory note and guaranty agreement acquired from an assignee of the FDIC. Essentially, these debtors' defenses included claims of payment, the lack of a verifiable interest rate due to the failure of the original bank, and the failure to dispose of collateral in a commercially reasonable manner. The debtors managed to convince the trial court; however, the case was reversed and remanded.

The court of appeals recited the basic requirements for recovery on a note. The court next acknowledged the difficulty of establishing interest when the rate is variable, and the index is tied to the prime rate of a failed bank. The court of appeals disposed of the payment claims, finding that the evidence in the trial court was legally and factually sufficient to support the debtor's affirmative defense. The court of appeals also disposed of the variable interest claims, citing case law and statutory developments that in effect modernized the UCC and maintained the ability to preserve the negotiability of variable interest rate notes. Specifically, courts may substitute a reasonable rate of interest, and in *Regency*

---

146. *Id.* at 893 (distinguishing Ashcraft v. Lookadoo, 952 S.W.2d 907, 913-14 (Tex. App.—Dallas 1997), *pet. denied per curiam*, 977 S.W.2d 562 (Tex. 1998)).

147. *Id.* at 893-94. Texas courts have routinely upheld waivers in guaranty agreements. For example, in *Wiman v. Tomaszewicz*, 877 S.W.2d 1, 7 (Tex. App.—Dallas 1994, no writ), a court of appeals held that a guarantor was not released from guaranty liability after renewal of a note, even in light of a $6,000 renewal fee having been added to the debt. The guaranty agreement provided that the note could be extended, renewed, or modified without the guarantor's notice or consent. Similarly, in *Mann v. NCNB Texas National Bank*, 854 S.W.2d 664, 667 (Tex. App.—Dallas 1992, no writ), a guarantor remained liable for non-payment of a loan despite his lack of consent to a number of loan extensions where the guaranty agreement unambiguously waived such notice. Likewise, in *Lawyer's Title Insurance Corp. v. Northeast Texas Development Co.*, 635 S.W.2d 897, 899 (Tex. App.—Tyler 1982, *writ ref'd n.r.e.*), the court held that in light of an unambiguous waiver, the substitution and/or release of underlying collateral would not diminish guaranty liability, even when collateral is released without notice to the guarantors. See also *SEI Bus. Sys., Inc. v. Bank One Texas, N.A.*, 803 S.W.2d 838, 840 (Tex. App.—Dallas 1991, no writ).

148. 21 S.W.3d 670 (Tex. App.—Austin 2000, *pet. denied*).

149. "To collect on a promissory note, a plaintiff must establish: (1) the existence of the note in question, (2) the defendant signed the note, (3) the plaintiff is the owner and holder of the note, and (4) a certain balance is due and owing on the note." *Id.* at 674.

150. *See Amberboy v. Societe de Banque Privee*, 831 S.W.2d 793, 797 (Tex. 1992) (funding a variable rate note is a negotiable instrument).
Homes, the trial court's failure to imply such a reasonable rate of interest was reversible error.\textsuperscript{151}

Regarding the guaranty, the guarantor also relied (unsuccessfully) on the same Dallas Court of Appeals opinion distinguished in Boyd. Specifically, the court of appeals found that the Cadle Company possessed the original guaranty, which was introduced into evidence without objection, and the guarantor also admitted acknowledging the guaranty. The purchase agreement governing the assignment of the notes to Cadle also included in its definition of "collateral documents" personal guaranties, corporate guaranties, etc.\textsuperscript{152} The court found, based in part on the Boyd opinion discussed above, that there was no need to imply a transfer of a guaranty, but rather the transfer was established. Therefore, the Cadle Company owned the guaranty and could enforce it according to its terms.\textsuperscript{153}

Neither Boyd nor Regency Homes necessarily presents a significant change in the law; however, they are both indicative of the potential pitfalls faced by note buyers and successor banks. The bottom line, however, is that assignees and endorsees will typically recover on promissory notes and underlying guaranty agreements if the terms of the original documents are proven up, and particularly if transfer of the ownership of the guaranty can be established. Guaranty agreements will typically be enforced according to their express terms, and payment is an \textit{affirmative defense} that must be established by the payor/debtor/guarantor.

2. \textit{Statutes of Limitations—Subsequent Assignees of FDIC}

In an appeal of yet another attempt to avoid liability on an assigned note, the Eastland Court of Appeals followed Boyd in disposing of Bosque Asset Corp. v. Greenberg.\textsuperscript{154} In Greenberg, the borrower apparently managed to convince the trial court that a slight variance between the name of the payee bank and the name of the bank identified in the comptroller's declaration of insolvency, together with an endorsement from FDIC corporate instead of FDIC receiver, was sufficient to avoid liability on a note. The court of appeals, however, reversed, finding that the bank identified in the declaration of insolvency was the same as the payee of the subject note.\textsuperscript{155} Additionally, following Boyd, the court also found that "it was irrelevant that FDIC corporate endorsed the note, even though FDIC receiver was the purported owner. The relevant fact was that the 'FDIC was without question the holder of the note.'"\textsuperscript{156}


\textsuperscript{152} Regency Homes, Inc., 21 S.W.3d at 682.

\textsuperscript{153} Id. at 683.

\textsuperscript{154} 19 S.W.3d 514 (Tex. App.—Eastland 2000, pet. denied).

\textsuperscript{155} Id. at 518.

\textsuperscript{156} Id. at 519-20 (citing FDIC v. Patel, 46 F.3d 482, 485 (5th Cir. 1995) and Boyd v. Diversified Fin. Sys., 1 S.W.3d 888, 891-92 (Tex. App.—Dallas 1999, no pet.)).
In a somewhat new twist on the six year federal statute of limitations, the borrower argued that even though assignees of the FDIC enjoyed the federal six year statute of limitations, a subsequent assignment destroyed that special status. The court found this argument unpersuasive, finding that to the extent the law of assignments applies to the first assignee, there is no reason to deprive subsequent assignees of the same rights. Therefore, the six year statute applied to the noteholder in this case, even though the noteholder was not the direct assignee of the FDIC. Finally, the borrower argued that because the new noteholder intervened more than six years after the maturity date, its claims were somehow barred, even though the original petition had been filed by the prior owner well within the six year limitations. The court of appeals also disposed of this argument, and the case was reversed.

F. Actual Damages Under Truth in Lending Act

In a case arising out of Louisiana after the Survey period, the Fifth Circuit recently held that a claimant must show detrimental reliance on a lender/lessor's disclosure violation to recover actual damages under the Federal Truth in Lending Act or Consumer Leasing Act. Because Perone v. General Motors Acceptance Corp., was issued after the Survey period and is not yet in the permanent reporter, it will be more thoroughly examined in the next Survey issue.

157. It has long been held by Texas courts that an assignee of the FDIC enjoys the benefit of the same federal six year statute of limitations granted the FDIC. Jackson v. Thweatt, 883 S.W.2d 171 (Tex. 1994).
158. Greenberg, 19 S.W.3d at 521.
159. Id. at 522. The borrower relied on a prior Texas case in which numerous interveners asserted new and different causes of action, which were barred by limitations. In Greenberg, however, the intervention essentially involved a substitution of parties pursuing the original claim, which had been timely filed. Compare Russell v. People's Nat'l Bank of Bellon, 2 S.W.2d 961, 962 (Tex. Civ. App.—Austin 1928, writ ref'd) (intervention by new noteholder asserting same claim does not constitute a new cause of action) with Koch Oil Co. v. Wilber, 895 S.W.2d 854, 863 (Tex. App.—Beaumont 1995, writ denied) (new plaintiffs asserting new causes of action does not relate back to original filing). Both of these cases were cited in Greenberg.
163. The court found that under the plain meaning of these statutes, detrimental reliance was an element of the plaintiff's claim with respect to actual damages. Apparently, this holding did not apply to statutory liquidated damages, regarding which the statute has no similar provision. Id. at 440.