Bankruptcy & (and) Creditors' Rights

Roger S. Cox
BANKRUPTCY & CREDITORS’ RIGHTS

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This topic has been revised somewhat from previous years to emphasize recent developments in bankruptcy and to de-emphasize somewhat caselaw development under the Financial Institutions Reform, Recovery, and Enforcement Act1 (FIRREA) and D’Oench Duhme.2 This article addresses recent development of the application of the federal six-year statutes of limitations; however, FIRREA is covered more extensively in the article on banking law and in other areas of this issue.

Although there is a greater emphasis on developments in bankruptcy law, this article is not intended as an exhaustive survey of all bankruptcy-related caselaw developments in Texas and the Fifth Circuit. Rather, the author has attempted to emphasize those cases that may be of interest to the Texas practitioner or otherwise involve application of Texas law or implementation of Fifth Circuit precedent previously reported in earlier Survey issues.

In the areas of creditors rights and consumer credit, this article addresses cases dealing with such issues as wrongful foreclosure and statutory changes regarding computation of notice periods in real property foreclosure.

The article reviews statutory developments of interest in the above areas. Emphasis is given to the 73rd term of the Texas Legislature, which adjourned in May of 1993. Additional developments in the United States Congress were pending as the Survey period expired.3

I. BANKRUPTCY

A. UNITED STATES SUPREME COURT

During the Survey period, the United States Supreme Court issued only four opinions that directly addressed bankruptcy issues, three of which are reported here. Coincidentally, the first two cases both deal with treatment of residential mortgages in Chapter 13. The third case addresses bar dates and late filed proofs of claim.

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1. Chapter 13 — Home Mortgages

The Supreme Court, in *Nobleman v. American Savings Bank*, held that a Chapter 13 debtor could not reduce an undersecured homestead mortgage to the fair market value of a mortgaged residence. In *Nobleman* the Chapter 13 debtors' modified plan valued their residence at $23,500.00, which was uncontested, and proposed mortgage payments up to that amount plus prepetition arrearages only. According to the lender's proof of claim, the full amount of principal, interest, and fees claimed was $71,335.00.

The debtors, relying on Section 506 of the Bankruptcy Code, sought to treat the remainder of the bank's claim as unsecured. The mortgagee and the Chapter 13 trustee both objected to the modified plan, arguing that bifurcation of the bank's claim into a secured claim and an unsecured claim modified the bank's rights as a mortgagee of a debtor's principal residence, which violated Section 1322(b).

In affirming the Court of Appeals for the Fifth Circuit, the Supreme Court held that to give effect to Section 506(a)'s valuation and bifurcation for a Chapter 13 plan would require a modification of the rights of the holder of the secured claim. Again, this would have violated Section 1322(b)(2), which allows modification of the rights of both secured and unsecured creditors, subject to special protection for creditors whose claims are secured only by a lien on the debtor's principal residence.

Although not key to the court's analysis, *Nobleman* was a practical extension of the court's earlier holding in *Dewsnup v. Timm*. In *Dewsnup* the court found that a Chapter 7 debtor could not "strip" property of a lien to

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5. Id. at 2108.
6. Id.
7. Id. at 2108-09. Section 506(a) provides in part:
   An allowed claim of a creditor secured by a lien on property in which the estate
   has an interest . . . is a secured claim to the extent of the value of such creditor's
   interest in the estate's interest in such property . . . and is an unsecured claim to
   the extent that the value of such creditor's interest . . . is less than the amount of
   such allowed claim.
   Id. at 2109 n.1 (quoting 11 U.S.C. § 506(a) (1988)).
8. Id. at 2109; see also 11 U.S.C. § 1322(b)(2) (1988).
10. *Nobleman*, 113 S. Ct. at 2111. The Court held that the "rights" bargained for by the mortgagor and the mortgagee included those protected from modification by § 1322(b)(2) of the Code. *Id.* at 2110; see also *Dewsnup v. Timm*, 112 S. Ct. 773, 778 (1992). The Court also noted that the mortgagee's rights were not completely unaffected by the Chapter 13 bankruptcy. For instance, the mortgagee was subject to the automatic stay. See 11 U.S.C. § 362 (1988); United Sav. Ass'n v. Timbers of Inwood Forrest Assoc., Ltd., 484 U.S. 365, 369-70 (1988). Moreover, the debtor could have cured pre-petition defaults on their home mortgage by paying off the arrearages over the life of the plan. See 11 U.S.C. § 1322(b)(5) (1988).
11. 11 U.S.C. § 1322(b)(2) provides that a Chapter 13 plan may "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." 11 U.S.C. § 1322(b)(2) (1988) (emphasis added).
the extent the amount of the underlying indebtedness exceeded the value of the property.13 Because the net effect on the respective debtors was the same, it is tempting to view Nobleman as simply another limitation on a debtor's right to bifurcate a secured and unsecured claim. The reader is cautioned, however, to note that the Nobleman court was dealing with a specific statute. The particular statute was Section 1322(b)(2) of the Bankruptcy Code, which deals with a specific type of claim: a claim secured by a debtor's principal residence in the context of a Chapter 13 proceeding. Nowhere in Dewsnup or Nobleman is there any indication that these cases have any direct impact on reorganizations under Chapters 11 or 12 (or for that matter, Chapter 13 debts secured by property other than the debtor's principal residence). Moreover, the Nobleman court acknowledged that the debtors were correct in looking to Section 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim. As the court noted, however, such a determination "does not necessarily mean that the rights the bank enjoys as a mortgagee, which are protected by § 1322(b)(2), are limited by the valuation of its secured claim."14

In Rake v. Wade,15 another Chapter 13 case, the Supreme Court held that an oversecured creditor was entitled to pre-confirmation and post-confirmation interest on home mortgage arrearages paid off under the debtor's Chapter 13 plans. In Rake two pairs of debtors initiated separate Chapter 13 proceedings. Those debtors, together with another married couple, were in arrears on long-term promissory notes held by Wade and secured by the debtors' home mortgages. Those mortgages did not provide for interest on arrearages. The value of the residence owned by each pair of debtors exceeded the respective notes' outstanding balance, making Wade an oversecured creditor. In their Chapter 13 plans, the debtors proposed to make all future payments due on the notes and to pay off arrearages without interest.

The court disregarded the debtors' interpretation of Sections 506(b) and 1322(b)(5). The court specifically held that under Section 506(b), the holder of an oversecured claim is allowed interest on its claim to the extent of the value of the collateral.16 In other words, post-petition interest must be paid on all oversecured claims.17 Turning to Section 1325(a), the debtors asserted that the subsection of that statute directing payment of the "present value" of a secured creditor's claim applies only to secured claims modified in the Chapter 13 plan, which, by reason of Section 1323(b)(2), does not include home mortgages.18 Relying on the plain language of the Code, however, the court held that the secured creditor was entitled to post-confirmation inter-

13. Id. at 778. Dewsnup was reported during last year's Survey period. See Rerko & Esserman, supra note 9, at 1191-92.
16. Id. at 2191.
17. Id. at 2188 (citing United States v. Ron Pair Enter., Inc., 489 U.S. 235, 245 (1989)).
18. Rake, 113 S. Ct. at 2192.
2. Bar Dates; Excusable Neglect

In Pioneer Investment Services, Co. v. Brunswick Associates, Ltd. a number of secured creditors sought leave to file proofs of claim after the bar date that had been included in a notice for meeting of creditors. The creditors sought leave under Bankruptcy Rule 9006(b)(1), which allows a court to permit late filings that result from excusable neglect. The creditors' counsel had assured the creditors that there was not a bar date.

The Supreme Court held that the lawyer's inadvertent failure to file the proofs of claim could constitute "excusable neglect" under the Bankruptcy Rules, even if the neglect was not caused by intervening circumstances beyond the parties' control. The Court added that the proper focus requires taking into account all relevant circumstances, including the danger of prejudice to the debtor, the length of the delay, potential impact on judicial proceedings, reasons for the delay, and whether the creditor acted in good faith. Importantly, the Court noted that a party may be held accountable for its lawyer's acts and omissions, so the focus would be not only on the creditor but their counsel as well. Based on the Court's review of the circumstances, the Court found excusable neglect and allowed the late filing of the claims, based in part on the fact that the debtor's second amended plan of reorganization took into account claims of the moving creditors.

Significantly, the Court also noted that a bar date should be prominently announced and accompanied by an explanation of its significance, criticizing the court's "peculiar and inconspicuous placement of the bar date in a notice regarding a creditors' meeting."

3. Miscellaneous

As Judge Leif Clark has noted, the Supreme Court declined to consider a number of cases that are of importance to the bankruptcy practitioner. For instance, the Court denied certiorari in at least two cases that addressed

19. Id. at 2193-94.
21. Id. at 1491-93; see also FED. R. BANKR. PROC. 9006(b)(1). Rule 3003(c) provides that a court shall fix and for cause shown may extend the time within which proofs of claim or interest may be filed in a Chapter 11 case. Id. 3003(c)(3).
22. Pioneer Inv. Servs., Co., 113 S. Ct. at 1496-98 (1993) (discussing analogous procedural rules dealing with excusable neglect, describing excusable neglect as "a somewhat elastic concept . . . not limited strictly to omissions caused by circumstances beyond the control of the movant").
23. Id. at 1498 (citing the opinion of the Court of Appeals); see Brunswick Assocs. Ltd. Partnership v. Pioneer Inv. Servs., Co. (In re Pioneer Inv. Servs., Co.), 943 F.2d 673, 677 (6th Cir. 1991).
the issue of new value and classification of creditor classes, including the Fifth Circuit case of In re Greystone III Joint Venture.\footnote{See Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture), 948 F.2d 134 (5th Cir.), cert. denied, 113 S. Ct. 72 (1992); Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Properties, XVIII), 961 F.2d 496 (4th Cir.), cert. denied, 113 S. Ct. 191 (1992).} Other issues addressed by the Fifth Circuit in which the Supreme Court denied certiorari include the following: (i) how the rate of interest payable to an oversecured creditor should be determined;\footnote{Crozier v. Bradford (In re Layman), 958 F.2d 72 (5th Cir.), cert. denied, 113 S. Ct. 328 (1992).} (ii) whether the automatic stay prevents ad valorem taxes from becoming perfected post-petition;\footnote{Farmers Branch and Carrollton-Farmers Branch Indep. Sch. Dist. (In re Pointer), 952 F.2d 82 (5th Cir.), cert. denied, 112 S. Ct. 3035 (1992).} and (iii) whether the FDIC’s claims on notes acquired from an insolvent bank were compulsory counterclaims in the maker's fraud action against a bank.\footnote{Douglass v. NCNB Tex. Nat’l Bank, 979 F.2d 1128 (5th Cir. 1992) (ruling that the FDIC’s claims on notes acquired from an insolvent bank were not compulsory counterclaims in the bank’s fraud action), cert. denied, 114 S. Ct. 68 (1993).} Certiorari has been granted, however, in a Ninth Circuit case, In re BFP,\footnote{BFP v. Imperial Sav. & Loan Ass’n (In re BFP), 974 F.2d 1144 (9th Cir. 1992).} which held that the price received at a non-collusive, regularly conducted foreclosure sale irrefutably establishes the reasonably equivalent value in the context of Section 548. This allows a trustee to avoid fraudulent transfers of a debtor’s interest in property.

As Judge Clark also points out, the Supreme Court issued at least one other opinion with ramifications for all federal practitioners, including those who find themselves in bankruptcy court. In Harper v. Virginia Department of Taxation\footnote{Id. at 2517; see also James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991); Murray v. Anthony J. Bertucci Constr. Co., 958 F.2d 127 (5th Cir. 1992).} the Supreme Court established a new precedent regarding whether and to what extent new principles of federal statutory or constitutional law will apply retroactively to other pending cases, stating the new rule as follows:

When this Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events pre-date or post-date our announcement of the rule.\footnote{Clark, supra note 26, at J-8.}

In Judge Clark’s analysis, he points out that this opinion could have significant ramifications in a bankruptcy context, especially in Chapter 13 proceedings, which do not become “final” until a plan is completed and a discharge is granted.\footnote{Clark, supra note 26, at J-8.}

B. FIFTH CIRCUIT

During the Survey period, the United States Court of Appeals for the
Fifth Circuit addressed numerous issues interpreting both federal bankruptcy law and state law.

1. Dischargeability

The Fifth Circuit addressed dischargeability under Section 523 of the Bankruptcy Code on at least four different occasions. First, in In re Coston, the court revisited the issue of "whether the reasonableness of a creditor's reliance under 11 U.S.C. § 523(a)(2)(B)" on a false financial statement "is an issue of law subject to de novo review on appeal or a question of fact to be reviewed under the clearly erroneous standard." Initially, the Fifth Circuit reversed a district court's decision upholding a bankruptcy court's finding that the creditor reasonably relied on the debtor's financial statements. The finding was based on the Fifth Circuit's previous application of the de novo standard of review. In its initial opinion, the Fifth Circuit held that the bank's reliance on the debtor's financial statement "without so much as making a single telephone call to verify liquidity simply was not reasonable." Subsequently, the court noted its conflict with the policy of other circuits and granted rehearing en banc. The court reasoned that the reasonableness of a creditor's reliance should be judged in light of the totality of the circumstances, and "the bankruptcy judge, who is most familiar with those circumstances, should have the benefit of the clearly erroneous rule when making the reasonableness determination." Based on this rationale, the court overruled its previous authority to the contrary. Having reached that conclusion, the court affirmed the lower court's ruling, holding the subject debt nondischargeable.

The effect of the ruling in Coston is that the reasonableness of a creditor's reliance on a materially false financial statement will now be viewed in light of the totality of the circumstances. Furthermore, a bankruptcy court's findings of fact will not be set aside unless the appellate court is "left with a definite and firm conviction that a mistake has been committed."
Approximately a month later, the Fifth Circuit faced another situation involving a false financial statement. In In re Young, the debtor had submitted what the bankruptcy court found was a false financial statement in an effort to obtain a financial guarantee bond. The bankruptcy court found that the bonding company's reliance was reasonable. In applying Coston, the Fifth Circuit reiterated its earlier holding that reasonable reliance is to be determined from the totality of the circumstances, and a bankruptcy court's fact finding on that issue is subject only to review for clear error. Additionally, the contract documents between the debtor and the bonding company provided for payment of attorneys' fees in the event of default. The Fifth Circuit held that the attorneys' fees, in light of New York law, were likewise nondischargeable.

In In re Bennett, the Fifth Circuit addressed Subsection (a)(4) of Section 523, which provides that debts resulting from defalcation by the debtor while acting in a fiduciary capacity are not dischargeable. In Bennett the debtor was the managing partner of a limited partnership that was in turn the managing partner of another limited partnership. The limited partners in the second tier limited partnership sought a determination of dischargeability based upon the debtor's defalcation while acting as what amounted to the managing partner of the managing partner of the subject partnership.

The court first determined that in the context of a limited partnership, the general partner or managing partner, who typically has substantial control over the affairs of the partnership, stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust. Having determined that a managing general partner was in essence a fiduciary, the next step was to determine whether such a fiduciary status should be imposed on one who is not actually the managing partner but rather operates, controls, or manages the managing partner of a limited partnership. The court noted that in the Texas cases addressing this issue, the control enjoyed by the person in question has always been the critical fact.

Having determined that Bennett essentially controlled the limited partnership in question, the court determined that Bennett's charging of repairs (resulting from alleged mismanagement) and equipment leases to the limited partners amounted to a willful neglect of his duties as the managing partner.

46. Id. at 549. The existence of white-outs and handwritten additions to the financial statement did not constitute a "red flag" giving rise to a duty to investigate. Additionally, the court noted uncontroverted testimony that the relevant practice in the industry was to rely solely on documentation presented by the applicant. Id.
47. Id. at 550.
48. LSP Inv. Partnership v. Bennett (In re Bennett), 989 F.2d 779 (5th Cir. 1993).
50. In re Bennett, 989 F.2d at 787; see also Crenshaw v. Swenson, 611 S.W.2d 886, 890 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.); Watson v. Limited Partners of WCKT, Ltd., 570 S.W.2d 179, 182 (Tex. Civ. App.—Austin 1978, writ ref'd n.r.e.).
51. In re Bennett, 989 F.2d at 789.
of the managing partner of the limited partnership. Therefore, those claims were nondischargeable. Additionally, the court found that Bennett’s payment of an unauthorized distribution to himself constituted a breach of his duty of good faith and fair dealing, also non-dischargeable under Subsection (a)(4).

More recently, the Fifth Circuit addressed a common issue arising in dischargeability litigation: the question of issue preclusion. In In re Davis the debtor had been found liable in litigation between the debtor, the majority owner of a corporation, and its minority owner. A state court (pre-petition) awarded substantial damages based on jury findings that the debtor had engaged in a conspiracy to deprive a corporation’s minority shareholder of stock ownership, in addition to committing other wrongful acts. In addition to monetary damages, the trial court granted several equitable remedies, including resulting trust, partition in kind, deed reformation, appointment of a receiver, and dissolution of a partnership. The state court judgment was affirmed in substantial part on appeal.

The defendant then filed bankruptcy, and the successful state court claimant sought a determination of nondischargeability based upon the state court judgment. The evidence in the bankruptcy court consisted of the state court judgment, the jury’s instructions and answers, the appellate court opinion, and testimony of both parties. The entire trial court record was not introduced. Noting that the Supreme Court had recently reaffirmed that issue preclusion principles apply in Section 523 proceedings, the Fifth Circuit applied the three elements of issue preclusion, finding that issue preclusion applied to Davis and affirmed the district court’s findings that the damage claims were nondischargeable. The court then addressed the equitable remedies imposed by the lower courts. The court found three of the five equitable remedies nondischargeable, in part because there were no money damage alternatives.

52. Id. at 790-91. “Defalcation is a willful neglect of duty, even if not accompanied by fraud or embezzlement.” Id. at 790; see also Moreno v. Ashworth, 892 F.2d 417, 421 (5th Cir. 1990).

53. In re Bennett, 989 F.2d at 791.

54. Sheerin v. Davis (In re Davis) 3 F.3d 113 (5th Cir. 1993).

55. See Davis v. Sheerin, 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

56. Sheerin v. Davis (In re Davis), 3 F.3d at 114-15.


58. The elements include the following:

1. the issue to be precluded must be identical to that involved in the prior action;
2. in the prior action, the issue must have been actually litigated; and
3. the determination made of the issue in the prior action must have been necessary to the resulting judgment.

In re Davis, 3 F.3d at 114.

59. Id. at 114. The jury findings regarding the conspiracy allegations and “oppressive” conduct of the debtor were sufficient to preclude relitigation of those issues. Id. at 115. The court declined to impose a requirement that the plaintiff introduce the entire trial record from the state court trial. Id. at 114-15 (citing Tober Saifer Shoe Co. v. Allman (In re Allman), 735 F.2d 863, 865 (5th Cir.), cert. denied, 469 U.S. 1086 (1984)).

60. Id. at 116-17.
In a case handed down after the Survey period, the Fifth Circuit held that a Chapter 7 debtor's discharge of debt in excess of $2,000,000.00 was properly denied for disposing of or encumbering numerous non-exempt assets within a year prior to his bankruptcy. In *In re Swift* 61 the debtor prepaid otherwise dischargeable alimony and satisfied the remaining liability on his otherwise exempt truck. He also under-reported insurance renewal commissions and transferred insurance policies to a family member. There were also short term pre-petition loans and encumbrances between the debtor and various family members immediately pre-petition. Presumably, this case will be reported in the next annual Survey.

2. **Chapter 11 Plan Confirmation — Single Asset Cases**

The Fifth Circuit affirmed a bankruptcy court's confirmation of a single asset case presented by *In re Briscoe Enterprises, Limited II*. 62 The case is significant because of the Fifth Circuit's determination of the burden of proof in the context of plan confirmation. The court also addressed separate classification in light of *Greystone*, 63 not to mention the fact that the case was single asset bankruptcy.

The court found that in both, a consensual plan and a cram-down, the appropriate burden of proof is the preponderance of the evidence standard. 64 The two standards addressed by the court were preponderance of the evidence and clear and convincing evidence. According to the court, "preponderance means that it is more likely than not. Clear and convincing is a higher standard and requires a high probability of success." 65 In addition to the other requirements of Section 1129, which are addressed in the opinion, the court faced a situation where the debtor had classified separately claims of unsecured creditors. This has been a topic of great interest in the context of Chapter 11 reorganizations since the Fifth Circuit's ruling in *In re Greystone*, 66 where the court held that classification of similar claims "in order to gerrymander an affirmative vote on a reorganization plan" is prohibited. As the *Briscoe* opinion points out, however, *Greystone* recognized that there may be good business reasons to support separate classification in certain circumstances. 67 The court found those business purposes present in *Briscoe Enterprises*, emphasizing, however, the narrowness of its holding. 68 The court also found that the plan was proposed in good faith, and also made the

61. Swift v. Bank of San Antonio (*In re Swift*), 3 F.3d 929 (5th Cir. 1993).
64. *In re Briscoe Enter., LTD.*, III, 994 F.2d at 1165.
65. *Id.* at 1164 (citations omitted). The court followed the Supreme Court's ruling in *Grogan v. Garner*, 498 U.S. 279 (1991), in which the court applied the preponderance of the evidence standard to a dischargeability determination.
67. *In re Briscoe Enter., LTD.*, III, 994 F.2d at 1167.
68. *Id.*
other findings necessary to permit cram-down under Section 1129(b).

3. Avoidable Transfers

As discussed elsewhere in this article, Section 548 of the Bankruptcy Code allows a trustee or debtor-in-possession to avoid a transfer of an interest of the debtor in property made or incurred within one year pre-petition if the debtor voluntarily or involuntarily received less than a reasonably equivalent value. In In re Besing the transfer in question was the dismissal, with prejudice, of a state court claim asserted by the debtor. In the state court litigation, the debtor's claim was dismissed, with prejudice, as a result of apparent discovery abuse. The lower courts had held that the dismissal was not a transfer within the context of Section 528, so the debtor's action to avoid the transfer was unsuccessful. The Fifth Circuit affirmed but on other grounds.

The Fifth Circuit found that the dismissal of the plaintiff's claim was a transfer within the broad meaning of that term, which includes involuntary transfers and dispositions of property brought about by state judicial proceedings. "Congress intended for the Code's definition of transfer to be as broad as possible." The transfer, however, was found by the Fifth Circuit to be for reasonably equivalent value because the debtor's state court claims apparently had no merit. Accordingly, even though the Fifth Circuit found that there was a transfer, the debtor failed to establish the other primary element: The transfer was without reasonably equivalent value. Therefore, the Fifth Circuit affirmed.

4. Eligibility

In In re Lindsey, Stephenson & Lindsey a case originating in the Northern District of Texas, the Fifth Circuit held that a nonrecourse obligation was not only a "claim" held by the creditor (the FDIC), but it was also a "debt" for purposes of computing Chapter 12 eligibility. The debtor had asserted that although a nonrecourse note to the FDIC was a claim under the Bankruptcy Code, because there was no recourse liability on the part of the debtor, the claim should not be included as a debt for purposes of

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69. Id. at 1167-69.
70. See infra notes 96 & 131-32.
73. Id. at 1490.
74. Id. at 1492-93.
75. Id. at 1492 (citing S. Rep. No. 989, 95th Cong., 2d Sess. 27 (1978)).
76. Id. at 1496-97.
78. Under the Bankruptcy Code, "claim" means a right to payment, regardless of whether it is liquidated, fixed, contingent, or disputed, or a right to an equitable remedy. 11 U.S.C. § 101(4) (1988).
computing the debtor's aggregate debt in the context of Chapter 12 eligibility. The Fifth Circuit disregarded this attempt at a distinction between the two definitions, relying on at least one United States Supreme Court case reiterating congressional intent that the meanings of “debt” and “claim” be co-extensive. Based on this analysis, the amount of the nonrecourse claim was included in the eligibility computation, and the debtor was ruled ineligible for Chapter 12 relief.

5. Discrimination

The Fifth Circuit reiterated the Bankruptcy Code's prohibition against discrimination, indicating the court's willingness to assume subject matter jurisdiction even after a bankruptcy proceeding has been closed. In In re Bradley the Fifth Circuit reversed the lower courts' dismissal of a debtor's complaint under Section 525 of the Bankruptcy Code arising two years after the debtor's discharge. Given the clear importance of Section 525, which prohibits bankruptcy-based discrimination in the context of government licensing and permits, governmental employment, and private employment, the Fifth Circuit held that a court must assume subject matter jurisdiction in order to determine whether or not a creditor's action violated the anti-discrimination prohibitions of the Code. This is true even when such discrimination occurs after a case has been closed.

C. District and Bankruptcy Courts

1. Substantial Abuse

A Texas bankruptcy court issued an extensive opinion on the issue of dismissal of a Chapter 7 case for "substantial abuse." In In re Fitzgerald Judge Leif Clark was faced with a trustee's motion to dismiss the debtors' Chapter 7 petition for substantial abuse. Specifically, the debtors had a combined gross income in excess of $4,800.00 per month, substantial retirement plans, and, excluding a payment to the debtor's mother, they had approximately $950.00 per month available for debt payment. The debtors were advised of the various chapters but chose Chapter 7. They intended to continue to repay a debt owed to the debtor's mother. The trustee moved for

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80. Only "family farmer(s) with regular annual income" are eligible for relief under Chapter 12. 11 U.S.C. § 109(f) (1988). To be considered a family farmer, a debtor's aggregate debts may not exceed $1,500,000.00. 11 U.S.C. at § 101(17) (1988).


82. In re Lindsey, Stephenson & Lindsey, 995 F.2d at 628.


84. Id. at 804-05. The Fifth Circuit, citing Applegate v. March, 64 B.R. 448, 450 (Bankr. E.D. Va. 1986), noted that "[n]o court in the realm holds such a wide subject matter jurisdiction as does the Bankruptcy Court . . . the entirety of § 525, every word, is utterly sweeping." In re Bradley, 989 F.2d at 804.

dismissal, alleging substantial abuse under Section 707(b) of the Bankruptcy Code. The trustee argued that the debtors' schedules and budget reflected a present ability to fund a Chapter 13 plan that would have yielded a significant return to creditors. The trustee also mentioned the debtors' efforts to prefer the wife's mother over similarly situated creditors.

The court adopted what can be described as a "last resort" analysis. The primary question asks, "is there no other choice available?" In applying its "last resort" analysis, the court noted the numerous alternatives available to the debtors that had not been pursued and granted the trustee's motion. This could be a significant decision for Texas practitioners who should think twice before filing a Chapter 7 petition on behalf of a debtor who has an ability to resolve his or her debt situation by a means other than Chapter 7. This author would suggest that Fitzgerald is must reading for all debtors' counsel.

2. Property of the Estate; Disclaimers as Transfers

In In re Brajkovic the debtor inherited real estate interests in Missouri within a year prior to her Chapter 7 filing in Texas. Prior to the bankruptcy filing, the debtor disclaimed her inheritance to allow it to pass to her four minor children under the decedent's will, in accordance with Missouri law. The bankruptcy court found that although a disclaimer "relates back" to the death of the decedent, it does not change the fact that a "transfer" of property occurred. Disregarding a case out of the Seventh Circuit, Judge Kelly

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86. See 11 U.S.C. § 707(b) (1988) (United States trustee and court given standing to dismiss a case based on substantial abuse of Chapter 7).
88. Id. at 716. The court noted that the test should be broader than whether and to what extent the debtors can fund a Chapter 13 plan. In other words, the court should look to other alternatives besides court-supervised repayment systems. Id. The court mentioned other alternatives such as consumer credit counseling services, assignment for the benefit of creditors, a family supported volunteer payment system, and even Chapter 13 relief. Id. Essentially, this was somewhat of a hybrid of the approach taken in two cases reviewed by Judge Clark. Compare Zolg v. Kelly (In re Kelly), 841 F.2d 908 (9th Cir. 1988) (debtors' ability to fund Chapter 13 plan is primary factor) with In re Harris, 960 F.2d 74 (8th Cir. 1992) (narrow standard applied, somewhat of a rebuttable presumption approach; inquiry into "egregious behavior" disregarded as a prerequisite for dismissal). The Fitzgerald court disagreed with the approach taken by the 4th Circuit. See Green v. Staples, (In re Green), 934 F.2d 568 (4th Cir. 1991) (numerous, and somewhat contradictory, factors taken into account).
90. For a more extreme example, see In re Nolan, 140 B.R. 797 (Bankr. D. Colo. 1992). In that case, the debtor was a sportscaster earning in excess of $170,000 per year. The court also noted numerous necessary lifestyle-related expenses incurred by the debtor all the while the debtor was seeking to discharge his personal liability under Chapter 7. There, the court focused on the debtor's ability to pay his debts, not simply whether he would qualify for Chapter 13 relief. Id. at 802-03 (discussing various approaches taken by courts discussed by Judge Clark in the Fitzgerald case).
92. Id. at 409-10. Section 548 of the Bankruptcy Code provides that a trustee may avoid any transfer of an interest of the debtor in property made or incurred within one year before the filing of the bankruptcy, if the debtor received less than a reasonably equivalent value and was insolvent on the date that the transfer was made. 11 U.S.C. § 548(a) (1988). The Bankruptcy Code defines a transfer as "[e]very mode, direct or indirect, absolute or conditional,
BANKRUPTCY wrote as follows:

When a beneficiary executes a disclaimer, she “parts with” an “interest in property,” i.e., her vested albeit inchoate, interest in property of the decedent. The moment prior to the execution, she has an equitable interest. The moment after, she does not. That is a transfer, pure and simple, and no matter what state law says the effect of such a disclaimer might be, state law may not define the transfer away if, as of the moment of execution, all the requisites for transfer under the Bankruptcy Code are present. No matter how it redefines property interests the moment after the execution of the disclaimer, Missouri law does not purport to rewrite property interests for the time before the execution of the disclaimer. Nor may it, because by doing so, state law would operate to define the transfer out of existence after the fact.93

The Court disagreed with the Seventh Circuit’s analysis in In re Atchison,94 in which the Court held that a valid disclaimer under Illinois law retroactively erased any interest in the person doing the disclaiming.95 Accordingly, the Brajkovic court found that an interest in property was created on the date of the decedent’s death and that a transfer of that interest occurred upon the debtor’s pre-petition execution of the disclaimer. Thus, the transaction was held to meet all of the requirements of a voidable transfer under Section 548 of the Bankruptcy Code.96

In In re Hart97 Judge John Akard found that a Chapter 12 debtor’s inheritance received after the last year of the three-year term of the Chapter 12 plan constituted property of the estate but would not be included within disposable income for purposes of the plan.98 The court reasoned that although the inheritance was received before the case was closed and defined as property of the estate, the decedent’s date of death (and therefore the date the property vested in the debtor) fell well after the conclusion of the debtor’s final “crop year.” It was beyond that anticipated by or the creditors were otherwise covered by the plan.99

3. Lien Avoidance

a. Tools of the Trade

In two opinions authored by Judge John Akard, he reiterated the effect of the Supreme Court’s holding in Owen v. Owen.100 Owen held that a judicial

voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . .” 11 U.S.C. § 101(50) (1988).

95. Id. at 211-12.
96. In re Brajkovic, 151 B.R. at 411-12.
98. Section 541 of the Bankruptcy Code provides that property of the estate includes property that the debtor acquires or becomes entitled to acquire within 180 days after the date of filing. 11 U.S.C. § 541(a) (1988). Additionally, in a Chapter 12 proceeding, property of the estate includes, in addition to that provided by § 541, property acquired by the debtor after the commencement of the case but before the case is closed. 11 U.S.C. § 1207(a) (1988).
100. 111 S. Ct. 1833 (1991). Section 522(f) of the Bankruptcy Code provides that a debtor
lien could be avoided under Section 522(f) of the Bankruptcy Code even though a state statute excluded otherwise exempt property encumbered by a lien.\(^{101}\) This holding effectively overruled Fifth Circuit decisions to the effect that property encumbered by a lien could not qualify for exemption under Texas law, and liens on that property could not be avoided.\(^{102}\) The two opinions were issued in *In re Davis*\(^{103}\) and *In re Neal*.\(^{104}\) Because of an apparent settlement in *In re Neal*, that opinion was vacated; therefore, this discussion will focus on the *Davis* case.

Before reviewing *Davis*, however, it is necessary to go back to *Owen* and its progeny. The Lubbock court first applied *Owen* to *In re Nash*,\(^{105}\) in which the debtors sought to avoid non-possessory, non-purchase money liens against tractors and other items of farm equipment used in the debtor's farming operation. The court, applying *Owen* retroactively, focused the issue on whether this type of farm machinery and equipment was exempt under the Texas Property Code.\(^{106}\) The Court noted that only items "peculiarly adapted to" the debtor's trade or profession are exempt as tools of the trade; but, this could include larger items such as farm equipment.\(^{107}\) The court ruled that Nash's farm equipment qualified as tools of the trade under Texas exemption statute, and because those items took on the character of the state statute providing the exemption, they could be avoided under Section 525(f).\(^{108}\)

Following *Nash*, the court was faced with another farmer seeking to avoid a non-purchase security interest in five items of farm equipment based upon the same analysis provided in *Nash*.\(^{109}\) In *Davis*, however, some of the items were referenced only in security agreements predating the effective date of the Bankruptcy Code. The court allowed avoidance of the security interests that postdated the Code, but it did not allow avoidance as to items contained in security agreements predating the Code.\(^{110}\) The importance of *Davis* is that it reiterates the court's holding in *Nash*.

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1. Owen, 111 S. Ct. at 1838.
2. See Bessent v. United States (*In re Bessent*), 831 F.2d 82 (5th Cir. 1987); Allen v. Hale County State Bank (*In re Allen*), 725 F.2d 290 (5th Cir. 1984).
6. Id. at 151-53. The Texas Property Code provides that farming or ranching vehicles or equipment and tools, equipment, books, and apparatus used in a trade or profession are exempt. TEX. PROP. CODE ANN. § 42.002(a) (Vernon Supp. 1994).
7. *In re Nash*, 142 B.R. at 152 (noting further that there is no longer a requirement that tools of the trade under the Texas exemption apply only to small hand tools or tools of inconsequential value) (citing Hrncirik v. Farmers Nat'l Bank (*In re Hrncirik*), 138 B.R. 835, 839-40 (Bankr. N.D. Tex. 1992) (large farm items)); *In re Hernandez*, 131 B.R. 61, 63 (Bankr. W.D. Tex. 1991) (two gooseneck trailers, a stock trailer, and a box scraper exempt).
10. Id. at 476-77.
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Obviously, the ability to avoid non-purchase money liens against farm equipment has far-reaching implications in agricultural financing. Under Owen, it is clear that a debtor for whom farm equipment is legitimately a tool of the trade may avoid a non-purchase money, non-possessory lien. The Texas Legislature has attempted to address Owen by way of an amendment to Chapter 42 of the Texas Property Code. Specifically, the amendment purports to prohibit the avoidance of any liens or security interests against exempt property solely on the ground that the property is otherwise exempt.\(^\text{111}\) The practical effect of this amendment is uncertain unless and to the extent there is a corresponding amendment to the Bankruptcy Code. As of this writing, such legislation had been introduced in Congress, but its outcome is uncertain as of this writing.\(^\text{112}\)

b. Homesteads — Judgment Liens

In In re Henderson\(^\text{113}\) the court dealt with an attempt at lien avoidance under Section 522 in a slightly different context. The debtors were denied a discharge under Section 727 of the Bankruptcy Code. Prior to their bankruptcy, an abstract of judgment had been recorded creating a judicial lien against all of the non-exempt real property of the debtors located in the county of filing.\(^\text{114}\) Having been denied their discharge, the debtors sought to avoid the judgment lien under Section 522. They claimed that it impaired their homestead exemption. The court held that the debtor could file a motion to avoid the lien, even though the subject debt was nondischargeable, because the purposes of nondischargeability and lien avoidance are different.\(^\text{115}\)

That said, however, because of the well-established principle that a Texas judgment lien will not attach to a homestead, there is no impairment of the debtor's homestead exemption and no encumbering lien to be avoided.\(^\text{116}\) The court interpreted Owen v. Owen, discussed above, to the effect that the purpose of Section 522 is not to confirm or document the absence of liens but to remove voidable liens attached to property so that the debtor may enjoy

\(^{111}\) See Tex. Prop. Code Ann. § 42.002(b) (Vernon Supp. 1994). The amended statute now provides as follows:

(b) Personal property, unless precluded from being encumbered by other law, may be encumbered by a security interest under Section 9.203, Bus. & Comm. Code, or Sections 41 and 42, Certificate of Title Act (Article 6687-1, Vernon’s Tex. Civ. Stat.), or by a lien fixed by other law, and the security interest or lien may not be avoided on the ground that the property is exempt under this chapter.

\(^{112}\) Id. at 160.

\(^{113}\) In re Henderson, 155 B.R. at 159.

\(^{114}\) Id. at 160.

\(^{115}\) See Tex. Prop. Code Ann. § 41.001 (Vernon Supp. 1994). Essentially, § 522(f) is not dependent upon or related to the nature of the debt secured by an otherwise voidable lien. In re Henderson, 155 B.R. at 159.

\(^{116}\) Id. at 160.
the exemption to which he is entitled.\textsuperscript{117} The Court concluded that "where state exemption laws mandate that judicial liens do not attach to a debtor's exempt homestead, a debtor's Section 522(f)(1) motion to avoid the lien is unavailing and must be denied."\textsuperscript{118} Therefore, the debtor's motion to avoid the judgment lien was denied.\textsuperscript{119}

4. \textit{Dischargeability of Student Loans}

Section 523(a)(8) of the Bankruptcy Code provides that an individual may not be discharged from liability for most student loans absent certain limited statutory exceptions.\textsuperscript{120} In at least one Texas bankruptcy court decision, it was held that this non-dischargeability, when applicable, applies not only to the student, but to any person liable on such a debt. In \textit{In re Mackey} \textsuperscript{121} the court held that this subsection of the Code "does not refer to student debtors but limits the discharge of any individual debtor for any debt for covered educational loans. The fact that the student was the maker of the loan and the debtor the co-maker does not change the result."\textsuperscript{122} According to the bankruptcy court, this was a matter of first impression in the Fifth Circuit;\textsuperscript{123} however, the court's ruling was consistent with an earlier district court ruling on the same issue.\textsuperscript{124}

5. \textit{Automatic Stay}

In \textit{In re Abacus Broadcasting Corp.}\textsuperscript{125} the court construed Section 362(h) of the Bankruptcy Code, which provides that "an individual injured by any willful violation of a stay" shall receive actual damages, possibly including costs, attorneys' fees, and, where appropriate, punitive damages.\textsuperscript{126} The court, in interpreting this statute based upon its plain meaning, held that because of the use of the word "individuals," this damage provision of Section 362 is inapplicable to corporate debtors.\textsuperscript{127} The court noted that a corporate debtor is not without relief, however, but has a remedy under the civil contempt of powers found in Section 105 of the Code.\textsuperscript{128}

In \textit{In re First City Asset Servicing Co.}\textsuperscript{129} Judge Harold C. Abramson de-

\textsuperscript{118} \textit{In re Henderson}, 155 B.R. at 161.
\textsuperscript{119} \textit{Id.}
\textsuperscript{121} Mackey v. Nebraska Student Loan Program (\textit{In re Mackey}), 153 B.R. 34 (Bankr. N.D. Tex. 1993).
\textsuperscript{122} \textit{Id.} at 35; \textit{see} Pelkowski v. Ohio Student Loan Comm'n (\textit{In re Pelkowski}), 990 F.2d 737 (3d Cir. 1993); \textit{see also} Dull v. Ohio Student Loan Comm'n (\textit{In re Dull}), 144 B.R. 370 (Bankr. N.D. Ohio 1992).
\textsuperscript{123} \textit{In re Mackey}, 153 B.R. at 35.
\textsuperscript{125} 150 B.R. 925 (Bankr. W.D. Tex. 1993).
\textsuperscript{127} \textit{In re Abacus Broadcasting Corp.}, 150 B.R. at 926-27.
\textsuperscript{128} \textit{Id.} at 928; \textit{see} 11 U.S.C. § 105 (1988).
\textsuperscript{129} First City Asset Servicing Co. v. Fed. Deposit Ins. Corp. (\textit{In re First City Asset Servicing Co.}), 158 B.R. 78 (Bankr. N.D. Tex. 1993).
nied the FDIC's motion to dismiss an adversary proceeding that was based on the FDIC's alleged violation of the automatic stay. The court held that the bankruptcy court had subject matter jurisdiction notwithstanding FIRREA's comprehensive, administrative claims procedure.\(^{130}\)

6. **Durrett Rule**

The so-called "Durrett Rule" was applied to set aside a sheriff's sale to satisfy delinquent real property taxes. In *In re Hernandez*\(^{131}\) local taxing authorities obtained a judgment lien against the debtor for unpaid real property taxes. The property was sold at a sheriff's sale for less than half its appraised value. The bankruptcy court found that the foreclosure sale was voidable under Section 548 of the Bankruptcy Code, because the debtor was insolvent at the time of the transfer, and the seller received less than reasonably equivalent value.\(^{132}\) The court invalidated the sheriff's sale, allowing the purchasers a lien against the property for the purchase price plus interest at the rate of ten percent per annum.\(^{133}\)

7. **Redemption; Section 521**

In *In re Harper*\(^{134}\) Judge Larry Kelly found that under Section 521 of the Code, a debtor is not limited exclusively to redemption or reaffirmation when a debtor desires to retain property that secures consumer debt.\(^{135}\) The practical effect of this holding according to Judge Kelly is that so long as a debtor remains current on any payment obligations, the debtor would be allowed to maintain possession of his or her property. Also, in the event of default, the creditor would still be entitled to repossession.\(^{136}\) Judge Kelly's opinion predates the Survey period, but it is included because of the existence and development of authority to the contrary, in particular circuit level caselaw developing in other courts of appeals during the survey period.\(^{137}\)

\(^{130}\) *Id.* at 79-82.


\(^{132}\) *Id.* at 30. See generally *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201 (5th Cir. 1980). Section 548 allows a bankruptcy trustee to avoid any voluntary or involuntary transfer made within one year of the bankruptcy if the debtor received less than reasonably equivalent value and was insolvent. See 11 U.S.C. § 548(a)(2) (1988).

\(^{133}\) *In re Hernandez*, 150 B.R. at 30-31.


\(^{135}\) *Id.* at 686-87. Section 521 of the Bankruptcy Code provides that a debtor shall within thirty (30) days after filing a Chapter 7 case:

(A) . . . file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property;

(B) . . . within 45 days after the filing of a notice of intent . . . the debtor shall perform his intention with respect to such property . . . ; and

(C) . . . nothing contained in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property.


\(^{136}\) *Id.* at 686.

\(^{137}\) See *Taylor v. Ace Fed. Credit Union (In re Taylor)*, 3 F.3d 1512, 1513-16 (11th Cir. 1993) (if debtor retains secured property, debtor must either redeem or reaffirm); *In re Edwards*, 901 F.2d 1383 (7th Cir. 1990) (same holding). *But see Home Owners Funding Corp. of*
Essentially, the authority on which Judge Kelly relies finds Section 521 to be procedural in nature, compelling debtors to inform secured creditors of their intentions with respect to certain property. Moreover, the last subsection of Section 521 specifically provides that the notice provisions contained in Section 521 do not alter the rights of the debtor or trustee with regard to the property in question. As one commentator has noted, the approach taken in Harper and the cases on which it relies appears to be the more reasoned approach.138

8. Chapter 11 Plan Confirmation — More Separate Classification

In In re Schoeneberg139 the separate classification issue raised in Greystone was again revisited. As was the situation in Briscoe Enterprises discussed above,140 separate classification was allowed because there was no “gerrymandering.”141 The opinion is also instructive on other plan confirmation issues in a cram-down context.

9. Valuation

Two Chapter 13 cases provide somewhat of a contrast in the approaches taken to valuation issues. As noted by one of the courts, “no other area is more central to the bankruptcy process yet more perplexing to those practitioners and courts presented with its permutations than the question of valuation of assets.”142 In In re Carlan143 the court addressed valuation of a vehicle. The court declined to look exclusively to the debtor’s proposed use, and the court was also concerned that neither the debtor nor the secured creditor received a windfall from the court’s valuation. Accordingly, the court placed the value “somewhere between wholesale and retail.”144

In In re Sherman,145 decided within two weeks after Carlan, the court addressed valuation of pasture land owned by Chapter 13 debtors. The court based its valuation according to its highest and best use.146 The debtors had used the property in the past for agricultural purposes, and the debtors purported that the same future use was anticipated. The court then struggled with the effect of language contained in Section 506(a) of the Code, which provides that value should be determined “in light of the purpose of the valuation and of the proposed disposition or use of such property

Am. v. Belanger (In re Belanger), 962 F.2d 345 (4th Cir. 1992), and Lowry Fed. Credit Union v. West, 882 F.2d 1543 (10th Cir. 1989), both of which accord with Harper.
138. As noted in Harper, Collier is critical of the Seventh Circuit’s decision in Edwards. Collier notes that the court simply ignored subsection (C) and its legislative history. See 3 Collier on Bankruptcy ¶ 521.09(A) (1992).
140. See supra notes 62-69.
141. In re Schoeneberg, 156 B.R. at 967-69.
144. Id. at 326.
145. See supra note 142.
146. Id. at 990. “Highest and best use is defined as the reasonable, probable, and legal use of vacant land or an improved property which is physically possible, appropriately supported, financially feasible, and results in the highest value.” Id.
Apparantly, the court was concerned with setting the value too low and then allowing the debtor to liquidate the property at a greater value by utilizing it for its highest and best use. The court interpreted Section 506 to mean that the court should consider all factors. The court found that valuing the property at its agricultural use (pasture land), allowing the debtors to pay only that value to the secured creditor, would be inequitable and amount to a confiscation of the creditor's property for no legitimate purpose. Additionally, the court found that the debtors, in exchange for the opportunities provided by Chapter 13, are bound by an affirmative duty to maximize values and returns for assets that are property of the estate. Accordingly, the court found that the subject property should be valued at its highest and best use, which was considered to be use as rural, residential home sites.

II. CREDITORS' RIGHTS

A. EXEMPTIONS; HOMESTEADS

Much of the action with respect to the nature and extent of the Texas homestead exemption came out of the bankruptcy courts, which although arising in a bankruptcy context, involved interpretations of state law. Thus, these opinions are discussed in this section of the article.

1. Urban or Rural?

First, in In re Davis the district court reversed a bankruptcy court determination that Section 41.002(c) of the Texas Property Code provided the definitive method for classifying a homestead as either rural or urban. The district court reversed, turning to the more traditional factors in determining whether the debtors' claimed exemption of over thirty-two acres was permissible as a rural homestead exemption. The factors to be considered include: the location of the land with respect to nearby city limits; the location of the tract in question; the existence of municipal utilities and services; the use of the land and adjacent property; and the presence or absence of platted streets, blocks, and the like. The court then remanded the matter back to the bankruptcy court with instructions to address the homestead issue based upon the traditional factors outlined in the opinion and not restricted by the Property Code subsection discussed above.

149. Id. at 992.
151. At the time of the bankruptcy court ruling, the subsection in question provided as follows: "A homestead is considered to be rural if, at the time the designation is made, the property is not served by municipal utilities and fire and police protection." TEX. PROP. CODE ANN. § 41.002(c) (Vernon Supp. 1994).
152. In re Davis, 152 B.R. at 135; see also Bradley v. Pacific Southwest Bank (In re Bradley), 960 F.2d 502, 511 (5th Cir. 1992); Vistron Corp. v. Winstead, 521 S.W.2d 754 (Tex. Civ. App.—Eastland 1975, no writ).
2. Business Homestead Claimed by Surviving Spouse

In In re Finkel the bankruptcy court addressed the issue of whether a surviving spouse who did not continue her deceased husband's business operations could claim a business homestead exemption. The court applied the common test for determining whether a business homestead exemption exists. Those conditions require that the head of the family must have a calling or business to which the subject property is reasonably adapted and reasonably necessary, and the property must be used as a place to exercise the calling or business of the head of the family. In Finkel the widow was essentially a passive investor in her husband's company, and she turned over control of the business to her son well in advance of her bankruptcy filing. The court therefore held that Ms. Finkel intended to abandon and did abandon the business. In light of the fact that the debtor's fifty-year-old son resided with her, the court addressed whether the claimed homestead could be a "family" homestead, or whether, and to what extent, the widow could claim the homestead as a continuation of her deceased spouse's homestead. The court found that the debtor's exemption claim did not qualify under either test, because the son was not financially dependent on the debtor, and, notwithstanding the ability to claim a continuing homestead as a widow, the debtor had abandoned the homestead.

Finally, the court addressed an earlier Fifth Circuit decision. The decision held that an individual may lease property claimed as business homestead to a corporation owned and operated by the individual who still holds a right to the business homestead exemption. The court likewise disregarded that claim as well. The critical fact being the continued operation of the business by the debtor, regardless of the entity used, which was lacking in this case.

3. Loan Renewals; Fees and Expenses

In In re Freytag the court held that the assignment of a note and lien, which was originally a legitimate purchase money and construction lien enforceable under Texas homestead laws, did not adversely affect the validity of the lien. The loan in question was originated in compliance with Texas Property Code requirements; however, it had been assigned to another

155. Id. at 781; see also Webb v. Reserve Life Ins. Co. (In re Webb), 954 F.2d 1102, 1108 (5th Cir. 1992); In re Krug, 102 B.R. 98, 99 (Bankr. W.D. Tex. 1989).
156. In re Finkel, 151 B.R. at 783-84. "With business homesteads, we look for facts showing a voluntary discontinuance of the business, i.e., facts which demonstrate a cessation of any further intent to continue in the business." Id. at 783.
157. Id. at 785-86.
159. Id.
161. Id. at 154-55. The Texas Property Code provides as follows: "(b) Encumbrances may be properly fixed on homestead property for: (1) purchase money; (2) taxes on the property; or (3) work and material used in constructing improvements on the property if contracted for in
lender, and the payments and interest rates had been adjusted. Additionally, loan fees and other fees and expenses were added as part of the renewal and extension of the note. The court held, however, that both the borrowers and the lender acted in good faith to preserve the debtor's homestead rights, and they did not "intentionally increase the burden on the homestead" in a manner prohibited by Texas homestead laws.\(^{162}\)

### 4. Business Homestead: Non-Contiguous Lots; Written Disclaimers

In another business homestead case, a bankruptcy court addressed the issue of whether a business homestead exemption may extend to two or more non-contiguous lots. This issue had to be addressed in the face of one or more disclaiming affidavits and language in one or more deeds of trust to the effect that the subject property did not constitute the debtor's homestead. Finally, the court had to address whether and to what extent *D'Oench Duhme* could bar the debtor's assertion of his homestead rights in light of the deeds of trust contained in the bank's files.

In *In re Hughes\(^ {163}\)* the debtor claimed certain property as both his residential and business homestead. The debtor leased approximately thirty percent of the subject property to his sole proprietorship,\(^ {164}\) which the court found was the debtor's principal occupation. The rest of the property was leased to other unrelated businesses.\(^ {165}\) The court quickly disposed of the issue of whether the debtor could occupy two noncontiguous lots as a business homestead. The court noted that although a business homestead exists only writing as provided by Sections 53.095(a), (b) and (c)." These sections require that such contract be made "before the material is furnished or the labor is performed and in a manner required for the conveyance of a homestead, with joinder of both spouses if the homestead claimant is married." TEX. PROP. CODE ANN. § 53.095(a)-(c) (Vernon 1994). The original construction loan was documented by way of a deed of trust for construction costs, payable to the debtor's contractor, which then simultaneously assigned its note and its mechanic's lien to the bank. Additional funds were borrowed to complete the house, financed in the same manner and by the same parties as the original construction loan. After the parties moved in, a new deed of trust note was executed and delivered in renewal, extension, and consolidation of the two construction notes. This is not unlike documentation of the typical construction loan on property to be used as a borrower's homestead. *In re Freytag*, 155 B.R. at 152.

162. *In re Freytag*, 155 B.R. at 154-55. The Freytag court noted that there was no new advance of cash, and the adjustment and fees were limited to matters necessarily included in effectuating the transaction, which the court held permissible under Texas law. *Id.* at 155; see *Machicek v. Barcak*, 141 Tex. 165, 169, 170 S.W.2d 715, 717 (1943) ([The borrower] "may change the form of the obligation so long as he acts in good faith and does not intentionally increase the burden on the homestead for purposes other than are necessary for the readjustment of the outstanding obligation.").


164. The sole proprietorship was originally a corporation, but it had lost its corporate status years earlier. This was not crucial to the court's analysis.

165. *In re Hughes*, 153 B.R. at 742. The court found that the usage of a portion of the property was sufficient to impress the entire property with a business homestead character. *Id.* at 742 n.6. As alluded to by the *Finkel* court, the fact that the debtor leased the property to a corporation wholly owned and operated by him did not affect the property's homestead character. *Id.*; see *Taylor v. Knostman* (*In re John Taylor Co.*), 935 F.2d 75 (5th Cir. 1991).
in connection with the principal business of the homestead claimant, the business homestead itself can consist of two or more noncontiguous lots.\textsuperscript{166}

Over a period of years and in conjunction with a series of renewals, extensions, and consolidations, the debtor had executed two affidavits. In the affidavits, he claimed that he did not use or claim the subject property as a business or residence homestead, nor did he have any intention of doing so.\textsuperscript{167} Additionally, the debtor executed one or more deeds of trust, pursuant to which he reiterated the claimed validity and binding nature of the liens purportedly granted against the subject property. The court essentially disregarded the affidavits and the deeds of trust. The court found that neither was binding upon the plaintiff, apparently based in part on the fact that during much of the time the debtor was openly and obviously utilizing the property as a homestead.\textsuperscript{168}

Finally, the creditor, a successor by merger to another bank that was an assignee of the FDIC as receiver for yet another bank, claimed that the D'Oench Duhme doctrine barred the debtor from offering evidence that the subject property was his homestead in contradiction of his earlier written representations. The court held, however, that homestead rights exist independent of any agreement, scheme, or bank representation. As the Fifth Circuit had earlier noted, "the reach of Section 1823(e) is not so broad as to override Texas homestead laws."\textsuperscript{169}

5. Estoppel by Written Disclaimer

A state court opinion provides an example of when a debtor may be estopped from claiming a homestead interest. In \textit{NCNB Texas National Bank v. Carpenter}\textsuperscript{170} two borrowers had asserted a rural homestead claim with respect to property that was being used in conjunction with their sons' dairy operation. Like the debtor in \textit{In re Hughes}, discussed above, one or more documents had been signed disclaiming any homestead interest in the property. Unlike \textit{Hughes}, however, the debtors were not actually using the property for themselves; rather, the property was being used by their sons. The debtors, nevertheless, asserted that they were entitled to a homestead claim because of the references in the Texas Constitution to the homestead "of a family."\textsuperscript{171}

On the family issue, the court noted that there must be a legal or moral responsibility on the head of the family for the support of the rest of the

\begin{itemize}
  \item \textsuperscript{166} \textit{In re Hughes}, 153 B.R. at 741. This issue had apparently been well settled by the Texas Supreme Court. See \textit{Ford v. Aetna Ins. Co.}, 424 S.W.2d 612, 616 (Tex. 1968). Lots that are used "in aid of" but not essential to the business are not likewise protected; \textit{Webb v. Reserve Life Ins. Co. (In re Webb)}, 954 F.2d 1102 (5th Cir. 1992).
  \item \textsuperscript{167} \textit{In re Hughes}, 153 B.R. at 740-41.
  \item \textsuperscript{168} \textit{Id.} at 743-44.
  \item \textsuperscript{169} \textit{Id.} at 744 (citing \textit{Patterson v. Federal Deposit Ins. Corp.}, 918 F.2d 540, 544-45 (5th Cir. 1990)). Section 1823(e) is essentially the codification of the so-called "D'Oench Duhme doctrine." See 12 U.S.C. § 1823(e) (1988).
  \item \textsuperscript{170} 849 S.W.2d 875 (Tex. App.—Fort Worth 1993, no writ).
  \item \textsuperscript{171} \textit{Id.} at 879-81; see also \textit{TEX. CONST. art. XVI, § 50; TEX. PROP. CODE ANN. § 41.002(b)(1) (Vernon Supp. 1994).}
\end{itemize}
members of the family and a corresponding dependence by the others upon the head of the family. In Carpenter that apparently did not exist.

With respect to the estoppel issue, the court acknowledged that estoppel may not arise in favor of a lender attempting to secure a lien on homestead property when the borrower is in actual use and possession of the property despite written or oral assurances to the contrary.\textsuperscript{172} On the other hand, when the debtor makes representations that were intended to be and in fact were relied upon by a lender, the homestead claimant may be estopped to claim the exemption when there are facts open to observation that could lead to a conclusion that the property is in fact not homestead.\textsuperscript{173} In Carpenter the court found that there were material fact issues existing as to who actually possessed and used the subject property. The appellate court reversed the trial court ruling in favor of the debtors.

6. Proceeds

Despite Texas' rather liberal homestead exemption, and the lengths to which some courts will go to protect that exemption, the Fifth Circuit has made it clear that a borrower may not simultaneously claim a homestead exemption in both the proceeds of his prior homestead and his interest in his current homestead. In \textit{In re England}\textsuperscript{174} the debtor claimed both a newly acquired ranch and note proceeds from the sale of his prior homestead as exempt property under Chapter 41 of the Texas Property Code. The court acknowledged that homestead proceeds are exempt for a six-month period, but applying the plain meaning of Chapter 41, the court also found that once the new homestead is acquired the prior homestead is abandoned. Therefore, the proceeds then relate to a former homestead.\textsuperscript{175} The court framed the issue as whether the proceeds of the sale of a former homestead are exempt. The court held they were not, the primary object of the proceeds exemption being to allow the homestead claimant to invest the proceeds in another homestead.\textsuperscript{176} In \textit{England} that mission had been accomplished which obviated the need for a homestead exemption.

B. FDIC / RTC

1. Statutes of Limitation (Six-Year and Four-Year)

During the Survey period, the Fifth Circuit addressed the issue of applica-

\textsuperscript{172} Carpenter, 849 S.W.2d at 880. "Possession and use of land by one who owns it and who resides upon it makes it the homestead in law and in fact." \textit{Id.} (citing First Interstate Bank v. Bland, 810 S.W.2d 277, 286 (Tex. App.—Fort Worth 1991, no writ)).

\textsuperscript{173} Id. at 881.

\textsuperscript{174} England v. Federal Deposit Ins. Corp. (\textit{In re England}), 975 F.2d 1168 (5th Cir. 1992).

\textsuperscript{175} Id. at 1172-73. Section 41.001(c) of the Texas Property Code provides as follows: "(c) The homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale." \textit{TEX. PROP. CODE ANN. § 41.001(c)} (Vernon Supp. 1992) (text as of the date of the opinion).

\textsuperscript{176} \textit{In re England}, 975 F.2d at 1174-75; see Taylor v. Mosty Bros. Nursery, Inc., 777 S.W.2d 568, 570 (Tex. App.—San Antonio 1989, no writ) ("The six-month provision was enacted in order that the proceeds might be reinvested in another homestead.").
bility of federal statutes of limitations to loans held by failed financial institutions. Specifically, the Fifth Circuit has resolved the issue of whether and to what extent the federal six-year statutes apply to assignees of the FDIC; however, Texas courts remain divided.

a. Federal Courts

Perhaps the most significant opinion in the context of debt collection arose in Federal Deposit Insurance Corp. v. Bledsoe,177 in which the court addressed the applicability of the federal statutes of limitation to a private, non-governmental assignee. In Bledsoe the note in question was originally owned by State Savings & Loan Association of Lubbock, which was declared insolvent on December 19, 1985. The next day, the FSLIC transferred substantially all of the State Savings' assets, including the subject note, to State Federal Savings & Loan Association of Lubbock, a private institution. The note was again assigned to the FSLIC on August 26, 1988, when State Federal Savings was declared insolvent. Approximately a year later, while the note was still held by the FSLIC, Congress passed FIRREA, pursuant to which Congress abolished the FSLIC and transferred all of the FSLIC's assets to the FDIC.178 On FIRREA's effective date, the note passed into the hands of the FDIC.179

The district court granted the guarantor's motion for summary judgment based on the Texas four-year statute of limitations.180 The Fifth Circuit then traced what it called the juridical journey of the note. When the note was first transferred to the FSLIC, the FSLIC was subject to the federal six-year statute of limitations then in effect, which began to run when the cause of action accrued, effective the date the note matured.'81 It is at the next stage of the note's journey that the crucial issue arose, that being whether the FSLIC's six-year statute of limitations under Section 2415 was transferred to State Federal Savings, a private entity, when the note was assigned; or whether, upon transfer to a private party, the statute of limitations reverted to Texas' four-year period. This is crucial, because had the court concluded that upon the transfer to State Federal Savings the state statute applied, the note would have become barred by limitations on May 27, 1988, and the government would have been unable to revive a claim that had become stale.182

The opposite would have resulted, however, if the federal six-year period,

177. 989 F.2d 805 (5th Cir. 1993).
179. Bledsoe, 989 F.2d at 807.
180. Id.; see TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(3) (Vernon 1986).
181. Every action for money damages brought by the United States or an agency thereof based upon an express or implied contract is barred unless filed within six years after the cause of action accrues. See 28 U.S.C. § 2415(a) (1988).
182. See Bledsoe, 989 F.2d at 808; FDIC v. Hinkson, 848 F.2d 432, 434 (3d Cir. 1988) ("[I]f the state statute of limitations has expired before the government acquires a claim, it is not revived by transfer to a federal agency."); see also RTC v. Boyar, Norton & Blair, 796 F. Supp. 1010, 1013 (S.D. Tex. 1992) ("[G]overnmental acquisition of a claim cannot revive a cause of action already barred by state law — legal malpractice claim.").
then in effect, would have applied, thus extending the limitations period through May 27, 1990. Therefore, on August 26, 1988, when FSLIC reacquired the note, and on August 9, 1989, the effective date of FIRREA, the claim would have remained viable. The ultimate analysis was quite simple. The court applied the common law principle that an assignee stands in the shoes of his assignor, so the transfer to State Savings included the six-year statute. The holding was based on earlier authority where the federal holder in due course doctrine and the *D'Oench Duhme* doctrines have been applied under this same principle.  

The effect of *Bledsoe* is that when the FSLIC was appointed receiver of State Savings, the FSLIC received the benefit of the then general six-year limitation period applicable to government entities. Because the note was still alive at the time FIRREA was enacted, the six-year statute of limitation in FIRREA applied retroactively to this pending claim. Under FIRREA, the six-year statute began to run on the later of (i) the date of the appointment of the receiver or (ii) the date on which the cause of action accrued. The fact that a private entity owned the note at one time did not deprive the holder of the note of this six-year statute.

Prior to *Bledsoe*, the Fifth Circuit declined to extend FIRREA's retroactive application to a claim that had already been barred under Section 2415 prior to FIRREA's effective date. In *FDIC v. Belli* the court acknowledged that FIRREA would be applied retroactively, but only to claims that were not already barred as of FIRREA's effective date. The significance of *Belli* is that the Fifth Circuit refused to imply that under the general federal statute a cause of action accrued when the FDIC or FSLIC acquired the failed bank's assets, as is now provided under FIRREA. In so holding, the court applied the plain meaning of the statute.

The net effect of these two holdings is that the statute of limitations under FIRREA, which is somewhat more protective of the FDIC than that found under Section 2415, will be applied retroactively. This retroactive applica-

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183. *Bledsoe*, 989 F.2d at 810-11; FSLIC v. Cribbs, 918 F.2d 557, 559 (5th Cir. 1990) ("[T]he FDIC and subsequent note holders enjoy holder in due course status whether or not they satisfy the technical requirements of state law"); Porras v. Petroplex Sav. Ass'n, 903 F.2d 379, 380-81 (5th Cir. 1990) (holding that the *D'Oench Duhme* protection transferred to private assignee of FSLIC because "the policy behind *D'Oench Duhme* applies with equal force where the purchaser is a private party."); Bell & Murphy & Assoc., Inc. v. Interfirst Bank Gateway, N.A., 894 F.2d 750, 754 (5th Cir. 1990), cert. denied, 498 U.S. 895 (1990) ("Assignees of the FDIC also enjoy protection from claims or defenses based upon unrecorded side agreements.").


185. 981 F.2d 838 (5th Cir. 1993).

186. *Id.* at 842-43.

187. *Id.* at 840. The Third Circuit, in *FDIC v. Hinkson*, 848 F.2d 432, 434 (3d Cir. 1988), held that under Section 2415, a cause of action on a note accrued when the FDIC acquired the failed bank's assets. Similarly, the Ninth Circuit held that a cause of action against former officers and directors for breach of fiduciary duties similarly accrued under Section 2415 when the FDIC acquired those claims by assignment. *FDIC v. Former Officers and Directors of Metropolitan Bank*, 884 F.2d 1304, 1307-09 (9th Cir. 1989). The Tenth Circuit, however, has held that a cause of action on a note under Section 2415 accrued on the date the note matured. *FDIC v. Galloway*, 856 F.2d 112, 116 (10th Cir. 1988).
tion should only apply, however, to notes that are not already time barred when acquired by the government. According to the Fifth Circuit, these holdings now apply not only to government entities, but also to private nongovernmental assignees of assets of failed financial institutions.

This may not be the case, however, in every context. In *Prince v. First City Texas-Houston* a Texas court of appeals held that the six-year statute of limitations under FIRREA was inapplicable to an “open bank assistance transaction.” The court refused to hold that the assisted buy out of First City Bank-Houston was in essence a “constructive receivership” and that the successor banks were performing tasks that otherwise would have been performed by the FDIC. Because there was no actual receivership, and the FDIC never became a party in interest, the court applied the four-year limitations period.

b. State Courts

Under *Bledsoe* the Fifth Circuit has clearly established that an assignee is entitled to the protection of FIRREA’s six-year limitation period. As of this writing, however, the Texas courts of appeals are in conflict on this issue, and the Texas Supreme Court has granted writ in two cases that it has consolidated for purposes of addressing this issue. Perhaps the best history of the split in the court of appeals is found in *John Luce Builder v. First Gibraltar Bank* in which the Austin Court of Appeals reiterated its holding in *Thweatt v. Jackson,* and held that common law principles applicable to assignees vested a non-governmental transferee with the same rights as the

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188. *Bledsoe,* 989 F.2d at 808 (“It is well established that the subsequent transfer of a note to the government cannot revive a claim that is already stale.”); *FDIC v. Wheat,* 970 F.2d 124, 128 n.7 (5th Cir. 1992) (“Had the state limitations period expired [when the FDIC took over the bank], then the FDIC would have no rights.”); *FDIC v. Hinkson,* 848 F.2d 432, 434 (3d Cir. 1988) (“If the state statute of limitations has expired before the government acquires a claim, it is not revived by transfer to a federal agency.”); see also *Guaranty Trust Co. v. United States,* 304 U.S. 126, 142 (1938) (“The United States never acquired a right free from a pre-existing infirmity, the running of limitations against its assignor, which public policy does not forbid.”).

189. *Bledsoe,* 989 F.2d at 810-11.

190. 853 S.W.2d 691 (Tex. App.—Houston [1st Dist.] 1993, no writ).

191. *Id.* at 694.

192. *Id.*

193. *Id.* at 693-94 (citing City of Houston v. First City, Texas, 827 S.W.2d 462, 466-67, 477-79 (Tex. App.—Houston [1st Dist.] 1993, writ denied)).


196. See supra note 194.
Interestingly, in one of the cases cited in *John Luce Builder*, the supreme court denied a borrower's application for writ of error in a case arising out of the Corpus Christi Court of Appeals.198

2. **Tax Liens vs. The FDIC**

   In *State v. Bankerd* 199 local taxing authorities filed suit against a property owner and a bank that held a deed of trust lien on the property. The bank was declared insolvent and the FDIC became a party to the litigation as the bank's receiver. The FDIC answered, asserting that the tax liens were not superior to the FDIC's interest in the property because of federal statutes prohibiting involuntary liens against the property of the FDIC.200 The court held that the FDIC's newly acquired lien constituted property under the federal statute, and as such, was not subject to foreclosure of the state's involuntary lien, even in face of the taxing authority's due process rights.201 The trial court ordered foreclosure of the tax liens subject, however, to the FDIC's lien, which the appellate court affirmed.202

C. **ENFORCEMENT OF PERSONAL PROPERTY SECURITY INTERESTS**

1. **Private Sales; Good Faith Purchaser**

   In *Thomas v. Price*203 a former partner in a private banking enterprise challenged the foreclosure sale of his partnership interest by a secured creditor. The Fifth Circuit affirmed a summary judgment in favor of the secured creditor.204 The crux of the debtor's complaint was that the disposition of the collateral was by private sale to a buyer whom the debtor alleged was not acting in good faith.

   First, the court addressed the private nature of the sale. Disagreeing with the debtor's assertions that a private sale should be subject to closer scrutiny than a private sale, the court noted that in many circumstances, a private sale is actually the preferred method of disposition, citing the comment to Section 9.504 of the UCC.205 The court added that where the collateral was

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197. *Id.* at 727-28.
201. *Bankerd*, 838 S.W.2d at 642.
202. *Id.* at 641-43. The court held that Section 1825(b), enacted as part of FIRREA, prevailed over 28 U.S.C. § 2410, which provided somewhat of a waiver of sovereign immunity. *Id.* *See also Rust v. Johnson*, 597 F.2d 174, 179 (9th Cir.), *cert. denied*, 444 U.S. 964 (1979) ("[L]ocal governments cannot take any action to collect unpaid taxes assessed against property which would have the effect of reducing or destroying the value of a federally held purchase money mortgage lien.").
203. 975 F.2d 231 (5th Cir. 1992).
204. *Id.* at 240.
205. *Id.* at 238. The official comment to Section 9.504 provides as follows:

   It is hoped that private sale will be encouraged where, as is frequently the case, private sale through commercial channels will result in higher realization on collateral for the benefit of all parties. The only restriction placed on the secured party's method of disposition is that it must be commercially reasonable.
an interest in a partnership, "[A] private sale was almost certain to result in a higher realization on the collateral." 206

The borrower also attempted to rely on Subsection (d) of Section 9.504, specifically to the extent that it provides that a good faith purchaser at a foreclosure sale takes free of the debtor's rights in the collateral. 207 The debtor argued that in order to receive the protections under Section 9.504, a buyer must act in good faith, the implication being that the lack of good faith on a buyer's part could invalidate a foreclosure sale.

This case represents a misapplication of the plain meaning of the statute, the primary purpose of which is to protect a good faith purchaser from a situation where the foreclosing secured party may have failed to comply with requirements of Article 9 regarding disposition of collateral. In other words, even in a situation where there may be a lack of notice or commercial reasonableness, a good faith purchaser may obtain the property free and clear of any such claims. 208 To raise the issue of the purchaser's lack of good faith, a debtor must first establish that the secured party did not act in a commercially reasonable manner. Only then is the purchaser's good faith, or lack thereof, an issue. The Thomas court noted that there was no allegation or proof of the lack of commercial reasonableness. Therefore, Section 9.504, which is simply a savings clause for a good faith purchaser, had no application. 209

2. Transfer of Inventory Outside Ordinary Course of Business

In Amarillo National Bank v. Komatsu Zenoah America, Inc. 210 the Fifth Circuit addressed a secured creditor's claim that a transfer of lawn care products (inventory), in which the secured creditor had a perfected security interest, constituted conversion. Amarillo National Bank had provided financing to the debtor, secured by a written security agreement granting the bank a security interest in all inventory, accounts, notes, proceeds, and goods owned by the debtor. The debtor distributed certain lawn care products purchased from Komatsu Zenoah America, Inc. (KZA). After the bank perfected its security interest in the debtor's inventory, the debtor transferred to KZA its stock of the KZA-financed lawn care products, in return for which KZA issued the debtor a credit memorandum in partial satisfaction of the debtor's preexisting debt to KZA.

The court, applying Texas law, held that the transfer of the lawn care products from the debtor to KZA did not occur, by definition, in the ordinary course of business. 211 Because the transfer was outside the ordinary

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206. Thomas, 975 F.2d at 238.
207. Id.
208. Id. at 238-39.
209. Id. at 239-40.
210. 991 F.2d 273 (5th Cir. 1993).
211. Id. at 276; see Crocker Nat'l Bank v. Ideco, 889 F.2d 1452, 1454 (5th Cir. 1989), cert. denied, 495 U.S. 919 (1990); see also Tex. Bus. & Com. Code Ann. § 1.201(9) (Tex. UCC) (Vernon 1991). The Texas UCC defines buying in the ordinary course of business to be:
course of the debtor’s business and in light of the bank’s prior perfected security interest in the inventory (which included lawn care products), the court held that the bank presented a valid claim for conversion and remanded to the lower court for a determination of damages under the bank’s conversion claim.\textsuperscript{212}

3. \textit{Perfection of Purchase Money Security Interest Within Grace Period}

In \textit{Citizens National Bank v. Cockrell}\textsuperscript{213} the Texas Supreme Court addressed the meaning of the term possession within the provision of the UCC governing the twenty-day grace period for perfection of a purchase money security interest.\textsuperscript{214} In \textit{Cockrell}, Cockrell sold a mini-blind manufacturing business to Sydnor. On August 1, a written agreement for the immediate sale, assignment, and transfer of the business and its assets was signed, and the Sydnors began operating the business that day. The Sydnors paid cash and signed a promissory note. The Sydnors agreed to grant Cockrell a security interest in the transferred assets, but apparently the parties failed to sign the security agreement at that time. Cockrell remained active in the day-to-day operations of the business and had access to the personal property until early October. According to Cockrell, he was concerned about relinquishing control of the equipment to the Sydnors while there were still orders in process for which he was responsible. On or about October 3, however, there were developments in the business that led the parties to believe that it was time for Cockrell to turn over complete control of the business to the Sydnors. Cockrell turned over his set of keys to the Sydnors, and on or about the same day, the parties apparently executed the security agreement and signed a financing statement. Cockrell filed the financing statement with the Secretary of State four days later, on October 7, 1985.

Meanwhile, prior to October, the Sydnors had become indebted to a bank secured by all equipment then owned or thereafter acquired by the Sydnors. The bank filed a financing statement in May of the same year. When the Sydnors acquired rights in the equipment by purchasing the assets from Cockrell, the bank’s security interest attached to the collateral and became perfected.\textsuperscript{215}

After assuming complete control of the business, the Sydnors defaulted on

\textsuperscript{212}\textit{Id.} \textsection 1.201(9) (emphasis added).
\textsuperscript{213}\textit{Komatsu}, 991 F.2d at 277-78.
\textsuperscript{214}Section 9.312(d) of the Texas Business & Commerce Code gives a purchase money security interest priority over a conflicting security interest “if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter.” \textit{Tex. Bus. \& Com. Code Ann.} \textsection 9.312(d) (Tex. UCC) (Vernon Supp. 1993) (emphasis added). In most states, the comparable Code section provides for a 10-day grace period. \textit{See Cockrell}, 850 S.W.2d at 466.
their bank obligations. The bank foreclosed on the equipment and sold it to a third party. Cockrell then sued the bank alleging conversion because his purchase money security interest had priority over that claimed by the bank. The issue, therefore, was whether the perfection of Cockrell's security interest in October was within the twenty-day grace period after the Sydnors received possession of the equipment.\textsuperscript{216} The court noted that the term possession is not defined in the UCC. The court considered significant, however, that the Code section in question referred to possession rather than rights in the collateral.\textsuperscript{217} The court reversed the court of appeals, which had limited the concept of possession to a power over property exercisable to the exclusion of all other persons.\textsuperscript{218} The court felt that notwithstanding Cockrell's continued presence in the business, the equipment in question was in the Sydnors' place of business beginning on August 1 and no evidence existed to suggest that the parties set aside the equipment or otherwise specially labeled to identify or denote a purchase money security interest. Because of this possession by the Sydnors on August 1, the court found that the October filing of a financing statement was not within the twenty-day grace period, which actually commenced on the Sydnors' possession of the property.\textsuperscript{219}

4. \textit{Equitable Exception to Bank's Offset Rights}

In \textit{FDIC v. Golden Imports, Inc.}\textsuperscript{220} a bank that provided floor plan financing for an automobile broker offset funds in the broker's account. The account secured the broker's floor plan bank financing, along with a security interest in the broker's inventory. At the time of the death of the president of the auto broker, whose death represented an event of default under the bank's loan agreement, the broker had certain funds on deposit that were designated to pay an outstanding draft to another dealer. The funds represented payment by the purchaser of the automobile that the broker purchased from the dealer holding the outstanding draft. After the bank exercised its right of set-off, there were no funds in the bank to pay the draft, and the wholesaler did not forward the car title to the ultimate customer. The customer and the wholesaler filed suit against the bank claiming conversion of the specific account funds. The court held that notwithstanding the fact that the bank's security interest in the account would normally entitle the bank to offset any funds on deposit, Texas courts allow an equitable exception to a bank's right of set-off when, on reasonable inquiry, the bank would discover that the funds were held by a depositor on behalf of a third party.\textsuperscript{221}

\textsuperscript{216} Cockrell, 850 S.W.2d at 463.
\textsuperscript{217} Id. at 465.
\textsuperscript{218} Id. at 466.
\textsuperscript{219} Id. at 466.
\textsuperscript{220} 859 S.W.2d 635 (Tex. App.—Houston [1st Dist.] 1993, n.w.h.).
\textsuperscript{221} Id. at 641.
5. **Subordination Agreements**

In *Western Auto Supply v. Brazos Port Bank* the court held that two secured parties claimed competing security interests in the same collateral. One of the secured parties had agreed to the subordination of its security interest. The secured party in whose favor the subordination was executed assigned its security interest and its rights under the subordination agreement. The court of appeals held that because the subordination agreement did not address assignment, the subordination was not enforceable by the third party assignee. Thus, foreclosure by the original secured party was allowed, its rights being deemed prior to the party claiming the assignment of the subordination agreement.

### D. Real Property Foreclosure

1. **Wrongful Foreclosure**

*First State Bank v. Keilman* is significant not because of the development of any new rules of law, but rather as an example of what can happen when a wrongful foreclosure claim is erroneously submitted to a jury. The borrowers had executed a series of promissory notes to Frontier National Bank, the predecessor of First State Bank. The final renewal note provided for the payment of $152,000.00 plus interest. The note provided that interest would be payable “at the prime rate established by Frontier National Bank as described in the [November 1, 1985] note, plus Two percent (12.5%) per annum.” In the original note produced at trial, the number “12.5%” inside the parenthesis was deleted and replaced with the numeral “2%.” Again, the written words provided “prime plus two percent.” Frontier was subsequently declared insolvent, and the FDIC closed Frontier. First State Bank purchased the borrower’s note from the receivership estate. A few months later, the borrowers defaulted. First State Bank accelerated the indebtedness and scheduled a substitute trustee’s sale. The bank posted a notice at the county courthouse and filed with the county clerk in accordance with the Texas Property Code. The notice otherwise complied with the minimum requirements of the Texas Property Code.

On the date of the foreclosure, the borrower and a companion drove to the courthouse to attend the foreclosure sale, scheduled between 10:00 a.m. and 1:00 p.m. Shortly before 10:30 a.m., the borrower left the courthouse to go to the local newspaper office to see if the sale had been advertised in the newspaper. Before leaving, the borrower authorized the companion to bid up to $16,000.00 for the property. Shortly after the borrower left, the substitute trustee arrived and began the sale. The companion asked the substitute trustee to wait until the borrower returned, but the substitute trustee refused and conducted the sale. Apparently having misunderstood the borrower’s

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223. Id. at 159-60.
224. 851 S.W.2d 914 (Tex. App.—Austin 1993, writ denied).
225. Id.
226. Id. at 919.
instructions, the companion stopped bidding at $13,000.00. The substitute trustee sold the property to First State Bank for $13,200.00. The bank apparently based its bid in part on an appraisal obtained by First State Bank that placed the value of the property at slightly in excess of $16,000.00. First State Bank credited the entire $13,200.00 toward the indebtedness on the renewal note, and the borrowers were subsequently contacted regarding a payment plan for the remaining deficiency. After the bank received no response, the bank filed suit to collect on the deficiency.

The borrowers counterclaimed, alleging material alteration of the promissory note, wrongful foreclosure, and usury. Among other things, the jury found that the bank: (i) altered the note without the borrowers' consent; (ii) wrongfully foreclosed on the property; (iii) committed usury; and (iv) engaged in a conspiracy with the substitute trustee. The jury found the unpaid principal balance was $40,000.00 and accrued, unpaid interest was $18,000.00. Based on these findings, the trial court awarded the borrowers $293,000.00 in statutory usury penalties, $18,200.00 in actual damages, $97,000.00 in exemplary damages, and $68,500.00 in attorneys' fees. The trial court also rendered judgment that the note was void and that the bank take nothing on its deficiency claim. The bank asserted fifteen points of error which the appellate court organized into five categories: material alteration; wrongful foreclosure; usury; attorneys' fees; and the bank's deficiency claim.

With respect to material alteration, the bank asserted both legal and factual insufficiency of the evidence on which the court of appeals sustained the bank's points of error.227 The jury found that the borrowers did not consent to an alteration of the interest rate, but there were no findings of materiality or fraudulent intent. Because of the absence of the jury findings, the appellate court deemed those issues as found by the trial court in a manner to support the judgment.228 The practical effect of the alteration of the parenthetical number, however, did not work any change or otherwise modify the legal effect of the contract. The alteration simply represented an effort to make the number consistent with the written words contained in the note. The court noted the well-established rule that unambiguous words prevail over arithmetic numbers in promissory notes.229 Because the written words were controlling, regardless of the alteration, the court found no evidence to support a finding of materiality with respect to the alteration.230 The court also took note of the borrower's testimony, pursuant to which he apparently understood that the renewal note was to be a variable rate note of prime plus two percent.231 Additionally, the borrowers presented no evidence of fraud-

227. Keilman, 851 S.W.2d at 919-20.
228. Id.; see TEX. BUS. & COM. CODE ANN. § 3.407(b)(1) (Vernon 1968) ("[A]lteration by a holder which is both fraudulent and material discharges any party whose contract is thereby changed unless that party assents.").
229. Keilman, 851 S.W.2d at 920; see also Guthrie v. Nat'l Homes Corp., 394 S.W.2d 494, 495 (Tex. 1965).
230. Keilman, 851 S.W.2d at 920.
231. Id. at 920-21.
ulent intent, which was an element of their cause of action on which they were required to present evidence and secure a finding.\textsuperscript{232}

The borrowers based their wrongful foreclosure assertion on three theories: common law wrongful foreclosure; conspiracy; and violation of the unconscionability provisions of the Deceptive Trade Practices Act (DTPA). The court of appeals again found that the evidence was both legally and factually insufficient to support a finding of wrongful foreclosure.\textsuperscript{233} The court addressed the facts in light of the well established principles regarding the extent of the duties imposed on a mortgagee in conducting a foreclosure sale. Under Texas law, if a defect or irregularity occurs in the foreclosure process, the result of which is to deter third parties from bidding, then a borrower may have a claim against the mortgagee for damages resulting from the purportedly unfair sale.\textsuperscript{234} It is well established, however, that mere inadequacy of consideration does not render a foreclosure sale void if the sale was otherwise conducted properly.\textsuperscript{235} Moreover, a mortgagee is under no duty to take affirmative action beyond that required by statute or the deed of trust to ensure a fair sale; in other words, the mortgagee should avoid affirmatively deterring prospective bidders.\textsuperscript{236} As the court stated, "a debtor may recover damages for common law wrongful foreclosure only if the mortgagee either (1) fails to comply with statutory or contractual terms, or (2) complies with such terms, yet takes affirmative action that detrimentally affects the fairness of the foreclosure process."\textsuperscript{237}

In their effort to support the jury's findings and the trial court's ruling, the borrowers claimed among other things that the bank failed to advertise the foreclosure sale in the manner required by the deed of trust. Apparently, the deed of trust contained a reference to advertising the time, place, and terms of the sale. The debtors claimed that this meant the trustee owed a duty to do more than meet the minimal requirements of the Property Code.\textsuperscript{238} In other words, the bank or the substitute trustee should have advertised the sale by means other than posting and notice. The court, of course, disagreed, refusing to find the deed of trust ambiguous and applying the plain meaning of the word "advertise."\textsuperscript{239} The court relied on resources such as Black's Law Dictionary to address the issue of the meaning of the word "advertise." Essentially, the court found that the borrower showed no evidence that the bank obligated itself to engage in one type of advertising over another.\textsuperscript{240}

\textsuperscript{232} Id. at 921.
\textsuperscript{233} Id. at 921-22.
\textsuperscript{234} Id.; see Pentad Joint Venture v. First Nat'l Bank, 797 S.W.2d 92, 96 (Tex. App.—Austin 1990, writ denied).
\textsuperscript{235} Keilman, 851 S.W.2d at 921. See Tarrant Sav. Ass'n v. Lucky Homes, Inc., 390 S.W.2d 473, 475 (Tex. 1965).
\textsuperscript{236} Keilman, 851 S.W.2d at 921; Pentad Joint Venture, 797 S.W.2d at 96.
\textsuperscript{237} Keilman, 851 S.W.2d at 921-22.
\textsuperscript{238} Section 51.002 of the Texas Property Code provides the minimum requirements for notice of a trustee's sale. \textit{Tex. Prop. Code Ann.} § 51.002 (Vernon 1984 and Supp. 1994). Compliance with the basic requirements of the statute was not at issue.
\textsuperscript{239} Id. at 922.
\textsuperscript{240} Id.
Continuing in its efforts to support the wrongful foreclosure finding, the borrowers made several more assertions. First, the borrowers claimed insufficient notice because the notice contained only a legal description and not a common street address, and the sale notice was tacked upon a cluttered bulletin board, ending up underneath other papers. The court was unswayed by this assertion, noting the extensive authority regarding the content and posting of sale notices. Second, the borrowers complained of the trustee conducting the sale in the absence of the debtor. This assertion lacked merit because it is well established under Texas law that the trustee has no legal duty to wait for the debtor. Third, the notice of sale contained warranty disclaimers not unlike those referenced in Article 2 of the UCC. This complaint was also without merit, despite the fact that the borrowers asserted this chilled the bidding at the sale.

The court then addressed the borrowers' conspiracy claims. This failed primarily because in order to establish a cause of action for a conspiracy, the purpose to be accomplished as a result of the conspiracy must be unlawful. In other words, where the purpose to be accomplished is lawful and no unlawful means are used, there can be no civil conspiracy. The court found that the purpose to be accomplished — the foreclosure — was lawful, and no unlawful means were used. Thus, there cannot be a civil conspiracy. No civil conspiracy existed in the face of the borrowers' allegations that the conspiracy attempted to breach what the borrower claimed to be a fiduciary duty. In Texas, however, a trustee does not owe a fiduciary duty to a mortgagor, rather, the only duty is to act with absolute impartiality and fairness.

Moving to the unconscionability assertions, the court noted that only a consumer may maintain a cause of action for damages and attorneys' fees under the DTPA. The borrowers asserted that they purchased foreclosure services from the trustee, based on the fact that the trustee was to pay

241. Id. at 923.
242. Id.; see, e.g., FDIC v. Myers, 955 F.2d 348, 350 (5th Cir. 1992) (stating that under Texas law, a posted notice was sufficient despite failure to advertise specific time of sale, the nature of the property being sold, identity of the lender, address and telephone number of the trustee, and other potential information that would have been available to potential buyers); Chambers v. Lee, 566 S.W.2d 69, 73 (Tex. Civ. App.—Texarkana 1978, no writ) (“If the notices are actually posted the required number of days prior to the sale, it is not essential that they remain intact and visible during every one of the intervening days.”).
243. Keilman, 851 S.W.2d at 923; see also Bering v. Republic Bank, 581 S.W.2d 806, 808 (Tex. Civ. App.—Corpus Christi 1979, writ ref’d n.r.e.).
244. Keilman, 851 S.W.2d at 924; see also Henke v. First S. Properties, Inc., 586 S.W.2d 617, 620 (Tex. Civ. App.—Waco 1979, writ ref’d n.r.e.) (“One who bids upon property at a foreclosure sale does so at his peril.”).
245. Keilman, 851 S.W.2d at 925. The essential elements of a cause of action for conspiracy are: two or more persons; an object to be accomplished; a meeting of minds on the object or course of action; one or more unlawful, overt acts; and damages as a proximate result. Massey v. Armco Steel Co., 652 S.W.2d 932, 934 (Tex. 1983).
246. Keilman, 851 S.W.2d at 925.
247. Id.; see Hammonds v. Holmes, 599 S.W.2d 345, 347 (Tex. 1977) (holding that trustee must act with absolute impartiality and fairness); FDIC v. Myers, 955 F.2d 348, 350 (5th Cir. 1992) (holding that a trustee does not owe a fiduciary duty to the mortgagor).
248. Keilman, 851 S.W.2d at 928.
himself a commission of five percent (5%). Under Texas law, however, an extension of credit alone does not confer consumer status under the DTPA, even in the context of secured credit.249

Finally, the court addressed the borrowers’ usury claims, based primarily on a demand letter sent by the bank’s lawyer. The court found that there was more than a scintilla of evidence to support the borrowers’ claim of unauthorized interest. The jury, however, found an amount of unauthorized interest totally inconsistent with the evidence presented by either party. The court stated, “[T]he jury pulled its answer out of a hat.”250 Although the court remanded on this point, it refused to find that the purportedly wrong foreclosure constituted a valid basis for usury.251 The borrowers had asserted that the amount that should have been credited against the debt constituted a charge of excessive compensation for the loan of money.

As noted above, there are not necessarily any new legal principles established in this opinion. This case is important, however, because it points out the risks inherent in submission of wrongful foreclosure and other lender liability claims to a jury, even in the absence of evidence that is either legally or factually sufficient. Although the appellate court corrected the mistakes of the trial court, the opinion is nevertheless instructive for lenders and lenders’ counsel on the point that preventing even the most minor irregularity is crucial, if a lender liability claim, meritorious or otherwise, is to be avoided.

2. Equitable Subrogation; Notice

In First National Bank v. O’Dell252 the Texas Supreme Court held that the doctrine of equitable subordination upon satisfaction of a secured mortgage indebtedness does not apply to the notice provisions regarding renewal and extension of a prior lien unless at least one maker of the renewal note is personally liable on the original note.253 As stated by the court, “The facts underlying the suit are not simple.”254 The operative fact was that a bank acquired first and second liens against the subject property by purchasing the notes, the payment of which was not at the instance of any debtor liable on them. Thus, the equitable subrogation doctrine by its literal terms would not apply.255 The court found that a party to a note secured by an inferior

249. Id.
250. Id.; see Riverside Nat’l Bank v. Lewis, 603 S.W.2d 169, 175 (Tex. 1980).
251. Keilman, 851 S.W.2d at 928; see, e.g., FSLIC v. Kralj, 968 F.2d 500, 507 (5th Cir. 1992); Smith v. United States Nat’l Bank, 767 S.W.2d 820, 824 (Tex. App.—Texarkana 1989, writ denied); Briercroft Serv. Corp. v. De Los Santos, 776 S.W.2d 198, 206 (Tex. App.—San Antonio 1988, writ denied). The key principle in determining consumer status under the DTPA is that the goods or services purchased must be an objective of the transaction, not merely incidental to it. FDIC v. Munn, 804 F.2d 860, 863-64 (5th Cir. 1986); Keilman, 851 S.W.2d at 929.
252. Keilman, 851 S.W.2d at 931.
253. Id. at 932.
254. 856 S.W.2d 410 (Tex. 1993).
255. Id. at 411.
256. Id.
257. Id. at 415. Essentially, the equitable subrogation doctrine applies when one discharges a lien by paying as a surety or at the request of a debtor or at a judicial sale, that party
lien could enforce the notice provisions in that inferior note, notwithstanding
the bank's otherwise prior position.258

3. Other Irregularities in Foreclosure Sale

Gainesville Oil & Gas v. Farm Credit Bank259 presents an example of a
defect in a foreclosure sale that resulted in the sale being set aside. The
borrowers were led to believe prior to a foreclosure sale that certain mineral
interests would not be included in the foreclosure sale. The bank nevertheless
foreclosed, and the substitute trustee executed and delivered a deed, apparen-
tly including the mineral interest in question. The borrowers purportedly relied on the assurances of a bank officer that their producing
well was not included in the foreclosure, so they did not attend the sale. The
court held that the bank's conduct, which resulted in the borrowers losing
an opportunity to protect themselves by bidding at the sale (which the bor-
rrowers apparently claimed they would have done) diminished competition
and stifled a free and open sale. Based upon this irregularity, the court re-
versed a summary judgment and remanded for resolution of fact issues.260

4. Computation of 21 Day Notice Period

A number of Texas courts during the Survey period struggled with the
computation of the twenty-one day notice period required before a trustee's
sale. This problem appears to have been addressed legislatively, but the
cases leading up to this legislative amendment merit review.

In Onwuteaka v. Kohen261 the owner of a condominium unit alleged
wrongful foreclosure, conversion, and fraud in connection with a lien fore-
closure sale of his unit for nonpayment of maintenance fees. In his first
point of error, the plaintiff claimed the trial court erred in failing to find that
he was provided twenty-one days notice as required under the Texas Prop-
erty Code.262 Apparently, the plaintiff argued that he was not given the
required notice, because the notices were sent to his condominium unit
rather than his business address.

The court noted that service of notice of a trustee's sale is complete when
deposited in the mail "addressed to the debtor at the debtor's last known
address as shown by the records of the holder of the debt."263 The court

is entitled to be subrogated to the lien of the creditor to the extent of the payment made. Id.;
see Faires v. Cockrill, 88 Tex. 428, 31 S.W. 190, 194 (1895). On the other hand, this doctrine
is not applied when a mere stranger or volunteer pays the debt of another absent an agreement
for subrogation. O'Dell, 856 S.W.2d at 415; Oury v. Saunders, 77 Tex. 278, 13 S.W. 1030,
1031 (1890).

258. 856 S.W.2d at 416.
259. 847 S.W.2d 655 (Tex. App.—Texarkana 1993, no writ).
260. Id. at 664.
261. 846 S.W.2d 889 (Tex. App.—Houston [1st Dist.] 1993, writ denied).
262. Id. Article 51.002(b) of the Texas Property Code as enacted at the time of the sale
provided that notice of the sale must have been given at least 21 days before the date of the
sale. The notice was to be provided by the holder of the debt, by certified mail, on each debtor
who, according to the records of the holder of the debt, is obligated to pay the debt. TEX.
PROP. CODE ANN. § 51.002(b) (Vernon Supp. 1993).
263. Id. § 51.002(e).
specifically stated that the statute's purpose is to provide a minimum level of protection for the debtor "and it provides for only constructive notice of the foreclosure . . . . To establish a violation of the statute, it must be shown that the holder of the debt had in its records the most recent address of the debtor and failed to mail a notice by certified mail to that address."264

The plaintiff also argued that he was provided twenty days rather than twenty-one days notice, because the day of the foreclosure sale and the date of posting and mailing should be excluded. The court, however, noted that based upon the Code Construction Act,265 the first day is excluded and the last day is included.266 The plaintiff also asserted other irregularities, essentially consisting of a grossly inadequate sale price due to a purported irregularity, conspiracy, and fraud. The court dismissed those assertions and affirmed the trial court's finding.267 A federal district court, in FDIC v. Royal Park No. 14, Ltd.,268 reached the same conclusion with respect to the computation of the twenty-one day notice period. In that case, however, the court excluded the date of sale rather than the date of notice.269

At least one more court struggled with the twenty-one day notice period. In Parker v. Frost National Bank270 the Austin Court of Appeals held that the day of posting is included in the twenty-one day notice, but the date of the sale is excluded.271 Additionally, the debtor unsuccessfully attempted to invoke the additional twenty day notice found in the Property Code regarding mortgages secured by a debtor's principal residence.272 The court disregarded that argument simply because the subject indebtedness was not secured by the borrower's residence.273

The Texas legislature has finally addressed the issue of the computation of the notice period. Section 51.002 of the Texas Property Code has now been amended to provide that the calendar day on which the notice is given is included in computing the twenty-one day period; however, the day of the foreclosure sale is excluded.274 A similar amendment was included to pro-

264. Onwuteaka, 846 S.W.2d at 892; see also Krueger v. Swann, 604 S.W.2d 454, 457 (Tex. Civ. App.—Tyler 1980, writ ref'd n.r.e.).
265. TEX. GOV'T CODE ANN. § 311.014(a) (Vernon 1988).
266. Onwuteaka, 846 S.W.2d at 893.
267. Id. at 894.
269. Id. at 482.
270. 852 S.W.2d 741 (Tex. App.—Austin 1993, writ dism'd by agr.).
271. Id. at 742-43.
272. The Texas Property Code requires that a creditor provide a debtor with 20 days notice and opportunity to cure a default when the indebtedness is secured by the debtor's principal residence. This 20 day period is in addition to the 21 day notice of trustee's sale, and the notice must be provided prior to posting of the notice of trustee's sale and the commencement of the 21 day notice period. TEX. PROP. CODE ANN. § 51.002(d) (Vernon Supp. 1994).
273. Parker, 852 S.W.2d at 744-45. Additionally, the debtor had waived notice of intent to accelerate, which became effective because it was clear and unequivocal and, again, did not pertain to a debt secured by the debtor's residence. Id.; see also Shumway v. Horizon Credit Corp., 801 S.W.2d 890, 892 (Tex. 1991) (holding that the waiver of right to notice of intent to accelerate must be clear and unequivocal).
274. TEX. PROP. CODE ANN. § 51.002(g) (Vernon Supp. 1994). Subsection (g) now provides as follows: "The entire calendar day on which the notice of sale is given, regardless of
vide similar computations of the twenty day notice period regarding an opportunity to cure an indebtedness secured by a debtor’s residence.275

5. Residential Mortgages — 20 Day Notice

As mentioned above, the Texas Property Code provides that when a debt is secured by a lien against the debtor’s principal residence, the secured creditor must provide twenty days notice and opportunity to cure default prior to acceleration or foreclosure posting.276 That statute took effect January 1, 1988. In Rey v. Acosta277 the note in question had been executed and delivered prior to the effective date of the twenty day notice statute but it was secured by real property that served as the debtor’s residence. After the debtors failed to pay a series of installments, the secured creditor’s lawyer sent written notice that the note had been declared immediately due and payable. Acosta, the creditor, thereafter filed suit and was granted judgment for the amount due under the note.278 Apparently, foreclosure had not been sought.

The borrowers appealed, claiming that they were entitled to the twenty day notice and opportunity to cure provided in the Property Code provision. Again, the amendment took effect after the promissory note had been executed and delivered. The issue, therefore, facing the appellate court was whether to apply the amended statute to a contract executed before the statute’s effective date. The court found that the statute was procedural and remedial in nature, not affecting substantive rights, and therefore the statute should be applied retroactively.279 Thus, the twenty day notice was required. Based upon the failure to give notice under the amended statute, the court further found that the borrowers were relieved from paying attorneys’ fees or costs.280

The court, however, found the borrowers liable for all past due payments, given the fact that the creditor’s single failure to provide the required notice of acceleration did not excuse the borrowers from paying required payments of principal and interest over that period of time.281 The court further re-

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275. Id. § 51.002(d). Subsection (d) now provides that the debtor must be given at least 20 days to cure a default before the notice of sale can be given. The amendment further provides as follows:

The entire calendar day on which the notice required by this subsection is given, regardless of the time of day at which the notice is given, is included in computing the 20-day notice period required by this subsection, and the entire calendar day on which notice of sale is given under Subsection (b) is excluded in computing the 20-day notice period.

276. Id. § 51.002(d).

277. 860 S.W.2d 654 (Tex. App.—El Paso 1993, n.w.h.).

278. Id. at 656-67.

279. Typically, retroactive laws or laws impairing the obligations of contracts are not permitted. See Tex. Const. art. I, § 16; see also Rey, 860 S.W.2d at 657. Remedial statutes that do not disturb vested rights, however, may apply retroactively. Tex. Const. art. I, § 16.

280. Rey, 860 S.W.2d at 658-59.

281. Id. at 658.
manded for consideration of the borrower's counterclaims under the Texas Debt Collection Practices Act and the Deceptive Trade Practices Act resulting from the premature acceleration of the note.

6. Notice to Last Known Address

In Onwuteaka v. Kohen, a case discussed above in the context of twenty-one day notices, the court also held that notice to a debtor's last known address is sufficient if addressed to the debtor's last known address as shown by the records of the holder of the debt. To establish a violation of the statutory requirements regarding notice, it must be shown that the holder of the debt had in its records the most recent address of the debtor and failed to mail a notice by certified mail to that address.

7. Separate Obligations of Note and Lien

In Whittington v. Whittington the Beaumont Court of Appeals reiterated the general rule regarding separate obligations of a note and a lien. The court, in dicta, stated that where there is a debt secured by a note, in turn secured by a lien, the note and the lien constitute separate obligations so that suit may be had on the note to obtain a personal judgment, and later suit may be had on the lien if the personal judgment is not satisfied. Although this was a divorce case, and the above statement appeared in dicta, it is significant from the standpoint that it implies that a creditor may seek a personal judgment on a note, in which event the underlying lien securing that note would be unimpaired. This is statutory with respect to personal property security interests, but there is no analogous statute requiring real property foreclosure.

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284. Rey, 860 S.W.2d at 659. “Wrongful acceleration of a real estate note, as occurred here, violates the Texas Debt Collection Practices Act and the Deceptive Trade Practices Act as a matter of law.” Id.
286. Id. at 892; see TEX. PROP. CODE ANN. § 51.002(e) (Vernon Supp. 1993).
287. 853 S.W.2d 193 (Tex. App.—Beaumont 1993, n.w.h.).
288. Id. at 195.
290. Whittington, however, reiterates the general rule found in earlier cases:

The holder of a secured note is not required to exhaust his remedies against the security before enforcing the debt against the original maker, but he may proceed to judgment against the maker without reference to such security whether the security is in the form of a pledge of collateral or a mortgage on real or personal property.

Garza v. Allied Fin. Co., 566 S.W.2d 57, 62 (Tex. Civ. App.—Corpus Christi 1978, no writ) (citing Maupin v. Chaney, 163 S.W.2d 380 (Tex. 1942)); see also Middleton v. Nibling, 142 S.W. 968, 969 (Tex. Civ. App.—Austin 1911, no writ) (stating that a mortgagee “may bring suit on [the debt] and obtain judgment for the debt; and if no foreclosure is asked in such suit he may subsequently maintain a suit to foreclose his lien.”)
E. FRAUDULENT TRANSFERS

Chapter 24 of the Texas Business & Commerce Code is the Texas version of the Uniform Fraudulent Transfer Act. Essentially, the act is designed to protect creditors against transfers made by a person or entity without receiving reasonably equivalent value when the indebted person or entity is insolvent, or as a result becomes insolvent. Additionally, Section 548 of the Bankruptcy Code allows a trustee in certain circumstances to avoid or set aside transfers and obligations that are similarly fraudulent as to a bankruptcy estate or its creditors.

1. Corporate Good Will: Transfers Between Corporations

*Airflow Houston, Inc. v. Theriot* presents a somewhat unusual situation because the bulk of the transferred assets essentially consisted of the intangible goodwill of two corporations. Generally, two related corporations experienced financial difficulties and failed to pay their franchise taxes. This resulted in the termination of their certificates of authority to do business in 1988. The corporations were unable to pay their bank debt in the years leading up to 1988, and the principals of the corporation agreed to liquidate their assets to reduce related bank debt. Around the same time, however, Theriot, an individual, loaned one of the corporations $100,000.00 in return for a promissory note. During the liquidation process, a new corporation was formed by or at the behest of one of the principals of the two insolvent corporations. Although no tangible assets were transferred to this new corporation, intangible assets such as the company logo, name, telephone number, goodwill, and possibly the client list of the company were all transferred to the new corporation, which had been created without the knowledge of Theriot. Additionally, the transfers also apparently occurred without Theriot’s knowledge.

The trial court, and the court of appeals in affirming, first disregarded the separate corporation identities of the two original corporations (a parent and its subsidiary) and the newly formed secret corporation. The appellate court held that the evidence was sufficient to disregard the corporate identities.

293. 849 S.W.2d 928 (Tex. App.—Houston [1st Dist.] 1993, no writ).
294. "Whether or not to disregard the corporate fiction is a question of fact and common sense." *Id.* at 931. Typically, the following factors may be considered in determining whether corporations have maintained their separate existence:

1. Common employees;
2. Common offices;
3. Centralized accounting;
4. Payment by one corporation of wages of the other corporation’s employees;
5. Common business names;
6. Services rendered by employees of corporation on behalf of the other corporation;
7. Undocumented transfers of funds between corporations; and
8. Unclear allocation of profits and losses between corporations.

*Id.; see also* Superior Derrick Servs., Inc. v. Anderson, 831 S.W.2d 868, 864 (Tex. App.—Houston [14th Dist.] 1992, writ denied).
With respect to the allegedly fraudulent transfer, the critical issue was whether a transfer of goodwill could be subject to the fraudulent transfer statute. The court noted that goodwill is property subject to being sold or otherwise transferred. Even though goodwill is intangible in nature, it is nevertheless an integral part of the business, just like physical assets. Accordingly, the court found that the transfer of good will constituted a transfer of property under the Fraudulent Transfer Act. Finally, the damage award against the secret corporation was not limited to the value of the good will transferred. Rather, the damages against the new corporation were in an amount equal to the entire indebtedness under Theriot's promissory note.

2. Insolvency — Balance Sheet Test

In Pioneer Home Builders, Inc. the bankruptcy court applied the balance sheet test, found in both the Bankruptcy Code and the state statute, to a series of foreclosures by and transfers to a major secured creditor of the debtor. Under the balance sheet test, a corporation is deemed insolvent when the sum of its debts exceeds the fair value of its assets. The court's analysis focused on the meaning of the phrase "a fair valuation," which the court found was the fair market price, based upon what price certain of the assets would bring on the open market, without a deduction for costs and expenses associated with the sale of the assets. Applying the balance sheet test, and based upon the court's interpretation of "a fair valuation," the court found that the debtor was not insolvent at the time the transfers were made.

That finding, however, did not conclude the resolution of whether the transfers could be set aside. The court noted that both the Bankruptcy Code and the state statute allow the avoidance of transfers "which financially cripple a debtor and leave it with unreasonably small capital." Neither statute, however, defines unreasonably small. The court examined the debtor's ability to generate enough cash from operations and asset sales to pay debts and remain financially stable. In Pioneer Home Builders the court noted that the debtor was having such difficulties before the subject transfers that the

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295. Theriot, 849 S.W.2d at 933.
296. Id. at 932-33. The court applied the 1967 version of the state's Fraudulent Transfer Act. Id.
297. Id. at 933-34. The court based its award of damages on the language in the statute allowing "any other relief the circumstances may require." Id. at 934.
299. See 11 U.S.C. § 101(32) (1988); see also TEX. BUS. & COM. CODE ANN. § 24.003(a), which provides as follows: "(a) A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation." TEX. BUS. & COM. CODE ANN. § 24.003(a) (Vernon 1991).
300. Pioneer Home Builders, 147 B.R. at 891-92. "A fair valuation of a debtor's assets, therefore, must concern itself with the price a debtor could obtain at open market, not the net proceeds of the sale." Id. at 892.
301. Id. at 893.
302. Id. at 893-94 (citing TEX. BUS. & COM. CODE ANN. § 24.005 (Vernon 1991) and 11 U.S.C. § 548 (1988)).
transfers did not significantly exacerbate the problem. The court applied the state and federal statutes to require "that the disputed transfers cause the unreasonably small capital condition." Accordingly, based on the court's finding that the debtor was not insolvent at the time of the transfer and that the transfers may have aggravated, but did not cause, the debtor's unreasonably small capital, the disputed transfers did not constitute fraudulent transfers subject to avoidance.

3. Federal Preemption of State Statute

In *Sweet Jan Joint Venture v. FDIC* borrowers filed suit against the FDIC, as receiver of a failed savings and loan, based upon certain allegations under the Uniform Fraudulent Transfer Act in connection with the transfer of notes as part of a purchase and assumption transaction. The court found, however, that the state statute presented an obstacle to the accomplishment of congressional objectives in connection with the FDIC and FSLIC's disposition of failed institutions. The court also dismissed a cause of action based upon an alleged breach of the duty of a duty of good faith and fair dealing on the part of one or more of the entities involved in the purchase and assumption.

F. Usury and Other Counterclaims

Although usury is more thoroughly covered in the article on banking law and elsewhere in this issue, it is not uncommon for borrowers to assert usury as a counterclaim in response to attempts to collect or enforce an indebtedness. Accordingly, a number of usury-related cases are included in this section of the article. Most of these cases center on usury, but as is the case in the foreclosure section of the article, many of these cases include allegations of DTPA violations, breach of a purported duty of good faith and fair dealing, and other claims.

1. Overdraft Charges

In a decision with potentially far reaching implications, a Houston Court of Appeals ruled that the honoring of an overdraft on a checking account is a loan by the bank, and a charge assessed against the customer for this service may constitute interest for purposes of the Texas usury law. In *Tony's Tortilla Factory, Inc. v. First Bank* the plaintiff maintained two checking

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303. *Id.* at 894 (emphasis in original). The court also noted that although a debtor may be unable to meet its financial obligations, this does not necessarily presuppose legal insolvent. *Id.* at 894 n.7. But see TEX. BUS. & COM. CODE ANN. § 24.003(b) (Vernon 1991) ("[A] debtor who is generally not able to pay the debtor's debts as they become due is presumed to be insolvent.").


306. *Id.* at 1258.

307. *Id.* The court found that there was no evidence to support that the entities in question had a special relationship of the type necessary for a plaintiff to prevail on such a claim. *Id.*

accounts in which it had overdrawn on checks ranging from $11.44 to $5,170.00 over the course of less than a year. The bank assessed a service charge of $20.00 for each overdraft.\textsuperscript{309} The trial court granted an instructed verdict in favor of the bank, and the customer (which was also a borrower of the bank from time to time) appealed on the basis that whether and to what extent the service charges were usurious constituted a question of fact for the jury.

The court applied a step-by-step analysis to determine whether overdraft payments were loans, whether the customer incurred an absolute obligation to repay those overdrafts, and whether the overdraft fees were excess compensation for the lending of money.\textsuperscript{310} As a threshold inquiry, there must have been an overcharge by a lender for the use, forbearance, or detention of the lender’s money. The essential elements of usury are: a loan of money; an absolute obligation that the principal be repaid; and exacting a greater compensation than allowed by law for the use of money by the borrower.\textsuperscript{311} The court also noted that under the UCC, a bank may charge an otherwise properly payable item against a customer’s account, even though that charge creates an overdraft.\textsuperscript{312} The court also noted that the Texas Supreme Court has stated, and numerous other jurisdictions hold, that when a bank voluntarily pays a check as an overdraft, it makes a loan to its customer.\textsuperscript{313}

The court next inquired whether the bank expected the customer to repay the bank for the overdrawn checks. Reviewing testimony in the trial court, the court concluded that there was sufficient evidence presented that the customer was expected to repay the bank for the overdrafts. Having addressed that issue, the court then analyzed the usury implications of the $20.00 per check service fee. As noted above, interest greater than that allowed by law is usurious,\textsuperscript{314} interest being defined as compensation allowed by law for the use, forbearance, or detention of money.\textsuperscript{315} The court held that a lender may make certain extra charges for distinctly separate and additional consideration other than the lending of money, in which event a court would look beyond the form of the transaction to its substance to determine whether the additional charges are usury.\textsuperscript{316} After reviewing substantial testimony regarding the imposition of the fee and the bank’s internal character-

\begin{itemize}
  \item \textsuperscript{309} \textit{Id.} at 586-87.
  \item \textsuperscript{310} \textit{Id.} at 584.
  \item \textsuperscript{311} \textit{Id.} at 584 (citing Holly v. Watts, 629 S.W.2d 694, 696 (Tex. 1982)).
  \item \textsuperscript{312} TEX. BUS. & COM. CODE ANN. § 4.401 (Vernon 1968).
  \item \textsuperscript{313} \textit{Tony’s Tortilla Factory}, 857 S.W.2d at 584; see Brian v. Citizens Nat’l Bank, 628 S.W.2d 761, 763 n.2 (Tex. 1982); see also United States v. Christo, 614 F.2d 486, 493 (5th Cir. 1980) (holding that a bank may enforce overdraft just like any other loan); Sayen v. Riggs Nat’l Bank, 544 A.2d 267, 269 (D.C. App. 1988). Numerous other cases are cited in the \textit{Tony’s Tortilla Factory} opinion. See \textit{Tony’s Tortilla Factory,} 857 S.W.2d at 584-85.
  \item \textsuperscript{314} TEX. REV. CIV. STAT. ANN. art. 5069-1.01(d) (Vernon 1987).
  \item \textsuperscript{315} \textit{Id.} at art. 5069-1.01(a). If there is no specified rate of interest agreed by the parties, then the rate is six percent (6%) per annum. \textit{Id.} at art. 5069-1.03.
  \item \textsuperscript{316} \textit{Tony’s Tortilla Factory,} 857 S.W.2d at 586 (citing Texas Commerce Bank v. Goldring, 665 S.W.2d 103, 104 (Tex. 1984)); Gonzales Sav. Ass’n v. Freeman, 534 S.W.2d 903, 906 (Tex. 1976). Whether such a fee or charge is interest or a service charge is a question of fact for the jury. \textit{Id.} at 104.
\end{itemize}
ization of those fees, the court determined that enough evidence existed to go to the jury on whether there was an absolute obligation that principal be repaid and whether the service charges constituted interest on a loan.317

Although this precise question could arise in any banking context, its possible implications are obvious, and as a practical matter, the situation would likely arise in the context of a financially troubled borrower asserting a counterclaim or an affirmative claim in response to a debt collection effort. In Tony's Tortilla Factory, for instance, that litigation arose in the form of a wrongful foreclosure suit.318


In Moore v. Liddell, Sapp, et al.319 Moore and his son were jointly and severally liable on a promissory note (the Carlson Park note). Moore had also guaranteed other indebtedness incurred by his son and sued his creditor's law firm alleging usury in making demand and filing suit on both debts. The court addressed Moore's usury allegations on the assumption that Moore's third party guarantee was required as a condition for the extension of funds on the note on which he was directly liable. Moore relied on the holding in Alamo Lumber Co. v. Gold320 to support his allegation that the amounts guaranteed on his son's notes constituted additional interest on the Carlson Park note. In Alamo Lumber Co., the Texas Supreme Court held that if payment or assumption of another's existing debt is required as a condition of the extension of credit, then the amount of the debt paid or assumed is treated as additional interest for usury calculations.321 In Moore, however, Moore was only required to guarantee subsequent loans to his son, which contrasted with Alamo Lumber Co., in which actual payment or direct assumption of the debt was the triggering event.322 In Moore the court reasoned that the liability of a guarantor is a contingent, secondary obligation in nature, liability for which is expressly contingent on the original maker's default. Therefore, the court held that Moore's guarantee of his son's indebtedness was not usury.323

3. Failure to Credit Principal

Kenton v. Karotkin324 involved another claim against a creditor's lawyers. Two lawyers, on separate occasions, made demand on Kentor for amounts that included both the full accelerated principal balance and a number of past due installments. The letters failed to take into account the fact that

317. Tony's Tortilla Factory, 857 S.W.2d at 586-87.
318. Id. at 582-584.
319. 850 S.W.2d 291 (Tex. App.—Austin 1993, writ denied).
320. 661 S.W.2d 926 (Tex. 1983).
321. Id. at 928.
323. Id. at 294.
324. 852 S.W.2d 261 (Tex. App.—Austin 1993, writ denied).
payment of the past due installments would necessarily result in a reduction of the principal amount also contained in the letter. In other words, principal was overcharged. Both lawyers admitted that the overcharge contained in their letters resulted from their "negligence and carelessness."\(^{325}\) This admitted negligence and carelessness did not constitute accidental and bona fide error which is generally characterized as a clerical error resulting from unintentional mishaps in office practice or routine.\(^{326}\) Kentor claimed that to the extent there was an overcharge or a failure to credit principal, that overcharge constituted a charge for the use, forbearance, or detention of money, and therefore constituted usury. The trial court found, however, and the court of appeals affirmed, that an overcharge of principal is just that — an overcharge of principal. The appellate court found that Kentor's reliance on an earlier case the court had decided was misplaced, instead relying on the same court's recent finding in a more recent case also addressing a failure to credit principal.\(^{327}\) That earlier case found that neither the failure to credit a large principal payment nor the resulting interest charge were usurious.\(^{328}\)

4. Usury Savings Clause

In *Bernie's Custom Coach v. Small Business Administration*\(^ {329}\) the Fifth Circuit, applying Texas law, addressed a claim that language contained in a promissory note constituted an illegal contract for the right to charge usurious interest.\(^ {330}\) The claims focused on the note's acceleration clause, which allowed for acceleration of the entire "indebtedness," which was defined as all principal interest, whether now due or "hereafter to become due."\(^ {331}\) The borrower claimed that based upon this definition, the note on its face allowed the lender to declare due unearned interest.

The promissory note in question, however, contained a usury savings clause to the effect that notwithstanding anything contained in the note, the interest in the note would never exceed the maximum rate allowed by law. Usury savings clauses have been routinely recognized as valid and enforceable to defeat claims of usury, and courts generally presume that the parties intended a non-usurious contract.\(^ {332}\) Accordingly, the Fifth Circuit held

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325. *Id.* at 265 n.8.
327. *Kentor*, 852 S.W.2d at 266. *See* McPherson Enters., Inc. v. Producers Coop. Mktg. Ass'n, Inc., 827 S.W.2d 94 (Tex. App.—Austin 1992, writ denied). Kentor relied upon the court's finding in Hardwick v. Austin Gallery of Oriental Rugs, Inc., 779 S.W.2d 438 (Tex. App.—Austin 1989, writ denied); however, that case involved an overcharge of money that was not contemplated by the parties to the original contract, and the facts otherwise were dissimilar to those in *Kentor*.
328. *Kentor*, 852 S.W.2d at 267 (citing *McPherson*, 827 S.W.2d at 96).
329. 987 F.2d 1195 (5th Cir. 1993).
330. The mere "contracting for" usurious interest may be a violation of the usury statutes, even though no interest is actually charged or collected. *Id.* at 1197 (citing Ashley v. Edwards, 626 S.W.2d 107, 111 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ)).
331. *Bernie's Custom Coach*, 987 F.2d at 1197.
332. *Id.* at 1197-98. *See*, e.g., FDIC v. Claycomb, 945 F.2d 853, 860 (5th Cir. 1991), cert.
that the note was not usurious. This finding obviated the need to address whether the note was otherwise usurious.333

5. Pre-Payment Penalties

In Affiliated Capital v. Commercial Federal Bank334 the lender first notified a borrower of a possible foreclosure following default in two monthly payments. In response, the borrower requested prepayment information. The lender responded that the note did not allow prepayment prior to a certain date, and the lender refused to waive note provisions to that effect. Later, the bank accelerated the note demanding payments for the balance due and the prepayment penalty. The borrower asserted that the prepayment penalty was usurious, the theory being that had the accelerated debt been paid following the acceleration, the entire prepayment penalty would have amounted to an astronomical charge of interest in a very short period of time. The court refused to characterize the prepayment penalty as a charge for unearned interest.335 Rather, the court found that the prepayment penalty was more in the nature of mitigation of the lender’s loss of the originally contracted interest.336 As such, the penalty would be susceptible to the application of the spreading doctrine and the usury savings clause found in the note.337

The borrower asserted three other claims, all relating to the no-prepayment and acceleration clauses contained in the note. Those claims were based on breach of contract, breach of duty of good faith, and the Deceptive Trade Practices Act. Before addressing those claims, the court found that the note was not ambiguous.

With respect to the various causes of action asserted by the borrower, the bank found that the lender’s refusal to allow prepayment did not constitute a breach of contract, moving next to the allegations of a breach of duty of good faith. The court noted the general rule that there can be no breach of a duty of good faith merely by a party’s acting in strict accordance with a contract’s terms.338 The court did not address whether and to what extent a debtor/creditor relationship can otherwise give rise to a duty of good faith and fair dealing. Numerous cases have held, however, that there is no such duty on the part of a lender absent other circumstances,339 nor is such a duty denied, 112 S. Ct. 2301 (1992) (“The court must, if reasonably possible, give effect to the savings clause and interpret the savings clause as to deny the right to usurious interest.”); Smart v. Tower Land & Inv. Co., 597 S.W.2d 333, 341 (Tex. 1980) (“[I]t will be presumed that the parties intended a non-usurious contract.”); Myles v. Resolution Trust Corp., 787 S.W.2d 616, 618 (Tex. App.—San Antonio 1990, no writ) (“Texas has repeatedly given effect to usury savings clauses to defeat a construction of a contract that would violate state usury laws.”).

333. Bernie’s Custom Coach, 987 F.2d at 1199.
334. 834 S.W.2d 521 (Tex. App.—Austin 1992, no writ).
335. Id. at 525-26.
336. Id.
337. Id.
338. Id. at 527; see English v. Fisher, 660 S.W.2d 521, 522 (Tex. 1983).
339. See, e.g., FDIC v. Coleman, 795 S.W.2d 706, 708-09 (Tex. 1990); Baskin v. Mortgage and Trust, Inc., 837 S.W.2d 743, 747 (Tex. App.—Houston [14th Dist.] 1992, writ denied); McDonald v. Foster Mortgage Corp., 834 S.W.2d 573, 576 (Tex. App.—Houston [14th Dist.]
presumed in typical contractual relationships.\textsuperscript{340}

Finally, the borrower asserted that the bank violated the DTPA in numerous respects. As was the case with the good faith claims, the court held that enforcing rights provided by contract is not a violation of the DTPA.\textsuperscript{341}

Moving to the more basic problem of asserting DTPA violations against a lender, the court found that the borrower did not contract to buy property, materials, or anything else from the bank. Rather, the borrower contracted to borrow money using certain real estate as collateral. Thus, the court found no DTPA violations, even assuming the bank's actions were "oppressive" as alleged by the borrower.\textsuperscript{342} Thus, the court affirmed the trial court's summary judgment in favor of the bank.\textsuperscript{343}

In a more recent opinion of the Dallas Court of Appeals, the court addressed the question of a no prepayment clause in a real estate lien note. Groseclose v. Rum\textsuperscript{344} did not arise in a debt collection context, but it is nevertheless instructive of the issues of prepayment penalties and spreading in a usury context. The borrowers sought declaratory relief to the effect that a no-prepayment clause in a real estate lien note violated the Texas statute that prohibits prepayment charges or penalties when residential mortgage loans exceed a specified rate of interest.\textsuperscript{345} The court held that the statutory prohibition applies only if the note's interest rate is greater than the twelve percent per annum referenced in the statute because, under Texas law, the general rule is that unless the loan agreement provides otherwise, and absent other statutory prohibition, a borrower does not have the right to prepay a loan.\textsuperscript{346} Therefore, according to the court, a no prepayment clause cannot in and of itself be interpreted as a penalty, because it merely states the rights of the parties.\textsuperscript{347} The court then applied the spreading test to allocate the pre-


\textsuperscript{341} \textit{Affiliated Capital}, 834 S.W.2d at 528; see also Ogden v. Dickinson State Bank, 662 S.W.2d 330, 333 (Tex. 1983) (no violation of DTPA when bank forecloses for partial default, as provided in contract).

\textsuperscript{342} Id. One whose only relationship with a lending institution is that of a borrower is not a consumer under the D.T.P.A. \textit{See} First State Bank v. McMordie, 861 S.W.2d 284, 285-86 (Tex. App.—Amarillo 1993, n.w.h.); Riverside Nat’l Bank v. Lewis, 603 S.W.2d 169, 173-75 (Tex. 1980).

\textsuperscript{343} \textit{Affiliated Capital}, 834 S.W.2d at 529.

\textsuperscript{344} 860 S.W.2d 554 (Tex. App.—Dallas 1993, n.w.h.).

\textsuperscript{345} Art. 5069-1.07(f) states that prepayment charges or penalties cannot be collected when interest rates exceed certain amounts: if a loan for property that is to be the residential homestead of the borrower is made at an interest rate that is greater than the rate prescribed by subsection (d) of this article, a prepayment charge or penalty may not be collected on the loan unless the charge or penalty is required by an agency created by federal law. TEX. REV. CIV. STAT. ANN. art. 5069-1.07(f) (Vernon 1987). Subsection (d) provides for an interest rate of twelve percent (12%) per annum. Groseclose, 860 S.W.2d at 556.

\textsuperscript{346} Id. at 557.

\textsuperscript{347} Id.
payment penalty across the life of the loan to determine whether the loan exceeded the statutory rate of interest. Based upon testimony in the trial court, the court found that there was a material fact issue, so it reversed a summary judgment in favor of the borrower.348

6. Federal Holder in Due Course

In RTC v. Ammons349 a trial court's summary judgment that apparently held a note void and unenforceable because the creditor demanded and charged usurious interest on a promissory note was reversed. During the course of the trial court litigation, the original plaintiff savings and loan was declared insolvent, and the RTC became the institution's receiver. After the RTC became a substituted party, it asserted D'Oench Duhme and its federal holder in due course status as an absolute defense against the borrower's usury claims. The appellate court agreed, holding that at a minimum, the RTC raised a fact issue with respect to its holder in due course status, presumably whether it acquired the note in good faith and without actual knowledge of any defenses.350 Additionally, the court held that because the alleged usury occurred in a summary judgment motion and supporting affidavit, it represented a pleading, and based on recent Texas authority, that did not constitute usury.351

III. CONSUMER CREDIT

A. FAIR DEBT COLLECTION PRACTICES ACT

There was little, if any, development in the Fifth Circuit or the Texas courts under the Fair Debt Collection Practices Act.352 Clomon v. Jackson353 may be the only circuit level authority under the Act during the Survey period. Even though it arises out of the Second Circuit, it is suggested reading as an example of the manner in which a lawyer can be found to have violated the Act, which prohibits the use of any false, deceptive, or misleading practice in an attempt to collect certain consumer debts.354 The Clomon

348. Id. at 557-58.
349. 836 S.W.2d 705 (Tex. App.—Houston [1st Dist.] 1992, no writ.)
350. Id. at 710. Texas case law acknowledges that there has developed a federal, common law holder in due course status conferred upon receivers of financial institutions, even when those receivers do not meet the requirements of state law to be a holder in due course. Id.; see also NCB Texas Nat'l Bank v. Campisi, 788 S.W.2d 115, 118 (Tex. App.—Houston [14th Dist] 1990, writ denied). The effect of being a holder in due course is that personal defenses, such as failure of consideration and usury typically may not be asserted against a holder in due course who has acquired a note in good faith and without actual knowledge of those defenses. Ammons, 836 S.W.2d at 709 n.5.
351. Id. at 710; see George A. Fuller Co. v. Carpet Servs., 823 S.W.2d 603 (Tex. 1992). A charge of interest must be more than a pleading filed with the court. "Usury statutes are designed to correct abusive practices in consumer and commercial credit transactions, not to serve as a trap for the unwary pleader in a court proceeding." Ammons, 836 S.W.2d at 710-11 (citing Murray v. O&A Express, Inc., 630 S.W.2d 633 (Tex. 1982)).
353. 988 F.2d 1314 (2d Cir. 1993).
354. The test used by the Second Circuit is an objective standard based on the "least sophisticated consumer standard." Id. at 1318.
court found that the use of a mass produced collection letter bearing a facsimile signature of a lawyer, who had not personally reviewed the matters referenced in the letter, amounted to a violation of the Act.355

B. TEXAS DEBT COLLECTION ACT

In Rey v. Acosta,356 a case discussed above,357 the court held that wrongful acceleration of a note secured by real property violates the Texas Debt Collection Practices Act and the Deceptive Trade Practices Act as a matter of law.358 In Rey the creditor failed to provide the notice of intent to accelerate as required by the Texas Property Code in the context of the indebtedness secured by a debtor's residence, so acceleration without that notice was premature. The court held that this violated the Texas Debt Collection Practices Act, which specifically prohibits any debt collector from "threatening to take any action prohibited by law."359 Moreover, when the creditor claimed that the note had been accelerated, this amounted to a representation that the creditor had the right to terminate a contract, when in fact that right had not yet ripened. According to Rey, this violated the Deceptive Trade Practices Act as a matter of law.360

355. Id. at 1322-23. The language used in the letters was sufficient to cause the least sophisticated consumer to believe that the lawyer had reviewed and considered individual files, which was misleading. Id. at 1320-21.
356. 860 S.W.2d 654 (Tex. App.—El Paso 1993, n.w.h.).
357. See supra notes 277-84.
358. Rey, 860 S.W.2d at 659.
359. Id.; see TEX. REV. CIV. STAT. ANN. art. 5069-1102(h) (Vernon 1987).
360. Rey, 860 S.W.2d at 659; see also Dixon v. Brooks, 604 S.W.2d 330, 334 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.).