



1989

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Recommended Citation

Vernon O. Teofan, et al., *Creditor and Consumer Rights*, 43 Sw L.J. 175 (1989)
<https://scholar.smu.edu/smulr/vol43/iss1/8>

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CREDITOR AND CONSUMER RIGHTS

by

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

THIS Article surveys significant developments under Texas law for the period beginning October 1987 through December 1988 in the areas of creditor and consumer rights. During the Survey period, the Texas courts decided a number of usury and consumer credit cases worthy of note. In addition, this Article highlights several important changes regarding exempt property under Texas law .

I. USURY

During the Survey period the Texas Supreme Court rendered two interesting usury decisions. In *Seiter v. Veytia*¹ the court held that the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA)² does not preempt state law with respect to a usury claim arising from late charges in a loan secured by a first lien on residential real property.³ In *Steve's Sash & Door Co. v. Ceco Corp.*⁴ the court applied the implied definition of the term "principal" for purposes of the forfeiture provision under the Texas usury statute in the context of a suit on a sworn account.⁵ In *Seiter* the dispute arose from the sale of residential real property by the Seiters to the Veytias in July 1981, after the effective date of DIDMCA. As evidence of the purchase price the Veytias executed two promissory notes payable to the Seiters. The Veytias secured the notes with deeds of trust on the subject property. In 1984 the parties modified the original agreements. Under the modified agreement, the Veytias contracted for the payment of late charges amounting to \$20 per day for each day that any installment was past due. Thereafter, the Seiters instituted nonjudicial foreclosure proceedings upon the Veytias' default under the modified agreement.

In response to the foreclosure notice, the Veytias filed suit for injunctive relief and damages, alleging that the late charges constituted usurious inter-

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1. 756 S.W.2d 303 (Tex. 1988).

2. Pub. L. No. 96-221, 96 Stat. 132 (1980). Title V of the Act deals with state usury laws. Title V, § 501 (codified as 12 U.S.C. § 1735f-7 (1980)).

3. 756 S.W.2d at 305.

4. 751 S.W.2d 473 (Tex. 1988).

5. *Id.* at 475.

est under Texas law.⁶ The Seiters moved for summary judgment on the theory that DIDMCA preempted state law limitations on interest on loans secured by first liens on residential real property. The trial court granted summary judgment in favor of the Seiters.⁷ On appeal the San Antonio court of appeals held that DIDMCA did not preempt usurious late charges and reversed and remanded the case for trial.⁸ The Texas Supreme Court took up the case with a writ of error.⁹

First, the Texas Supreme Court held that since Texas did not explicitly opt out of DIDMCA, that federal law applied to the modified agreement in the case at bar.¹⁰ Next, the court examined the legislative history to DIDMCA and determined that Congress did not intend the federal law to preempt state limitations on late charges or similar borrower protections.¹¹ Finally, the court considered the Seiters' argument that since Texas law characterizes late charges as interest and therefore these late charges are subject to the federal preemption relative to the annual percentage rate.¹² The court rejected this argument because the federal definition of interest is limited to the annual percentage rate.¹³ Based upon the foregoing, the Texas Supreme Court affirmed the decision of the court of appeals to remand the usury claim to the trial court for disposition.¹⁴

In *Steve's Sash & Door* the controversy arose from the credit sale of doors by Steve's Sash and Door Company to the Ceco Corporation at a total purchase price of \$71,702.95. Steve's Sash delivered the doors and invoiced Ceco in several installments. Each invoice that Steve's Sash issued to Ceco provided for a thirty-day grace period before interest would begin to accrue on the outstanding balance. Ceco paid only a portion of the purchase price and Steve's Sash bought a suit on a sworn account to collect the unpaid balance. At the time Steve's Sash filed the suit, Ceco had already paid invoices amounting to \$41,796.80 upon which Steve's Sash charged no interest, and a \$13,454.70 invoice upon which Steve's Sash charged \$245.69 interest. Ceco filed a counterclaim, alleging that Steve's Sash had engaged in

6. The Veytias based their claim on the interest protection provisions in Texas statutes. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 to .09 (Vernon 1987). They also requested forfeiture of principal, attorneys' fees, and other penalties under *id.* art. 5069-1.06(1).

7. See 756 S.W.2d at 304.

8. 740 S.W.2d 64, 66-67 (Tex. App.—San Antonio 1987), *aff'd*, 751 S.W.2d 473 (Tex. 1988).

9. 756 S.W.2d at 303.

10. *Id.* at 304-05.

11. *Id.* at 305. "In exempting mortgage loans from state usury limitations, the committee intends to exempt only those limitations that are included in the annual percentage rate. The committee does not intend to exempt limitations on prepayment charges, attorneys' fees, late charges or similar limitations designed to protect borrowers." *Id.* (emphasis by the court) (quoting S. REP. No. 368, 96th Cong., 2d Sess. 19, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 236, 255).

12. 756 S.W.2d at 305. The Seiters relied upon *Dixon v. Brooks*, 604 S.W.2d 330, 333 (Tex. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.), and *Watson v. Cargill, Inc.*, 573 S.W.2d 35, 42 (Tex. App.—Waco 1978, writ ref'd n.r.e.).

13. 756 S.W.2d at 305.

14. *Id.*

usurious credit practices because Steve's Sash charged Ceco interest on the \$13,454.70 invoice during the contractual grace period.

Following a jury trial, the trial court entered judgment for Steve's Sash on the sworn account, and in addition awarded Steve's Sash attorney's fees, costs, and post-judgment interest. The court also rendered a take-nothing judgment on Ceco's usury counterclaim. On appeal the San Antonio court of appeals reversed and rendered judgment for Ceco on the usury counterclaim, granting Ceco prejudgment interest on its awarded damages.¹⁵ Moreover, the appellate court reversed the judgment for Steve's Sash on the sworn account and held that Steve's Sash had forfeited the entire principal balance of the account, including the invoices upon which it charged no interest.¹⁶

Steve's Sash appealed to the Texas Supreme Court for a writ of error asserting that the court of appeals should limit the forfeiture of principal to the \$13,454.70 invoice upon which it charged Ceco interest and should not apply the forfeiture to the entire purchase price. The court granted the writ of error and held that, for the limited purposes of applying the forfeiture provision of the usury statute, the term "principal" consisted of only the amount upon which the creditor charged the debtor usurious interest.¹⁷ The Texas Supreme Court reversed the court of appeals and held that Steve's Sash should forfeit only the principal sum of \$13,454.70 and not the entire purchase price.¹⁸ Moreover, the court reinstated the jury verdict for Steve's Sash on the sworn account and allowed an offset of the judgment against the usury penalties.¹⁹

The Texas Supreme Court further held that the court of appeals had erred in awarding prejudgment interest to Ceco on its usury claim because the exclusive penalties for usury set forth in the usury statute do not include prejudgment interest.²⁰ The court also concluded that an award of prejudgment interest to usury victims would not serve any valid policy objectives.²¹ Finally, the Texas Supreme Court rejected the procedural attacks of both parties.²²

The Texas courts of appeal also decided several usury cases dealing with

15. *Ceco Corp. v. Steve's Sash & Door Co.*, 714 S.W.2d 322, 328 (Tex. App.—San Antonio 1986), *rev'd*, 751 S.W.2d 473 (Tex. 1988).

16. *Id.* The Texas statute provides that where the usurious interest amounts to more than double the maximum lawful interest, the principal amount of the debt is forfeited. TEX. REV. CIV. STAT. ANN. art. 5069-1.06(2) (Vernon 1987).

17. 751 S.W.2d at 475. The court noted that the usury statute does not define the term "principal." *Id.* The statute however, defines the term "interest" as "the compensation allowed by law for the use or forbearance or detention of money." *Id.* The court considered these two terms as synergistic words that taken together result in a definition of "principal" as "that amount which is used, forborne, or detained, and upon which the interest is charge." *Id.*

18. *Id.*

19. *Id.* at 476. The verdict of \$16,451.45 for Steve's Sash offsets the \$2,000.00 penalty under art. 5069-1.06(1) and the \$13,454.70 penalty under art. 5059-1.06(2), resulting in a net recovery to Steve's Sash of \$996.75. *Id.*

20. *Id.*, see TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (Vernon 1987).

21. 751 S.W.2d at 476. The court distinguished cases sounding in tort in which an award of prejudgment interest reimburses the victim for the lost use of money or compensation for an injury. *Id.* (citing *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549 (Tex. 1985)).

22. 751 S.W.2d at 477.

such diverse issues as the bona fide error defense,²³ the inapplicability of the usury statute to lease agreements,²⁴ and the acceleration of a wraparound note secured by a deed of trust.²⁵ In *Martinez v. Corpus Christi Area Teachers' Credit Union*²⁶ the Corpus Christi court of appeals held that the bona fide error defense, once established, prevented the imposition of a penalty for usurious interest.²⁷ In August 1981 the Martinezes signed a promissory note payable to the credit union in the sum of \$4,900.00.²⁸ The promissory note stated that interest would accrue at ".49315 percent per day, an Annual Percentage Rate of 18 percent."²⁹ Thereafter, in August 1985, the Martinezes filed suit against the credit union, alleging that the note was usurious and that the credit union was negligent in the note preparation and the disposition of the vehicle that secured the original loan. In October 1985 the credit union sued the Martinezes to collect the unpaid balance of the note, alleging default.

Following consolidation of the matters for trial, the credit union filed motions for summary judgment on its claim against the Martinezes and its affirmative defense of bona fide error to the Martinezes' usury claim. The credit union alleged in its motions that the excessive per diem rate set forth in the note was the result of a clerical error. The credit union asserted that the intended interest rate was .049315 per diem as evidenced by the annual percentage rate stated in both the note and the payment schedule. The credit union further asserted that the applicable statute of limitations had run on the negligence claims. The trial court granted both motions for summary judgment in favor of the credit union and the Martinezes appealed.

The Corpus Christi court of appeal held that it would determine whether the rate of interest was usurious on the basis of the payment schedule set forth in the note, regardless of the stated per diem rate.³⁰ The court also considered the note to be ambiguous on its face since two provisions (the annual percentage rate and the payment schedule) called for 18 percent interest per annum but a third provision (the per diem rate provision) called for 180 percent per annum.³¹ Based on its findings, the court of appeals affirmed the trial court's holding that the note was not usurious as a matter

23. *Martinez v. Corpus Christi Area Teachers' Credit Unions*, 758 S.W.2d 946 (Tex. App.—Corpus Christi 1988, writ ref'd n.r.e.).

24. *Potomac Leasing Co. v. Housing Auth.*, 743 S.W.2d 712 (Tex. App.—El Paso 1987, writ dism'd).

25. *Greenland Vistas, Inc. v. Plantation Place Assocs.*, 746 S.W.2d 923 (Tex. App.—Fort Worth 1988, n.w.h.).

26. 758 S.W.2d 946 (Tex. App.—Corpus Christi 1988, writ ref'd).

27. *Id.* at 950.

28. This sum represented the amount of a deficiency remaining after the credit union repossessed and sold the vehicle that the Martinezes purchased on credit. While in the credit union's possession the vehicle was allegedly vandalized and brought much less than the balance of the car loan at the foreclosure sale.

29. The stated per diem rate of .49315 amounts to an annual percentage rate of 180 percent. The note specifically provided for payments of 11 installments of \$100.00 each and a final balloon payment of \$4,654.40. Thus, the total amount that the Martinezes would be required to pay under the note was \$5,754.40 on the original principal balance of \$4,900.00.

30. 758 S.W.2d at 950.

31. *Id.*

of law.³²

With respect to the bona fide error defense, the Corpus Christi court of appeals accepted the credit union's unrefuted evidence of a clerical mistake in the per diem rate and upheld the lower court's decision that the defense was valid as a matter of law.³³ The court also affirmed the denial of relief to the Martinezes on their contract and tort claims against the credit union because the statute of limitations had run.³⁴

In *Potomac Leasing Co. v. Housing Authority*³⁵ the controversy concerned the applicability of the usury statute to the subject lease agreement. The Housing Authority had leased a copy machine at a cost of \$850 per month, but after experiencing difficulties with the copier, the Housing Authority stopped making the lease payments. Potomac then repossessed the copier and filed suit in Michigan to recover damages for breach of the lease, including late charges of \$795.60 and interest of \$612.36. The Housing Authority countered by commencing suit in an El Paso court alleging usury, fraud, and deceptive trade practices under Texas law based upon the late charges and interest claimed in the Michigan pleading. The El Paso trial court entered summary judgment in favor of the Housing Authority on the usury claim and severed the remaining causes of action for trial. Potomac appealed the summary judgment on the grounds that the transaction was not subject to Texas usury law.³⁶

On appeal the court in *Potomac Leasing* noted that a nonusurious loan agreement may give rise to a usury claim where the collection efforts include charges of excessive interest or late fees.³⁷ The appellate court next considered whether the same rule applied to collection efforts relative to a lease transaction and concluded that it did not, unless the lease was a disguised credit transaction.³⁸ In so holding, the court of appeals determined that the usury statute³⁹ applies only to lending transactions; thus, a bona fide lease is excluded from the scope of the usury statute.⁴⁰ Accordingly, the court reversed the summary judgment and remanded the matter to the trial court.

In *Greenland Vistas, Inc. v. Plantation Place Associates*⁴¹ the Fort Worth court of appeals decided that the acceleration of a purchase money wrap-

32. *Id.*

33. *Id.* at 951.

34. *Id.* at 952.

35. 743 S.W.2d 712 (Tex. App.—El Paso 1987, writ *dism'd*).

36. TEX. REV. CIV. STAT. ANN. art. 5069-1.01 to .06 (Vernon 1987).

37. 743 S.W.2d at 713 (citing *Danziger v. San Jacinto Sav. Ass'n*, 732 S.W.2d 300 (Tex. 1987) and cases cited in *Dryden v. City Nat'l Bank*, 666 S.W.2d 213 (Tex. App.—San Antonio 1984, writ *ref'd n.r.e.*)).

38. *Id.* *Holley v. Watts*, 629 S.W.2d 694 (Tex. 1982) ("The essential elements of a usurious transaction are: (1) a loan of money; (2) an absolute obligation that the principal be repaid; and (3) the exaction of greater compensation than allowed by law for the use of the money by the borrower." (citation omitted)); *Transamerican Leasing Co. v. Three Bears, Inc.*, 586 S.W.2d 472 (Tex. 1979) (lease-purchase agreements are covered by usury statute).

39. TEX. REV. CIV. STAT. ANN. art. 5069-1.01 to .06 (Vernon 1987).

40. *Id.* The statute implement arts. XVI, § 11 of the Texas Constitution, which neither expressly nor impliedly covers lease transactions. 743 S.W.2d at 713 (citing *Maloney v. Andrews*, 483 S.W.2d 703 (Tex. Civ. App.—Eastland, 1972, writ *ref'd n.r.e.*)).

41. 746 S.W.2d 923 (Tex. App.—Fort Worth, 1988, *n.w.h.*).

around note secured by a deed of trust did not constitute a charge of usurious interest when the interest demanded was based upon the entire outstanding principal balance of the debt, including the underlying lien.⁴² The controversy arose from the sale of an apartment project from Greenland Vistas to Plantation Place. The parties financed the project by means of a cash down payment and the execution of a purchase money wrap note in the original principal amount of \$2,707,433.96. The wrap note included an underlying indebtedness with a balance of \$2,704,830.19 at the time of the sale. Subsequent to the sale, Plantation Place stopped making payments and Greenland Vistas accelerated the indebtedness and commenced foreclosure proceedings on the property.⁴³ Plantation Place then filed suit to enjoin the foreclosure and recover statutory penalties based on alleged usury violations.⁴⁴

Following a nonjury trial, the district court ruled that the acceleration demand constituted a usurious charge of interest under article 5069-1.01 of the usury statute.⁴⁵ The trial court enjoined the foreclosure sale and awarded judgment to Plantation Place in the sum of \$1,350,453.53 with interest at a rate of ten percent per annum.⁴⁶

The Fort Worth court of appeals in *Greenland Vistas* examined the unique nature of a wraparound mortgage and determined that the usury issue raised by Plantation Place was dependent on the parties' intent as evidenced by the loan documents.⁴⁷ In the instant case, the transaction involved a sale of property rather than a loan of money. Plantation Place obtained the full use and benefit of the realty at the time of the sale and the benefit of the underlying debt. Reading all of the debt instruments together to establish the intent of the parties, the court included the underlying indebtedness in the amount owed by Plantation Place to Greenland Vistas and held that the acceleration and demand was not usurious.⁴⁸ Accordingly, the court reversed the trial court's judgment and rendered a take nothing judgment, charging costs to Plantation Place.⁴⁹

42. *Id.* at 927.

43. In connection with the acceleration, Greenland Vistas demanded payment of \$2,944,654.51, calculated to be the outstanding balance of the wrap note (including the underlying lien) with accrued interest.

44. Plantation Place argued that interest was properly chargeable only on the difference between the wrap note and the underlying debt.

45. TEX. REV. CIV. STAT. ANN. art. 5069-1.01, .06 (Vernon 1987).

46. The court rendered judgment against Greenland Vistas, Inc. and Louis M. Stoler, the substitute trustee under the wraparound mortgage. 746 S.W.2d at 923.

47. *Id.* at 925 (citing Consolidated Capital Special Trust v. Summers, 737 S.W.2d 327 (Tex. App.—Houston [14th Dist.] 1987, no writ)).

48. *Id.* at 927. The court reviewed the transaction documents and recited that:

(1) Plantation Place . . . in partial consideration [of the real estate purchase] delivered a \$2,707,433.96 wrap note to Greenland Vistas; (2) the face amount of the note included a prior lien indebtedness; (3) in order to convey free and clear title of the property, Greenland Vistas undertook, but did not assume, to pay the underlying obligations out of the payments received from Plantation Place; and (4) Plantation Place took the property subject to these underlying liens and upon acceleration would be liable for the underlying lien balance.

Id.

49. *Id.*

II. CONSUMER CREDIT AND DECEPTIVE TRADE PRACTICES

During the Survey period, Texas courts rendered several noteworthy decisions dealing with deceptive trade practices and consumer credit. Specifically, the Texas courts examined whether constructive notice barred a plaintiff's claims for fraud and deceptive trade practices;⁵⁰ whether the election of equitable relief precluded recovery of exemplary damages;⁵¹ and whether a borrower was a consumer entitled to bring an action against a lender for deceptive trade practices.⁵²

In *Ojeda de Toca v. Wise*⁵³ the Texas Supreme Court determined that despite constructive notice of the alleged defects based on the real estate recording statutes,⁵⁴ an aggrieved purchaser could maintain a cause of action against the seller under the Deceptive Trade Practice Act (DTPA)⁵⁵ for damages arising from the sale of real property.⁵⁶ The issue arose when Wise Developments sold a house to Mrs. de Toca that was subject to a recorded demolition order. After the city of Houston demolished the house, Mrs. de Toca sued Wise Developments, William J. Wise, and others on the basis of deceptive trade practices, fraud, and negligence.⁵⁷

At trial the jury found that Wise had actual knowledge of the demolition order and withheld the information from Mrs. de Toca in order to procure the sale. The jury also found that Mrs. de Toca would not have purchased the property had Wise disclosed the existence of the demolition order. The trial court entered judgment against Wise Developments and Wise individually (hereinafter referred to jointly as "Wise") for fraud and DTPA violations.⁵⁸

In a decision discussed in last year's Survey article,⁵⁹ the Houston court of appeals reversed the trial court's decision against Wise based upon constructive notice.⁶⁰ The appellate court held as a matter of law that recordation of the demolition order in the Harris County deed records operated as a bar to the DTPA and fraud claims.⁶¹

The Texas Supreme Court in *Ojeda de Toca* reviewed the applicable statutory provisions and concluded that the jury findings clearly established a cause of action against Wise under DTPA sections 17.50(a)(1) and

50. *Ojeda de Toca v. Wise*, 748 S.W.2d 449 (Tex. 1988).

51. *Consolidated Tex. Fin. v. Shearer*, 739 S.W.2d 477 (Tex. App.—Fort Worth 1987, writ ref'd).

52. *Holland Mortgage & Inv. Corp. v. Bone*, 751 S.W.2d 515 (Tex. App.—Houston [1st Dist.] 1987, no writ).

53. 748 S.W.2d 449 (Tex. 1988).

54. TEX. PROP. CODE ANN. § 13.002 (Vernon 1984).

55. TEX. BUS. & COM. CODE ANN. § 17.41 (Vernon 1987).

56. 748 S.W.2d at 451.

57. Two title companies named as defendants in the suit settled with Mrs. de Toca and were not parties to this appeal.

58. The trial court also rendered judgment against the title companies for negligence.

59. Teofan & O'Neill, *Creditor and Consumer Rights, Annual Survey of Texas Law*, 42 Sw. L.J. 208 (1988).

60. 733 S.W.2d 325, 327-28 (Tex. App.—Houston [14th Dist.] 1987). The appellate court reversed judgment against the title companies on other grounds. *Id.* at 327.

61. *Id.* at 328.

17.46(b)(23).⁶² As a result the court determined that Mrs. de Toca was entitled to recovery against Wise unless he could establish a defense to the DTPA and fraud claims. The *Ojeda de Toca* court next reviewed the case law cited by the appellate court⁶³ and expressly rejected the dictum that record notice serves as a defense to a claim arising under the DTPA.⁶⁴ The court noted that the legislature's intent in enacting the recording statute⁶⁵ was to protect the good faith purchaser's title to real property from the imposition of secret grants and liens not to bar the purchaser's DTPA or fraud claims.⁶⁶ Moreover, the court noted that the Texas courts historically had allowed fraud claims arising from real property transactions notwithstanding constructive notice afforded by the deed records.⁶⁷ Based upon the foregoing, the Texas Supreme Court determined that notice imputed under the recording statute would not operate as a defense to Mrs. de Toca's DTPA claims. Accordingly, the court reversed the court of appeals' decision and remanded the matter for appropriate disposition.

In *Consolidated Texas Financial v. Shearer*⁶⁸ the Fort Worth court of appeals reviewed a DTPA judgment that granted punitive damages to a plaintiff who had elected equitable relief instead of actual damages. The case arose from the foreclosure of a mechanics' and materialmen's lien upon the Shearers' residence. The Shearers sued the lienholder, Consolidated Texas Financial,⁶⁹ and Texas Insulators, alleging violations of the Texas Home Solicitation Transaction Act, the DTPA, and the Credit Code in connection with the purchase of storm windows and doors from Texas Insulators.⁷⁰ After a jury trial the Shearers elected the equitable remedy of voiding the fore-

62. 748 S.W.2d at 450. TEX. BUS. & COM. CODE ANN. § 17.50(a)(1) (Vernon 1987) provides redress to consumers sustaining damages as a result of trade practices set forth in § 17.46(b). The latter section proscribes, among other things, "the failure to disclose information concerning goods or services which was known at the time of the transaction if such failure to disclose such information was intended to induce the consumer into a transaction into which the consumer would not have entered had the information been disclosed." *Id.* § 17.46(b)(23).

63. The appellate court relied upon *Medallion Homes, Inc. v. Thermar Invs., Inc.*, 698 S.W.2d 400 (Tex. App.—Houston [14th Dist.] 1985, no writ); and *Jernigan v. Page*, 662 S.W.2d 760 (Tex. App.—Corpus Christi, 1983, writ ref'd n.r.e.) (judgment sustained on no evidence ground).

64. 748 S.W.2d at 450.

65. TEX. PROP. CODE ANN. § 13.002 (Vernon 1984).

66. 748 S.W.2d at 450-51 (citing 66 AM. JUR. 2d *Records and Recording Laws* § 48 (1973)).

67. *Id.* at 451, (citing *Graham v. Roder*, 5 Tex. 141, 147 (Tex. 1849); *Buchanan v. Burnett*, 102 Tex. 492, 119 S.W. 1141 (Tex. 1909); *Boucher v. Wallis*, 236 S.W.2d 519, 526 (Tex. Civ. App.—Eastland 1951, writ ref'd n.r.e.); and RESTATEMENT (SECOND) OF TORTS § 540 comment b (1977)). The court also distinguished *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903 (Tex. 1982), and *NRC, Inc. v. Pickhardt*, 667 S.W.2d 292 (Tex. App.—Texarkana 1984, writ ref'd n.r.e.), since title was not at issue in the *Ojeda de Toca* case.

68. 739 S.W.2d 477 (Tex. App.—Fort Worth 1987 writ ref'd).

69. Texas Insulators originally held the foreclosed installment contract and lien, but assigned them to Consolidated Texas Financial, a related entity.

70. The Shearers' specific complaints included failure to provide the Shearers with a copy of the retail installment contract, omission of the statutory rescission notice from the contract, backdating of the contract, and misrepresentations concerning the consequences of the lien on the home.

closure sale and quieting title to their home.⁷¹ In addition, the trial court granted punitive damages in the sum of \$20,000 pursuant to the jury findings.

Texas Insulators appealed the judgment of the trial court, asserting that the Shearers' election of equitable relief precluded an award of exemplary damages. Alternatively, Texas Insulators contended that the punitive award was disproportionate to the actual damages found by the jury. On appeal the court noted that when assessing punitive damages, a court should direct its attention towards the defendant's conduct and not to the nature or amount of the plaintiff's damages,⁷² because the purposes of exemplary damages are to punish the wrongdoer and to deter similar conduct.⁷³ In the instant case, the court of appeals said that the degree of the defendant's misconduct clearly warranted punitive measures and the plaintiffs established that they sustained verifiable injury. The court of appeals then ruled that the Shearers' choice of equitable relief did not preclude the award of exemplary damages.⁷⁴ Furthermore, the court held that the amount of the exemplary damages was reasonable in light of the actual damages sustained by the Shearers and the extent of Texas Insulator's misconduct. Accordingly, the court of appeals affirmed the trial court judgment.⁷⁵

In *Holland Mortgage & Investment Corp. v. Bone*⁷⁶ the Houston court of appeals considered the applicability of the DTPA to a lender/mortgagee and concluded that under proper circumstances a court should sustain liability. The Bones sued the mortgagee, Holland Mortgage and Investment Corporation, and the seller-builder after their home flooded as a result of the improper grading of the property. Following a jury trial, the court entered a judgment in the sum of \$33,000 against the builder and mortgage company, jointly and severally, for breach of warranty, negligence, and DTPA violations. Holland Mortgage and Investment Corporation appealed the judgment, alleging, among other things, that the Bones did not acquire goods or services from the mortgage company and were, therefore, not consumers⁷⁷ entitled to bring a DTPA action.⁷⁸

71. The jury found the actual damages to be \$36,288.00.

72. 739 S.W.2d at 480 (citing *Wright v. Gifford-Hill & Co.*, 725 S.W.2d 712, 714 (Tex. 1987); *Alamo Nat. Bank v. Kraus*, 616 S.W.2d 908, 910 (Tex. 1981)).

73. *Id.* at 479 (citing *Hofler v. Lavender*, 679 S.W.2d 470, 474 (Tex. 1984)).

74. *Id.* at 480. In reaching its conclusion, the court distinguished *Nabours v. Longview Sav. & Loan Ass'n*, 700 S.W.2d 901, 905 (Tex. 1985); and *Doubleday & Co. v. Rogers*, 674 S.W.2d 751, 755 (Tex. 1984) (punitive damages not sustained where plaintiff incurred no actual damages and did not seek equitable relief). *Id.* at 479-80.

75. *Id.* at 482. In its decision, the court also denied Texas Insulators' points of error relative to the special issues submitted to the jury. *Id.*

76. 751 S.W.2d 515 (Tex. App.—Houston [1st Dist.] 1987, n.w.h.).

77. TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon Supp. 1987) defines a "consumer" as "an individual . . . who seeks or acquires by purchase or lease, any goods or services." The term "goods means tangible chattels or real property purchased or leased for use." TEX. BUS. & COM. CODE ANN. § 17.45(1) (Vernon Supp. 1989). The DTPA defines "services" as "work, labor, or service purchased or leased for use, including services furnished in connection with the sale of repair of goods." TEX. BUS. & COM. CODE ANN. § 17.45(2) (Vernon Supp. 1989).

78. 751 S.W.2d at 517. One must be a "consumer" to prevail on an action under the DTPA, *Kennedy v. Sale*, 689 S.W.2d 890, 892 (Tex. 1985); *Riverside Nat'l Bank v. Lewis*, 603

In reaching its decision, the court of appeals considered the definition of consumer in the context of a lending relationship. Existing case law indicated that the DTPA did not apply to lenders when the borrower did not use the borrowed funds for the lease or purchase of goods or services, because the borrower in those circumstances did not qualify as a consumer.⁷⁹ Conversely, the DTPA did apply to lenders when the borrower earmarked the borrowed funds for specific acquisitions,⁸⁰ particularly when a relationship exists between the lender and the provider of the goods or services.⁸¹

In the instant case the Bones used the funds borrowed from Holland Mortgage and Investment Corporation for the purchase of the home. In addition, the evidence established that the builder recommended the mortgage company to the Bones and set up an interview for the mortgage loan application. Moreover, the contract between the parties provided for an inspection of the property by the mortgage company. Under the foregoing facts, the court determined that the Bones were consumers under the DTPA vis à vis the Holland Mortgage and Investment Corporation. Notwithstanding the applicability of the DTPA to the transaction, the appellate court reversed the judgment as to the mortgage company based upon no evidence points.⁸²

III. EXEMPTIONS

In *San Antonio Savings Association v. Komet (In re Komet)*⁸³ the bankruptcy court examined the validity of the 1987 amendment to the Texas Property Code exempting qualified pension and profit-sharing plans from the reach of a creditor.⁸⁴ Although the court subsequently withdrew the *Komet* decision for reconsideration, its discussion of the issues in the case warrants comments.

The Komets, relying on section 42.0021 of the Property Code claimed as exempt their interests in a pension plan valued at \$100,000 and a profit sharing plan valued at \$140,000.⁸⁵ Their creditors challenged the exemptions

S.W.2d 169, 174-76 (Tex. 1980); and the "goods or services" acquired by the consumer must give rise to the DTPA claim, *Cameron v. Terrell & Garret, Inc.*, 618 S.W.2d 535, 539 (Tex. 1981).

79. *Riverside Nat'l Bank v. Lewis*, 603 S.W.2d 169 (Tex. 1980) (refinancing of automobile).

80. 751 S.W.2d at 518 (citing *Knight v. Int'l Harvester Credit Corp.*, 627 S.W.2d 382, 389 (Tex. 1982) (purchase of truck); and *Fleniken v. Longview Bank & Trust Co.*, 661 S.W.2d 705, 707 (Tex. 1983) (purchase of home)).

81. 751 S.W.2d at 518 (citing *Wynn v. Kensington*, 697 S.W.2d 47 (Tex. App.—Austin 1985, no writ)).

82. 751 S.W.2d at 521. The court said the evidence did not show that Holland Mortgage and Investment Corporation misled the Bones about the quality of the house. Furthermore, the Bones failed to present expert testimony about the value of the home at the time they purchased it. *Id.* at 520-21.

83. Ch. 11, Case No. 88-50379-C, (Bankr. W.D. Tex. Nov. 21, 1988).

84. TEX. PROP. CODE ANN. § 42.0021 (Vernon Supp. 1989).

85. That section exempts, in addition to the eligible personal property set forth in sections 42.001 and 42.002:

a person's right to the assets held in . . . a stock bonus, pension, profit-sharing, annuity, or similar plan or contract, including a retirement plan for self-em-

and asserted in a case of first impression that only one of the plans could be exempt under a strict reading of the statute.⁸⁶

The bankruptcy court in *Komet* disregarded the arguments of both the debtors and the objecting creditors and ruled that neither plan was exempt because the Federal Employment Retirement Income Security Act of 1974 (ERISA)⁸⁷ preempts the Texas statutory exemption. In reaching this decision, the court focused its inquiry on whether the Texas exemption⁸⁸ "relates to an ERISA plan" according to recent United States Supreme Court guidelines.⁸⁹ The bankruptcy court concluded that, by virtue of the reference to the qualifying sections of the Internal Revenue Code and ERISA in section 42.0021 of the Texas Property Code, the exemption relates to an ERISA plan. Accordingly, the *Komet* court found that the federal law preempted the statute and denied the debtors' claimed exemption relative to the pension plan and the profit sharing plan.⁹⁰

Subsequent to the *Komet* decision, an Arizona bankruptcy court in *Penick v. Hirsch (In re Hirsh)*⁹¹ considered a challenge to the debtors' claimed exemption of ERISA-qualified retirement funds under Arizona law⁹² based upon the same federal preemption provision⁹³ and Supreme Court precedent cited in *Komet*.⁹⁴ In addition, the *Hirsh* court addressed the debtor's assertion of federalization of state exemptions as a defense to preemption.⁹⁵

In *Hirsh* the debtors alleged that section 522 of the Bankruptcy Code authorized them to assert exemptions under the law of the state of their domicile⁹⁶ thereby "federalizing" the Arizona statute and exception its exemption of ERISA-qualified plans from preemption. The *Hirsh* court first established that because the United States Supreme Court's broad interpretation of the

ployed individuals . . . unless the plan, contract, or account does not qualify under the applicable provisions of the Internal Revenue Code of 1986. . . . [A]ssets . . . under a government or church plan or contract are also exempt unless the plan or contract does not qualify . . . under [ERISA].

TEX. PROP. CODE ANN. § 42.0021(a) (Vernon Supp. 1989).

86. The Taxation Section of the State Bar of Texas has proposed legislation that would exempt all qualified plans. STATE BAR OF TEXAS PROPOSED LEGISLATION RELATING TO EXEMPTION OF PERSONAL PROPERTY FROM SEIZURE AMENDING TEX. PROP. CODE ANN. § 42.0021(a) (1988).

87. ERISA § 514(a) provides that federal law "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan [covered by this statute]." 29 U.S.C. § 1144(a) (1982).

88. TEX. PROP. CODE ANN. § 42.0021 (Vernon Supp. 1989).

89. "A law 'relates to' an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan" *Mackey v. Lanier Collections Agency & Serv.*, 108 S. Ct. 2182, 2185 (1978) (citation omitted) (emphasis original). The Court also said: "The pre-emption provision [of 514(a)] displaces all state laws that fall within its sphere, even including state laws that are consistent with ERISA's substantive requirements. *Id.* (quoting *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 739 (1985)).

90. *Id.*, slip op at 5; see 29 U.S.C. § 1144(a) (1982). The validity of the decision is in question since the court has withdrawn the decisions for reconsideration.

91. Ch. 11 Case No. B-876193, Adv. No. 88-44 (Bankr. Ariz. Dec. 15, 1988).

92. ARIZ. REV. STAT. ANN. § 33-1126(B) (West Supp. 1988).

93. 29 U.S.C. § 1144(a).

94. 108 S. Ct. at 2185.

95. 29 U.S.C. § 1144(d) provides that ERISA shall not preempt other federal law.

96. 11 U.S.C. § 522(b)(2) (1982).

ERISA preemption provision, the federal statute would supersede the Arizona exemption statute in a state court proceeding.⁹⁷ The *Hirsh* court then held that a different result was not warranted in the context of a bankruptcy case, notwithstanding the incorporation of state exemption law in section 522 of the Bankruptcy Code. Accordingly, the court denied the debtors' claimed exemptions as to the pension plans.⁹⁸

In *Brooks v. Interfirst Bank, Fort Worth (In re Brooks)*⁹⁹ the creditor's challenge to the debtor's claimed exclusion of a pension/profit-sharing plan from the bankruptcy estate arose prior to the effective date of the state exemption of qualified retirement plans.¹⁰⁰ In *Brooks* the debtor was a radiologist practicing as part of a professional association comprised of thirty-two doctors that had established a retirement plan for its members. At the time of the bankruptcy petition, Dr. Brooks' vested interest in the plan was in excess of \$500,000.

In his bankruptcy proceeding, Dr. Brooks asserted that the plan was excluded from the bankruptcy estate, since the plan qualified as a spendthrift trust under Texas law.¹⁰¹ Both the United States Bankruptcy Court¹⁰² and the United States District Court rejected Dr. Brooks' position on the grounds that his membership in the professional association rendered the plan "self settled" and unenforceable as a spendthrift trust under Texas law.¹⁰³

On appeal to the United States Court of Appeals, Dr. Brooks argued that by virtue of its size and structure, his professional association was analogous to a disinterested employer that may create an enforceable spendthrift trust for the benefit of its employees.¹⁰⁴ The court of appeals, however, rejected the argument ruling that partial ownership of the professional association rendered each of the thirty-two doctors a settlor of the trust. Thus, under

97. "State laws which are 'specifically designed to affect employee benefit plans' are preempted under [ERISA]." 108 S. Ct. at 2185 (citations omitted). That a state law may "effectuate ERISA's underlying purposes . . . is not enough to save the state law from pre-emption." *Id.*

98. Ch. 11 Case No. B-876193, Adv. No. 88-44, slip op. at 3; *cf.* *Small Business Admin. v. Bubert*, (In re Bubert), 61 Bankr. 362, 363-64 (Bankr. W.D. Tex. 1986), *aff'd*, 809 F.2d 259 (5th Cir. 1987) (state exemption statute is federal law for purposes of determining what property is property of the bankruptcy estate under 11 U.S.C. § 541 and what property is exempt under 11 U.S.C. § 522(b)(2)).

99. 844 F.2d 258 (5th Cir. 1988).

100. TEX. PROP. CODE ANN. § 42.0021 (Vernon Supp. 1989).

101. 11 U.S.C. § 541(c)(2) (1982) excludes property from the estate to the extent it is subject to a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law." This section has been interpreted to shield spendthrift trusts that are valid under state law. *See In re Goff*, 706 F.2d 574, 582 (5th Cir. 1983) (Keough Plan established by debtors for their own benefit was not a valid spendthrift trust and therefore was included in bankruptcy estate).

102. 60 Bankr. 155 (Bankr. N.D. Tex. 1986).

103. TEX. PROP. CODE ANN. § 112.035 (Vernon 1984) states: "If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest does not prevent his creditors from satisfying claims from his interest in the trust estate."

104. *See, Hines v. Sands*, 312 S.W.2d 275 (Tex. Civ. App.—Fort Worth 1958, no writ); *see also In re Goff*, 706 F.2d at 582.

Texas law, the plan's antialienation provision was unenforceable¹⁰⁵ and the plan was included in the bankruptcy estate.¹⁰⁶ Accordingly, the court affirmed the judgment of the lower court.¹⁰⁷

In *In re William Michael Brothers*¹⁰⁸ the bankruptcy court held that the cash surrender value of two life insurance policies was not exempt from the bankruptcy estate under a recent amendment to the Texas Insurance Code.¹⁰⁹ The amendment exempts payments made under a life, health or accident insurance policy.¹¹⁰ The bankruptcy court noted that the payments exempt under the Insurance Code are apparently in addition to and apart from the property exempt under the Property Code.¹¹¹

In *Brothers* the trustee of the debtor's bankruptcy estate challenged the exempt status of two insurance policies with an aggregate cash surrender value of approximately twelve thousand dollars because the value of the debtor's property would then exceed the thirty thousand dollar personal property limitation under the Property Code.¹¹² The debtor asserted that the policies were protected by the Insurance Code exemption without regard to value, and that the amendment to the Insurance Code impliedly repealed the provisions of the Property Code addressing cash surrender values.¹¹³

Based on the language of the statute and the applicable legislative history, the bankruptcy court concluded that the amendment to article 21.22(1) of the Insurance Code neither explicitly nor impliedly repealed section 42.002(7) of the Property Code with respect to the exemption of cash surrender values.¹¹⁴ Moreover, the court found that the only payments under a life insurance policy qualifying for the Insurance Code exemption are those paid to the beneficiary upon the death of the insured.¹¹⁵ Accordingly, the court held that the cash surrender value of the insurance policies was exempt, if at all, as eligible personal property subject to the thirty thousand dollar maximum limitation under the Property Code.¹¹⁶

In *In re Reed*¹¹⁷ the bankruptcy court considered the extent to which

105. 155 Bankr. at 160, *see* TEX. PROP. CODE ANN. § 112.035 (Vernon 1984).

106. 155 Bankr. at 160; *see* 11 U.S.C. § 541(c)(2) (1982).

107. 155 Bankr. at 160.

108. 94 Bankr. 82 (Bankr. N.D. Tex. 1988).

109. *Id.* at 85-86.

110. TEX. INS. CODE ANN. art. 21.22(1) (Vernon Supp. 1989). Prior to the amendment, insurance benefits were exempted only if payable on a weekly, monthly or other installment basis. Exemption of Insurance Benefits from Seizure Under Process, Ch. 491, art. 21.22 1951 Tex. Gen. Laws 868, 1076 *amended by* Exemptions of Insurance Benefits From Seizure Under Process, Ch. 5, art. 21.22 1987 Tex. Gen. Laws 22,22.

111. TEX. PROP. CODE ANN. §§ 42.001-.004 (Vernon 1984 & Supp. 1989). 94 Bankr. at 84 (citing Teofan & O'Neill, *supra* note 49, at 215).

112. TEX. PROP. CODE ANN. § 42.001 (Vernon 1984). Subject to certain conditions, the cash surrender value of life insurance policies is specifically included in eligible personal property exempt under the Property Code, subject to the \$30,000.00 maximum limitation. TEX. PROP. CODE ANN. § 42.001, .002(7) (Vernon 1984).

113. 94 Bankr. at 83 (citing TEX. INS. CODE ANN. art. 21.22(1) (Vernon Supp. 1989); TEX. PROP. CODE ANN. § 42.002(7) (Vernon 1984).

114. *Id.* at 85.

115. *Id.* (interpreting TEX. INS. CODE ANN. art. 21.22(1) (Vernon Supp. 1989)).

116. *Id.* at 85-86. TEX. PROP. CODE ANN. §§ 42.001, .002(7) (Vernon 1984).

117. 89 Bankr. 603 (Bankr. N.D. Tex. 1988).

jewelry is exempt from seizure by creditors. Following a protracted divorce and conversion action against her ex-husband, Mrs. Reed's former attorneys obtained a writ of garnishment against certain jewelry that had been placed in a lock box under the joint control of the Reeds' attorneys pending resolution of the consolidated divorce and conversion action.¹¹⁸

In Mrs. Reed's ensuing bankruptcy proceeding, the attorneys asserted a security interest in the jewelry and filed a motion for relief from the automatic stay¹¹⁹ to garnish the jewelry in partial satisfaction of their claim. Mrs. Reed objected to the attorneys' claim and opposed the motion, asserting, among other things, that the property was not subject to execution, and thus the writ of garnishment was invalid.¹²⁰

The bankruptcy court in *Reed* noted that prior to the codification of the Property Code, jewelry was deemed to be "wearing apparel" exempt under the former, exemption statute.¹²¹ When the legislature codified the exemptions, however, it amended the statute to exempt "clothing" rather than "wearing apparel."¹²² In determining whether jewelry is exempt under current Texas law, the *Reed* court considered whether the legislature in making the change in the statutory language intended to limit the scope of the exemption or to modernize the statute. After reviewing applicable legislative history¹²³ and noting contrary authority,¹²⁴ the court concluded that the legislature did not intend to make a substantive change in the law and that jewelry could be exempted as clothing.

The *Reed* court limited the exemption for jewelry, however, by reference to the "reasonably necessary" standard set forth in section 42.002(3) of the Property Code.¹²⁵ The court established a liberal definition of "necessary" to include those items that an objective person would deem "usual and appropriate for the reasonable comfort and convenience of the debtor."¹²⁶ Under the foregoing analysis, the court in *Reed* upheld the debtor's exemp-

118. The jewelry included Mrs. Reed's wedding band and ring guards and was valued at approximately \$8,700.00. In the final judgment of divorce in the state court action (Cause No. 86-6691-R, 254th District, Dallas, Texas, issued Jan. 14, 1987), Mrs. Reed was awarded the jewelry.

119. 11 U.S.C. § 362 (1982).

120. Mrs. Reed also argued that the property was held in custodia legis pending resolution of the divorce and conversion action and was protected from garnishment as if held by the registry of the court; the court concurred and invalidated the writ of garnishment. 89 Bankr. at 608.

121. 89 Bankr. at 605 (citations omitted); see Property Exempt From Forced Sales, Ch. 915, § 1, 1985 Tex. Gen. Laws 384, 385, repealed by Exemptions—Forced Sale, Ch. 588, § 4, 1973 Tex. Gen. Laws 1627, 1628.

122. Compare TEX. PROP. CODE ANN. § 42.002(3)(c) (Vernon 1984) with Property Exempt from Sale, Ch. 145, § 1, 1935 Tex. Gen. Laws 384, 385 (repealed 1973).

123. 89 Bankr. at 606 (citing *Nonsubstantive Revisions to the Property Code*, 1983: *Hearing on Senate Bill 748 Before the Senate Finance Committee (April 1983)* (statement of Senator Sam Kitret)).

124. *Id.* (citing *Fernandez v. Seidler* (In re *Fernandez*), 89 Bankr. 601, 602-3 (W.D. Tex. 1988) (jewelry not exempt)).

125. TEX. PROP. CODE ANN. § 42.002(3) (Vernon 1984).

126. 89 Bankr. 607 (citing *In re Millington's Estate*, 63 Cal. App. 498, 499, 218 P. 1022, 1023 (Cal. Dist. Ct. App. 1923)). The court distinguished jewelry purchased for investment or show from jewelry of sentimental value or useful purpose.

tion claim for the rings, ring guards, and pins worn by the debtor on a regular basis.¹²⁷

The Family Law Section of the State Bar of Texas has proposed an amendment to the Property Code¹²⁸ to the 1989 Texas Legislature, deleting the "reasonably necessary" requirement of section 42.002(3), thus, allowing an exemption for all eligible personal property up to the aggregate limit without regard to necessity. In addition, if the legislature adopts the amendment, it would replace the term "clothing" presently contained in section 42.002(3)(c) with the term "wearing apparel (including jewelry)." The bill attempts to clarify, among other things, that: (1) the computation of the aggregate personal property exemption includes only the debtor's equity in personal property;¹²⁹ and (2) that the calculation of the aggregate personal property exemption also excludes current wages, health aids, and funds otherwise exempt from seizure. The proposed amendment also suggests a procedure for designation of exempt property when eligible personal property exceeds the aggregate personal property exemption.¹³⁰

The legislative proposal also seeks to enable Texas debtors to avoid non-possessory, nonpurchase money liens on exempt personal property.¹³¹ This provision has the effect of overruling current case law applicable to debtors in bankruptcy who choose the Texas rather than federal exemption alternative.¹³² Finally, the amendment would reduce the statute of limitations for creditors' actions from four years to two years to avoid fraudulent conveyances of nonexempt to exempt property.¹³³

127. *Id.*

128. STATE BAR OF TEXAS PROPOSED LEGISLATION RELATING TO INTERESTS IN PERSONAL PROPERTY EXEMPT FROM CREDITOR'S CLAIMS AMENDING TEX. PROP. CODE ANN. §§ 42.001 to .004 (1988) [hereinafter State Bar Proposed Legislation].

129. *Cf. Barnett v. United States* (In re Barnett), 33 Bankr. 70 (Bankr. N.D. Tex. 1983) (exemption calculated fair market value).

130. State Bar Proposed Legislation, *supra* note 128, at 3.

131. *Id.* at 1.

132. See 11 U.S.C. § 522(b), (d), (f); *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); (debtors choosing Texas exemptions may not utilize § 522(f) to avoid nonpossessory, nonpurchase money liens on exempt property).

133. State Bar Proposed Legislation, *supra* note 128, at 3-4.

