

## **INS AND OUTS OF DEED OF TRUST FORECLOSURES**

### **Practical Tips for the Practitioner**

#### **WILLIAM H. LOCKE, JR.**

Graves, Dougherty, Hearon & Moody, P.C.  
401 Congress Ave., Suite 2200  
Austin, Texas 78701  
512-480-5736  
blocke@gdhm.com  
www.gdhm.com

#### **RALPH MARTIN NOVAK, JR.**

Brown, McCarroll, LLP  
111 Congress Ave., Suite 1400  
Austin, Texas 78701  
512-472-5456  
mnovak@mailbmc.com  
www.brownmccarroll.com

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### **CHAPTER 40**



**William H. Locke, Jr.**  
Graves, Dougherty, Hearon, Moody,  
A Professional Corporation  
401 Congress Ave., Suite 2200  
Austin, Texas 78701  
512/480-5736  
FAX: 512/480-5736  
[blocke@gdhm.com](mailto:blocke@gdhm.com)

**EDUCATION:**

B.A., The University of Texas  
J.D. with Honors, The University of Texas

**PROFESSIONAL ACTIVITIES:**

Board Certified in Real Estate Law: Commercial, Residential and Farm and Ranch  
Life Fellow, Texas Bar Foundation  
Fellow of College of Law of State Bar of Texas (20 Year Maintaining Member)  
Director, Texas College of Real Estate Attorneys  
Past Chairman, Zoning and Planning Commission of City of Corpus Christi  
Past President, Corpus Christi (Nueces County) Bar Association

**LAW RELATED PUBLICATIONS AND HONORS:**

Co-author of State Bar of Texas publication TEXAS FORECLOSURE MANUAL (1990 and 2005)  
Author/speaker for the State Bar of Texas, Advanced Real Estate Law Course on "*Field Guide for Due Diligence on Income Producing Properties*" (2000) and "*Papering the Deal: From Land Acquisition to Sale of Residential Lots and To-Be-Built Medical Condominiums* (2004)"  
Author/speaker for the State Bar of Texas, Annual Advanced Real Estate Drafting Course and the Annual Advanced Real Estate Law Course on "*Risk Management*"; "*Shifting of Extraordinary Risk: Contractual Provisions for Indemnity, Additional Insureds, Waiver of Subrogation and Exculpation*"  
Author/speaker for the Advanced Real Estate Law Course: Leases In-Depth of Southern Methodist University on "*Civil Forfeiture Actions*;" and at the Annual Mortgage Lending Institute on "*Seizure of Lender's Collateral Under Drug Enforcement Laws*"  
Author/speaker for the Real Estate Law Conference at South Texas College of Law June, 2004 on "*Protecting Landlords, Tenants and Contractors as Additional Insureds and Indemnified Parties*"  
Author for Austin Business Journal: "*Letting the Fox Protect the Chicken - Additional Insured Endorsements*"; and "*Due diligence course essential to buying 'as is'*"  
The Best Lawyers in America (Real Estate) (2005)  
Who's Who in America and Who's Who in American Law  
Texas Monthly, Super Lawyer (2005)



**Ralph Martin Novak, Jr.**  
Brown McCarroll, L.L.P.  
111 Congress Avenues, Suite 1400  
Austin, Texas 78701  
512/472-5456  
FAX: 512/479-1101  
[mnovak@mailbmc.com](mailto:mnovak@mailbmc.com)

#### Legal Practice

October, 2003 to present:

Partner in Business Law/Real Estate Section of Brown McCarroll, L.L.P. with a practice concentrated in commercial real estate, leasing, and Health Care.

March 1991 to September, 2003:

Partner in Real Estate Section of Hilgers & Watkins, P.C., with a practice concentrated in commercial real estate, leasing, and Health Care.

August 1982 - February 1991:

Associate, and then Director/Shareholder of Kleberg & Head, P.C. in Corpus Christi, Texas, with a practice concentrated in commercial lending, commercial real estate, and municipal law.

#### Professional Activities

Board Certified, Commercial Real Estate Law, Texas Board of Legal Specialization

Member, Texas College of Real Estate Attorneys

Member, College of the State Bar of Texas

Member, Real Estate and Banking Law Sections of the Travis County Bar Association

#### CLE Articles

Author and Speaker, "*Special Problems and Considerations in Title Transfers*" University of Houston Real Estate Documents, Workouts & Closings (2004)

Author and Speaker, "*An Overview of the Mechanic's Lien Process*" (May, 2003) State Bar of Texas CLE Collections Practice (2003)

Author and Speaker, "*Special Problems and Considerations in Title Transfers*" University of Houston Real Estate Documents, Workouts & Closings (2003)

Author and Speaker, "*Special Problems and Considerations in Title Transfers*" University of Houston Real Estate Documents, Workouts & Closings (2002)

Author and Speaker, "*Recent Developments In The Mechanic's Lien Statutes*", Lorman Education Services - Construction Lien Law In Texas (2001)

Author and Speaker, "*Special Problems and Considerations in Title Transfers*" University of Houston Real Estate Documents, Workouts & Closings (2001)

Author and Speaker, "*Recent Developments In The Mechanic's Lien Statutes*", Lorman Education Services - Construction Lien Law In Texas (2000)

Author and Speaker, "*Special Problems and Considerations in Title Transfers*", University of Houston Advanced Real Estate Short Course (2000)

Author and Speaker, "*Special Problems and Considerations in Title Transfers*", University of Houston Advanced Real Estate Short Course (1999)

Author and Speaker, "*The Austin Hill Country Aftermath: The New Law Concerning the Landlord's Duty to Mitigate*", State Bar of Texas Advanced Real Estate Drafting Course (1999)

Author and Speaker, "*Tenant Defaults and Landlord Remedies in Commercial Leases*" South Texas College of Law Commercial Real Estate Course (1998)

Author and Speaker, "*Special Problems and Considerations in Title Transfers*", University of Houston Advanced Real Estate Short Course (1998)

Author and Speaker, "*Special Problems and Considerations in Conveyances*", University of Houston Real Estate Documents, Workouts and Closings (1998)

Author and Speaker, "*The Effect of Health Care Regulations on Common Real Estate Transactions*", State Bar of Texas Advanced Real Estate Drafting Course (1998)

Author and Speaker, "*Special Problems and Considerations in Conveyances*", University of Houston Real Estate Documents, Workouts and Closings (1997)  
Author and Speaker, "*Residential Landlord Tenant Law*", Travis County Bar's Consumer Law Seminar (1996)  
Speaker, "*Recent Legislation and Case Law Developments in Real Estate Law*", Travis County Bar Banking Law Section (1995)  
Co-Author and Speaker, "*Seizure of Lender's Collateral Under Drug Enforcement Laws*", University of Texas Mortgage Lending Institute (1990)

#### Books

Christianity and the Roman Empire: Background Texts (Trinity Press International 2001)  
Co-Author of the TEXAS FORECLOSURE MANUAL (1990 and 2005)

#### Mediation Training

A. A. White Dispute Resolution Institute  
Texas Accountants and Lawyers for the Arts

#### Degrees and Professional Licenses

B.A., with honors, Rice University, 1973 - History and Anthropology  
M.A., University of Chicago, 1975 - Roman History  
J.D., with honors, University of Houston, 1982

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## **Ins and Outs of Deed of Trust Foreclosure Practical Tips for the Practitioner**

by William H. Locke, Jr.

The following article is not intended to be an all inclusive discussion of the law or the practice relating to foreclosure under deeds of trust in Texas. The topics covered are a collection of both some basic topics encountered in all foreclosures (for example, where to conduct the sale and what needs to be included in the notice) and other unusual but all too frequently encountered topics (what if the debtor is in the military?, what if the debtor is deceased at the time of sale?, what happens if the debtor does not pay its property taxes?, what do you do if the debtor calls and advises before the foreclosure sale that it has a contract to sell the property that will blow up if you do not postpone the sale?, how long due you have to give a bidder to come up with the cash?). These materials are a "work in progress" as they are taken from the draft of the Texas Foreclosure Manual (2005) to be published later this year by the State Bar of Texas. This work in progress began in the 1980's when we represented various financial institutions in the Gulf Coast region of Texas. As lending decreased and loan defaults increased, our practice shifted in part from negotiating and drafting loan documents to loan workouts and foreclosures. I recall the feelings I had as I drove the streets of the business sector of my home town and knew of or had a story about many of the properties I passed. Out of this experience grew a degree of "expertise," the kind I guess that the executioner had in France at the time of the fall of the monarchy. The idea about putting this experience in written form grew from our experience in not finding a good source that connected the law, as explained in Texas Jurisprudence, with the practice, as documented in the Bar Forms Manuals. This article does not have attached to it the "forms." For those you will have to purchase the Texas Foreclosure Manual.

### **1. Status of the Secured Loan**

#### **1.1 Contract Rights Restricted by Statute.**

Although the deed of trust reads as if it were a conveyance of the title to the mortgaged property and perhaps the collateral to the trustee "in trust," Texas law recharacterizes the

transaction as creating merely a nonpossessory lien on the mortgaged property in favor of the mortgagee. The mortgagee is granted a power of sale exercisable through the trustee. Neither the trustee nor the mortgagee is deemed to have any present right of possession or legal title to the mortgaged property or collateral. *Johnson v. Snell*, 504 S.W.2d 397 (Tex. 1973); *Humble Oil & Refining Co. v. Atwood*, 244 S.W.2d 637 (Tex. 1951). Additional authority on the nature of the deed of trust includes *Carroll v. Edmondson*, 41 S.W.2d 64 (Tex. Comm'n App. 1931, judgm't adopted); *Armenta v. Nussbaum*, 519 S.W.2d 673 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.); *Tarrant Savings Association v. Lucky Homes, Inc.*, 379 S.W.2d 386 (Tex. Civ. App.—Fort Worth 1964), rev'd on other grounds, 390 S.W.2d 473 (Tex. 1965); *Pioneer Building & Loan Association v. Cowan*, 123 S.W.2d 726 (Tex. Civ. App.—Waco 1938, writ dism'd judgm't cor.); *Texas Loan Agency v. Gray*, 34 S.W. 650 (Tex. Civ. App. 1896, writ ref'd). The deed of trust is regarded as a contract binding the mortgagor, the trustee, and the mortgagee, also referred to as the beneficiary. The deed of trust usually is executed by the mortgagor only and not the trustee and the beneficiary. The deed of trust typically contains numerous covenants by the mortgagor (e.g., payment of taxes, maintenance of insurance), the conditions permitting the mortgagee to cause the mortgaged property to be sold (e.g., definitions of default), and the procedures to be followed (e.g., acceleration, notices, waivers, substitutions of trustees, and advertisement of sale). Texas law does not condone extra-judicial seizure of mortgaged real property by the mortgagee, unless the property is voluntarily relinquished by the mortgagor. In other words, Texas does not recognize "self-help repossession" of real estate. The Texas Property Code instead provides an orderly means for resolving disputes. Sometimes security agreements contain provisions authorizing the secured creditor to go on to a debtor's property to take possession of personal property collateral if this can be done without a breach of the peace. In the absence of a similar provision as to real property mortgaged as collateral, absent grounds for a receivership or injunction preforeclosure, the mortgagee's remedy is to seek nonjudicial or judicial foreclosure of its mortgage lien. *Lighthouse Church of Cloverleaf v. Texas Bank*, 889 S.W.2d 595 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1994, writ denied). The procedures set forth in section

51.002 of the Texas Property Code are generally mandatory and nonwaivable. See Tex. Prop. Code Ann. § 51.002 (Vernon Supp. 2004). If the deed of trust conflicts with the statute, the statute controls. The conditions to exercising the power of sale and the manner of exercising the sale may be made more restrictive or burdensome by contract than the statute provides. See *Ford v. Emerich*, 343 S.W.2d 527 (Tex. Civ. App.—Houston 1961, writ ref'd n.r.e.); *Faine v. Wilson*, 192 S.W.2d 456 (Tex. Civ. App.—Galveston 1946, no writ). Foreclosure transfers title from the debtor to another party, but it does not put the new owner in possession; it gives him a right to possession. If a debtor remains on the property, most deeds of trust treat him as a tenant by sufferance. To remove a tenant at sufferance, the new owner must file a forcible detainer suit.

## 1.2 Identifying the Secured Debt

The deed of trust may secure a variety of obligations.

There appear to be no Texas cases on whether or not a deed of trust can secure contingent obligations. One commentator has argued that Texas courts will uphold the validity and superior priority of such liens. Danilowicz, *Validity of a Deed of Trust Securing Contingent Obligations (Mortgages for Future Advances and Standby Letters of Credit)*, 50 Tex. B. J. 1086 (1987). The court in *Taylor v. Transcontinental Properties*, 739 S.W.2d 873 (Tex. App.—Tyler 1987, no writ), held that a note and deed of trust given to secure a mortgagor's performance of obligations under a contract were supported by adequate consideration as a matter of law. Taylor had contracted with Transcontinental to purchase notes generated in Transcontinental's time-share sales program. In the note sales agreement, Transcontinental agreed to execute a deed of trust "[t]o guarantee [its] performance under the commitment and to assure SMSC that all taxes, insurance and maintenance costs are timely paid." *Taylor*, 739 S.W.2d at 877. Transcontinental executed a deed of trust to ensure its performance of the note sales agreement "and to further ensure the endorsement of all notes sold by Grantors [Transcontinental] to Beneficiary [Taylor]." *Taylor*, 739 S.W.2d at 877.

## 1.3 Payment Terms and Payment Default

There are at least three common forms of debt instruments: demand note, term note, and installment note. See M. Baggett, 15 Texas Practice, *Texas Foreclosure Law and Practice* § 1.01 *et seq.* (2001 & Supp. 2004).

### 1.3:1 Payable on Demand

Section 3.108(a) of the Texas Business and Commerce Code defines payable on demand:

(a) A promise or order is "payable on demand" if it: (1) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder; or (2) does not state any time of payment.

Tex. Bus. & Comm. Code Ann. § 3.108(a) (Vernon 2002). A demand note is matured on demand by the holder. However, one case has held that "[a] demand note is due from the moment of execution and actionable immediately without demand." *Stavert Properties v. RepublicBank of Northern Hills*, 696 S.W.2d 278, 281 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.). A note containing "on demand" language may be construed as not being a demand note, if the acceleration language contains explicit conditions of default. *Bank One, Texas, N. A. v. Taylor*, 970 F.2d 16 (5<sup>th</sup> Cir. 1992).

Formal demand for payment and failure to pay must occur on a demand note before commencement of the foreclosure process. The demand feature of the note involves a number of issues that have not been extensively dealt with by state and federal courts. In *Conte v. Greater Houston Bank*, 641 S.W.2d 411 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1982, writ ref'd), the court held that language providing for payment on demand, but if no demand was made, in monthly installments with a fixed maturity date was payable in full at time of demand, notwithstanding the provisions concerning monthly payments. *Conte* was followed by *Stavert Properties, Inc. v. RepublicBank of Northern Hills*, 696 S.W.2d 75 (Tex. App.—Dallas 1983, writ ref'd n.r.e.), the court interpreted the phrase "on demand and if no demand is made, then on December 1, 1922" as making the note a demand instrument.

However, a subsequent Fifth Circuit case has distinguished and declined to follow the *Conte* case. In *Bank One Texas, N. A. v. Taylor*, 970 F.2d 16 (5<sup>th</sup> Cir. 1992), the Fifth Circuit interpreted a promissory note which stated,

This obligation is, as an alternative to the above recited payment schedule, due and payable on demand.

The note also contained default provisions and acceleration clauses whereby the bank could accelerate the note on the occurrence of an event of default. In addition, the security interests securing the note listed various events of default which would allow the bank to declare the entire obligation immediately due and payable. The lender argued, citing *Conte* that this instrument was a demand note. The Fifth Circuit distinguished *Conte* on the grounds that, first, the note in *Conte* did not contain an acceleration clause and apparently was not accompanied by an underlying security agreement or terms which would modify the right of demand.

[H]ere, in contrast, the existence of explicit conditions of demand in the acceleration clause, as well as the related security agreements, shows a clear intention that the note be payable on demand only in the event Taylor failed to meet the installment obligation or the obligations imposed by the security agreement.

Citing to the opinion of the First Circuit in *Reid v. Key Bank of Southern Maine, Inc.*, 821 F.2d 9 (1<sup>st</sup> Cir. 1987), the Fifth Circuit held that the presence of such conditions in the documents qualified the demand provision and that,

Based upon the testimony and our reading of the loan documents, we determine that although these notes profess to be demand instruments, a fair reading of the notes and related security agreements demonstrates an intention that these installment notes be payable on demand only in the event of default. This construction comports with the common expectation that a promissory note with an installment feature and an acceleration clause is a time obligation and that the bank does not have the right to demand payment in the absence of default.

In view of the conflict between the state and federal case law, the terms of the entire loan transaction should be reviewed before making demand on a “demand” note.

Some commentators have raised a question as to the breadth of the language in Tex. Prop. Code Ann. § 51.002(d) (Vernon Supp. 2004) that

the debtor must be given at least 20 days to cure the default before the entire debt is due and notice of sale is given.

Unquestionably, this provision overrides any waiver or express demand feature without notice contained in a deed of trust encumbering a debtor’s residence.

Giving maker and mortgagor advance notice of the mortgagee’s intention to demand payment of a demand note may be advisable. The trend in some jurisdictions is to find a special relationship between the parties or an implied contractual obligation of “good faith and fair dealing.” For example, the Sixth Circuit, applying New York law, upheld a jury verdict for \$7,500,000 against Irving Trust Company for its breach of an implied obligation of good faith and fair dealing in refusing to advance additional credit under a line-of-credit note that was payable on demand. *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir. 1984). The Sixth Circuit found support for its position in chapter 2 of the UCC, which deals with sales agreements. (See Tex. Bus. & Comm. Code Ann. § 2.309 comment (Vernon 1994) for the equivalent section of the Texas UCC.) The Sixth Circuit held that

the application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement.

*K.M.C.*, 757 F.2d at 759.

#### 1.4 Default - Insecurity.

Texas Business and Commerce Code § 1.309 provides that when a contract allows a party to accelerate payment of a note “when he deems himself insecure,” the lender may do so only

if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

Tex. Bus. & Comm. Code Ann. § 1.309 (Vernon Supp. 2004). The comments to the Section, however, clearly state that the good faith requirement is not applicable to a demand note:

Obviously, this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an agreement or to paper which in the first instance is payable at a future date.

Under Texas Business and Commerce Code § 1.201(20), *good faith* means “honesty in fact and the observance of reasonable commercial standards of fair dealing.” Tex. Bus. & Comm. Code Ann. § 1.201(20) (Vernon Supp. 2004). The Texas Supreme Court has held that the obligation of good faith imposed under Texas UCC § 1.203 (the predecessor to Texas UCC § 1.201(20)) may be breached only by a showing of dishonesty by the creditor, and that the test for “honesty in fact” under Texas UCC § 1.108(19) (now Texas UCC § 1.201) did not include diligence or negligence. *FDIC v. Coleman*, 795 S.W.2d 706 (Tex. 1990). Texas does not recognize a common law duty of good faith and fair dealing in every contract, and such duty arises only if there is a “special relationship” between the parties. *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987).

Where a security instrument authorizes a creditor to accelerate maturity when the creditor deems itself insecure, the insecurity may be found as to the debt itself or as to the collateral. *Jack M. Finley, Inc. v. Longview Bank & Trust Co.*, 705 S.W.2d 206 (Tex. Civ. App.—Texarkana 1986, writ ref’d n.r.e.). Texas courts generally state that “good faith” must be decided on a case by case basis after acceleration has occurred. *American Bank of Waco v. Waco Airmotive, Inc.*, 818 S.W.2d 163 (Tex. App.—Waco 1991, writ denied), citing to *Ford Motor Credit Co. v. Powers*, 613 S.W.2d 30 (Tex. Civ. App.—Corpus Christi 1981, no writ) and cases cited therein. These cases suggest that the question is decided by fact issues, but in the *Finley* case, the court granted summary

judgment on the good faith issue to the lender by finding that “uncontroverted sworn evidence” that the debtor had threatened bankruptcy, was a sufficient basis to establish the Bank’s good faith in exercising an insecurity clause, notwithstanding that the \$750,000 loan at 11% interest was secured by a \$750,000 CD bearing 9% interest.

In *American Bank of Waco v. Waco Airmotive, Inc.*, 818 S.W.2d 163 (Tex. App.—Waco 1991, writ denied), the court stated that insecurity clauses are to be used only to protect the creditor from actions by the debtor which jeopardize or impair the security, and not offensively for the commercial advantage of the creditor. *Id.* at 72, citing to *Brown v. Avemco*, 603 F.2d 1367 (9<sup>th</sup> Cir. 1979). In this case, the borrower and the lender entered into a promissory note combining and renewing several loans held by the lender at a time when the borrower was delinquent on several installments on a separate SBA loan also held by the lender. Two weeks later, notwithstanding that no material change had occurred to the borrower’s financial situation and that the lender had just agreed to consider the borrower’s proposal for restructuring the delinquent SBA loan, the lender accelerated the delinquent SBA loan under an insecurity clause, cross-defaulted the renewal note, and then offset the borrower’s checking account to pay off the renewal note in full and the delinquent installments on the SBA note. The court in *Airmotive* found the lender’s acceleration of the note’s maturity and offsetting of borrower’s checking account was wrongful and found lender’s reliance on an insecurity clause to be misplaced.

## 1.5 Identifying the Security

Before writing the first demand letter or notice of intent-to-accelerate letter, the types of collateral securing the obligations should be identified. This first step is to verify perfection of security interests, to determine if the loan is secured by the intended mortgaged property and collateral, and to avoid the assertion of impermissible claims on homestead-exempt assets.

### 1.5:1 Personal Property

The deed of trust may expressly encumber both real property and personal property. The *Texas Real Estate Forms Manual* contains at Clause 15-9-9 suggested language for inclusion in the

deed of trust as to the creation of a lien as to such mixed collateral. Clause 15-9-9 provides

In addition to creating a deed-of-trust lien on all the real and other property described above, Grantor also grants to Lender a security interest in all of the above-described personal property pursuant to and to the extent permitted by the Texas Uniform Commercial Code.

See below for additional language suggested in the *Texas Real Estate Forms Manual* specifying that Lender may elect to proceed as to both the real property and personal property in a unified deed of trust lien foreclosure sale.

The Texas Uniform Commercial Code, as set out in the Texas Business and Commerce Code, provides an option to the lender if the deed of trust covers both real and personal property. Texas UCC § 9.604(a) (Vernon 2002). A lender may proceed against the personal property under the personal property foreclosure provisions of the Texas UCC as if there is no real property involved, or the lender may elect to foreclose on both real and personal property pursuant to section 51.002 of the Texas Property Code. If the personal property is foreclosed under section 51.002, then the provisions of subchapter F of the Texas UCC covering default do not apply.

Comment 2 of §9.604 states:

In the interest of simplicity, speed and economy, subsection (a) like former Section 9.501(4), permits, (but does not require), the secured party to proceed as to both real and personal property in accordance with its rights and remedies in respect of the real property. Subsection (a) also makes clear that a secured party who exercises rights under Part 6 with respect to personal property does not prejudice any rights under real property law.

Tex. Bus. & Comm. Code Ann. § 9.604 comment 2 (Tex. UCC) (Vernon 2002).

This election between real property and personal property foreclosure procedures is set out in Clause 15-9-9 to the form of Deed of Trust in *Texas Real Estate Forms Manual* Ch. 15, p. 15-50 immediately following the above-quoted

language as to dual deed of trust and security interest liens in mortgaged property. This clause provides:

[If the security agreement covers nonfixtures and other personalty, continue with the following.]

In the event of a foreclosure sale under the deed of trust, Grantor agrees that all the Property may be sold as a whole at Lender's option and that the Property need not be present at the place of sale.

Other states, most notably California, have attempted to reconcile seemingly conflicting real property and personal property foreclosure rules. California replaced the one-sentence provision of former U.C.C. § 9-501(d) with a seven-paragraph treatment of what had become known in California as the "mixed collateral problem." Cal. Comm. Code § 9501(4); see Hetland & Hansen, *The "Mixed Collateral" Amendments to California's Commercial Code—Covert Repeal of California's Real Property Foreclosure and Antideficiency Provisions or Exercise in Futility?*, 75 Calif. L. Rev. 185-216 (1987); Hirsh, Arnold, Rabin & Sigman, *The U.C.C. Mixed Collateral Statute—Has Paradise Really Been Lost?*, 36 UCLA L. Rev. 1-81 (1988). In *Van Brunt v. BancTexas Quorum, N. A.*, 804 S.W.2d 117 (Tex. App.—Dallas 1990, no writ) the court relied upon this section of the Texas UCC to justify not extending the rule announced in *Tanenbaum v. Economics Laboratory, Inc.*, 628 S.W.2d 769 (Tex. 1982) eliminating deficiencies after a defective personal property foreclosure sale to bar a subsequent real property foreclosure sale or suit for deficiency after the subsequent real property foreclosure sale.

In a case of first impression in Texas, we find that, as both real and personal property secured the note, [Lender] had the option under section 9.501(d) [now § 9.604 of the Texas Uniform Commercial Code] to proceed under that Code as to the personal property, and later proceed under the Texas Property Code as to the real property, without being adversely affected by any defects in its personal property foreclosure proceedings.

*Van Brunt*, 804 S.W.2d at 127.

We hold that any defect in [Lender's] foreclosure under the Code has no effect on its rights under the real property mortgage, including its right to seek a deficiency.

*Van Brunt*, 804 S.W.2d at 129-30. The defect in *Van Brunt* was the failure of the lender to re-notify the debtor that the lender would sell the collateral at a private sale after the lender held a public sale but rejected the highest bid and later sold to the highest bidder at private sale for a higher price. Additionally, the debt in *Van Brunt* was a series of notes each guaranteed by a guarantor and secured by separate security agreements granting a security interest in accounts, inventory and equipment to secure all indebtedness of the borrower to the lender. One of the notes of the borrower expressly stated that it was secured by a deed of trust but did not refer to any of the security agreements.

Complicating this issue as regards to real property foreclosures is the fact that the *Tanenbaum* rule appears to have been overturned in non-consumer personal property foreclosure cases by Texas legislature's adoption of the revised chapter 9 to the Uniform Commercial Code. Texas Business and Commerce Code § 9.626 provides that in non-consumer transactions, a secured party need not prove compliance with the provisions of subchapter F ("Default") relating to collection, enforcement, disposition, or acceptance unless the debtor or a secondary obligor places the secured party's compliance in issue. Tex. Bus. & Comm. Code Ann. § 9.626(a)(1) (Vernon 2002). If the secured party's compliance is placed in issue, the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with subchapter F. Tex. Bus. & Comm. Code Ann. § 9.626(a)(2) (Vernon 2002). Except as otherwise provided in Section 9.628, if a secured party fails to prove that the collection, enforcement, disposition, or acceptance was conducted in accordance with the provisions of subchapter F, the liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the greater of: (i) the proceeds of the collection, enforcement, disposition, or acceptance; or (ii) the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the

provisions of subchapter F. Tex. Bus. & Comm. Code Ann. § 9.626(a)(3) (Vernon 2002). For this purpose, the amount of proceeds that would have been realized is deemed equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party proves that the amount is less than that sum. Tex. Bus. & Comm. Code Ann. § 9.626(a)(4) (Vernon 2002). If a deficiency or surplus is calculated under § 9.615(f), the debtor or obligor has the burden of establishing that the amount of proceeds of the disposition is significantly below the range of prices that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought. Tex. Bus. & Comm. Code Ann. § 9.626(a)(5) (Vernon 2002). Section 9.626 further provides that its limitation to transactions other than consumer transactions is intended to leave to the court determination of the proper rules in consumer transactions, but that "the court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches." Tex. Bus. & Comm. Code Ann. § 9.626(b) (Vernon 2002). See also *Huddleston v. Texas Commerce Bank—Dallas*, 756 S.W.2d 343 (Tex. App.—Dallas 1988, writ denied) (court refused to require mortgagee to prove that its deed of trust lien foreclosure sale on real property was conducted in commercially reasonable manner, citing (former) section 9.104(10) that excepts from chapter 9 of Texas Business and Commerce Code "creation or transfer of an interest in or lien on real estate").

If the security includes personal property, such as equipment or consumer goods (stoves, furniture), a UCC search should be conducted to determine initial perfection, continued perfection, priority, and junior security-interest holders to be notified. The secured creditor is required to notify other secured creditors with security interests in the same collateral of the proposed personal property foreclosure sale. Tex. Bus. & Comm. Code Ann. § 9.611 (Vernon 2002). The presence of personal property may also affect the type of requests in the initial communication to the debtor (e.g., request for inspection of the collateral, for assembly of collateral, or for voluntary turnover to lender for foreclosure sale).

**Commercially Reasonable Sale Requirements:** If the lender decides to proceed against the personal property separately, the

lender must repossess the collateral in order to conduct a commercially reasonable sale. Section 9.610(b) of the Texas UCC requires that every aspect of a secured party's disposition of personal property collateral in foreclosure of its security interest be "commercially reasonable," including the method, manner, time, place, and terms of sale. Prior to its revision in 1999, the Texas UCC did not define "commercially reasonable," but revised Texas UCC § 9.627(b) provides rules that assist in the determination of "commercially reasonable" and, in certain circumstances, provide a safe harbor for certain actions.

**Inadvertent Omissions from Collateral and Mortgaged Property:** Use of the mortgaged property may require the continuation after the foreclosure sale of a variety of contracts, franchises, licenses, permits, leases, and other interests that may not be described by the phrase "TO HAVE AND TO HOLD the above described property, together with the rights, privileges, and appurtenances thereto belonging . . ." in an earlier version of the *Texas Real Estate Forms Manual's* deed of trust. ( at 7B (1976 & Supp. 1982)), or the phrase "property (including any improvements)" in the current version of the deed of trust, at ch. 15, form 15-1. Unless the mortgagee is in some manner a party or a legally recognized third-party beneficiary to the contract, franchise, license, permit, lease, or other interest, the mortgagee may not have the benefits or the burdens of such matters. Some permits necessary to continue operation of the mortgaged property may be personal to the mortgagor. See, e.g., Tex. Alco. Bev. Code Ann. §§ 11.03, .05 (Vernon 1995).

**Including Unwanted Property:** The deed of trust may include an omnibus description of mortgaged property (i.e., "all agreements affecting or benefiting the mortgaged property"). There is no way of knowing at the time of the execution of the deed of trust which present or future agreements will be assets and which will be liabilities. Whether the mortgagee or the purchaser can pick and choose at the foreclosure sale or whether the foreclosure sale documents can specifically exclude undesirable agreements are unsettled issues. Even if they can be excluded, the undesirable agreements may not be identifiable as such at the time of foreclosure.

## 1.5:2 Real Property

Identifying the real property may not be as easy as it first sounds. Sometimes not enough care is taken at the time of the loan to verify the property's description. If the description is by metes and bounds, a survey should be considered if one was not obtained at the time the loan was made.

**Changes In the Security:** Since the loan was originally made, the description of the mortgaged property may have changed through platting, replatting, partial release of liens, and condominium declaration. Failure to verify the description may result in clouding the title, inadequately advertising the sale; may be considered as additional evidence of the fraudulent conduct of the lender; and may result in failure to convey title to the lender of portions of the security.

**Homestead:** If the mortgaged property is the debtor's homestead or the debtor's residence, additional considerations should be given to cure rights, consumer debt-collection laws, and limitations on secured debt.

Two cases emphasize that "a lien cannot be 'estopped' into existence" over the homestead exemption. In *Hruska v. First State Bank*, 747 S.W.2d 783, 785 (Tex. 1988), the debtors misrepresented to the lender, subsequent to the funding of a construction loan on a homestead, that mechanic's lien documents had been prepared. The Texas Supreme Court found that these misrepresentations would not retroactively create a lien by estoppel. In *In re Niland*, 825 F.2d 801 (5th Cir. 1987), the Fifth Circuit held that a mortgagor's misrepresentations in a recorded homestead affidavit and designation identifying another residential property as the debtor's homestead did not estop the debtor from claiming a foreclosed residence as a homestead against a purchaser for value at a foreclosure sale. *But see Templin v. Weisgram*, 867 F.2d 240 (5th Cir. 1989) (borrower's homestead claim, made following simulated sale, barred by 12 U.S.C.A. § 1823(e) (West 1989)).

Additionally, the lender's attorney should ensure that the lender is not attempting to claim that the mortgaged property serves as collateral for debts not permitted to be secured by the homestead. The lender may also be asserting erroneously that the homestead loan, although

not otherwise in default, is in default because of a default on another loan. This problem can occur if the homestead loan documents do not clearly state that a default on other indebtedness is a default on the homestead loan. For example, the homestead loan documents may recite that a default on "any debt secured hereby" is a default permitting acceleration but fail to recite that a default on debt "not secured hereby" is a default permitting acceleration of the homestead loan.

**Improvements and Fixtures.** The *Texas Real Estate Forms Manual's* form for deed of trust provides for the description of the mortgaged real property by calling for the insertion of a description following the heading "Property (including any improvements):" *Texas Real Estate Forms Manual*, ch. 15, form 15-1. A frequent practice is to insert a description of the land without further reference to the "improvements" encumbered or to "fixtures" and "appurtenances." Although a better practice is to include at least a general description of the improvements and fixtures, this practice in most cases should suffice. Courts have given liberal construction to the scope of the "property" conveyed by deeds merely identifying the property conveyed by description of the land. The general rule is that "[d]eeds are construed to convey to the grantee the greatest estate possible." *Reeves v. Towery*, 621 S.W.2d 209, 212 (Tex. Civ. App.—Corpus Christi 1981, writ ref'd n.r.e.) (citing *Waters v. Ellis*, 312 S.W.2d 231 (Tex. 1958)). A deed that does not except property owned by the grantor conveys the grantor's entire estate. See *Waters v. Ellis*, 312 S.W.2d 231, 234 (Tex. 1958). Reservations must be by clear language. See *Reeves*, 621 S.W.2d at 212 (citing *State v. Black Bros.*, 297 S.W. 213 (Tex. 1927)). No exception or reservation exists absent a manifest intent expressed in the instrument. See *Garvin v. Hudson*, 353 S.W.2d 508, 510 (Tex. Civ. App.—Texarkana 1962, writ ref'd n.r.e.).

The term "improvement" generally includes anything that permanently enhances the value of such real property. See *Karisch v. Allied-Signal, Inc.*, 837 S.W.2d 679, 680 (Tex. App.—Corpus Christi 1992, no writ). The term "improvement" covers a broader range of items than does the term "fixture." See *Logan v. Mullis*, 686 S.W.2d 605, 607 (Tex. 1985); *Cantrell v. Broadnax*, 306 S.W.2d 429, 432 (Tex. Civ. App.—Dallas 1957, no writ). Items which have been held under

Texas law to be improvements include: (i) a building (see *Producers Lumber & Supply Co. v. Olney Bldg. Co.*, 333 S.W.2d 619, 624 (Tex. Civ. App.—San Antonio 1960, writ ref'd n.r.e.)); (ii) a house (see *Dennis v. Dennis*, 256 S.W.2d 964, 966 (Tex. Civ. App.—Amarillo 1952, no writ)); (iii) a fence (see *Jarrell v. Boedeker*, 146 S.W.2d 293, 295 (Tex. Civ. App.—Fort Worth 1940, no writ)); (iv) oil wells (see *Jenkins v. Pure Oil Co.*, 53 S.W.2d 497, 503 (Tex. Civ. App.—Dallas 1932, no writ)); (v) underground petroleum storage tanks (see *Big West Oil Co.*, 836 S.W.2d at 803); and (vi) a heat exchanger bolted to a concrete structure (see *Karisch*, 837 S.W.2d at 681). The permanent aspect of an improvement requires that it be placed on the land so that it is impossible to remove it or carry it away without injuring the real property or that the improvement be annexed to the soil as part of the freehold. See *Big West Oil Co. v. Willborn Bros. Co.*, 836 S.W.2d 800, 803 (Tex. App.—Amarillo 1992, no writ). Many of these examples indicate the difference between a fixture, which must be chattel, and an improvement which encompasses any permanent betterment.

If the property is leased, there are likely to be trade fixtures (items annexed to property that enable a tenant or occupant to carry on a trade or business) affixed to the property. The general rule is that a tenant's trade fixtures can be removed by a tenant if they may be done without injury to the property. See *Sonnier v. Chisolm-Ryder Co.*, 909 S.W.2d 475, 479 (Tex. 1995); *Reames v. Hawthorne-Seving, Inc.*, 949 S.W.2d 758, 761 (Tex. App.—Dallas 1997, writ denied).

"**Fixtures**" are broadly described under Texas law as items of property that are personal in nature and have been annexed to realty so as to become a part of the realty. See *Houston Bldg. Serv., Inc. v. American Gen. Fire and Cas. Co.*, 799 S.W.2d 308, 311 (Tex. App.—Houston [14th Dist.] 1990, writ denied); *Fenlon v. Jaffe*, 553 S.W.2d 422, 428 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.); *Ruby v. Cambridge Mut. Fire Ins. Co.*, 358 S.W.2d 943, 945 (Tex. Civ. App.—Dallas 1962, no writ). Generally, the term "fixture" includes all chattels or structures attached to realty that cannot be removed without materially damaging the property. See *Melendez v. State*, 902 S.W.2d 132, 137-38 (Tex. App.—Houston [1st Dist.] 1995, no writ). See TEX. BUS. & COMM. CODE ANN. § 9.313(9)(1) (Vernon 2002).

More specifically, a three part test has been developed to determine whether an item of personal property has become a fixture: (i) did the person who annexed the chattel to the realty intend for it to become a fixture? (ii) was the mode and sufficiency of annexation adequate to attach the chattel to the realty? and (iii) has the chattel been adapted to the use of the realty? See *Logan v. Mullis*, 686 S.W.2d 605, 607 (Tex. 1985); *House the Homeless, Inc. v. Widnall*, 94 F.3d 176, 181-82 (5th Cir. 1996). Absent any evidence to the contrary, an owner who affixes improvements onto land is assumed to have intended for such improvements to become fixtures. See *McDaniel v. Pettigrew*, 536 S.W.2d 611, 615 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.); *Clark v. Clark*, 107 S.W.2d 421, 424 (Tex. Civ. App.—Texarkana 1963, no writ). If there was intent that the improvement be temporary in nature, however, such improvements will not be deemed a fixture. See *O'Neil v. Quilter*, 234 S.W. 528, 529 (Tex. 1921). Secret intentions will not be dispositive of an intent for the issue of permanent annexation. See *Ruby*, 358 S.W.2d at 946; *C.D. Shamburger Lumber Co. v. Bredthauer*, 62 S.W.2d 603, 604 (Tex. Civ. App.—Fort Worth 1933, writ dismissed w.o.j.). The second and third prongs of the fixture test are typically used as further evidence of the question of intent. See *Hutchins v. Masterson*, 46 Tex. 551, 554 (Tex. 1887); *Logan*, 686 S.W.2d at 607; *Fenlon*, 553 S.W.2d at 42.

**Appurtenances.** “**Appurtenance**” means a real property interest that is annexed to, incident to or necessarily connected with the use and enjoyment of a tract of real property. BLACK’S LAW DICTIONARY (West 1999). “**Appurtenance**” includes improvements and easements. *Angelo v. Biscamp*, 441 S.W.2d 524 (Tex. 1969); *Pine v. Gibraltar Savings Association*, 519 S.W.2d 238 (Tex. Civ. App.—Houston [14th Dist.] 1974, writ ref'd n.r.e.) Under the common law, the conveyance of a tract of real property includes appurtenances, unless the deed provides otherwise. *Pollock v. Lowry*, 345 S.W.2d 587 (Tex. Civ. App.—San Antonio 1961, writ ref'd n.r.e.). “**Appurtenance**” does not, however, normally include personal property. *Ogden v. Jones*, 37 S.W.2d 777 (Tex. Civ. App.—Austin 1931, writ dismissed w.o.j.).

The *Texas Real Estate Forms Manual's* form for deed of trust does not attempt to describe the variety of appurtenances or agreements that

give value to the mortgaged property, nor does it refer to “appurtenances” but merely describes the mortgaged property as “Property (including any improvements).” *Texas Real Estate Forms Manual*, ch. 15, form 15-1. Prior to foreclosing on the deed of trust lien, a reexamination should be made to determine whether there are valuable rights associated with the property and whether these rights are appurtenances that pass to the foreclosure sale purchaser with title to the mortgaged property.

**Water Rights.** Water rights have been held to be included as part of the mortgaged property when the deed of trust did not expressly reserve or except water rights. *Graham v. Kuzmich*, 876 S.W.2d 446 (Tex. App.—Corpus Christi 1994, no writ). The obligation of a municipal utility district to lease and later purchase water, sanitary sewer and drainage facilities installed by the mortgagor have been held to be an appurtenance passing at a foreclosure sale. *Olmos v. Pecan Grove Municipal Utility District*, 857 S.W.2d 734 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1993, no writ).

#### **Peanut Allotment.**

A federal peanut allotment has been held to be appurtenant to farm land. *Lindsey v. FDIC*, 960 F.2d 567 (5<sup>th</sup> Cir. 1992).

#### **Parking Garage Lease.**

A garage parking lease has been held not to be appurtenant to an office building where the leasehold interest in the parking garage was not necessary to the intended function of the building because other parking was available near the building and not every tenant in the building leased parking space in the garage. *Law Offices of C. Kendall Harrell, P.C. v. Commerce Savings Association*, 824 F.Supp. 1159 (W. D. Tex. 1993).

#### **1.5:3 Crops, Crop Rent, and Farm Tenants**

The purchaser at a foreclosure sale will take title to crops and crop rent only if there has not been an actual or constructive severance of the crops and rent from the land. This severance may be created by harvest, sale, assignment, or mortgage. Lease of the land creates a severance of the crops under the proper

circumstances. The severance may be subsequent in time to the mortgage and without actual or constructive notice to the mortgagee. Furthermore, a tenant of the debtor's may also have rights in the crops that will survive the foreclosure, notwithstanding the fact that the tenant's lease is junior to the deed of trust.

**Crops:** Texas case law is well settled that crops produced by annual cultivation, whether growing or matured, are distinct in nature from the land on which they are cultivated and that title to the crops may reside in a person other than the owner of the land. Therefore, unless the deed of trust specifically covers crops, they will pass with the land at a foreclosure sale only if they have not been actually or constructively severed from the land before the foreclosure sale. *Greenland v. Pryor*, 360 S.W.2d 423 (Tex. Civ. App.—San Antonio 1962, no writ); *Gulf Stream Realty Co. v. Monte Alto Citrus Association*, 253 S.W.2d 933 (Tex. Civ. App.—San Antonio 1952, writ ref'd); *Dodson v. Beaty*, 144 S.W.2d 609 (Tex. Civ. App.—Dallas 1940, writ dism'd judgm't cor.); and numerous cases cited in these three opinions. The severance may be by harvesting or constructively by assignment or mortgage. *Willis v. Moore*, 59 Tex. 628 (1883); *Gulf Stream Realty Co.*, 253 S.W.2d at 936; *Dodson*, 144 S.W.2d at 611. There is case authority that even crops not yet planted may be severed by sale or mortgage, *Sanger Bros. v. Hunsucker*, 212 S.W. 514 (Tex. Civ. App.—Fort Worth 1919, no writ), but there is also case authority that an executory contract to sell, which provides that title to the crops shall not pass until they are "picked and prepared for delivery," is not sufficient to create a severance of the crops from the land, and the crops in such case pass to the purchaser at foreclosure. *Gulf Stream Realty Co.*, 253 S.W.2d at 936.

**Crop Rent:** The same reasoning is applied to crop rent due the mortgagor under a lease. The Crop rent passes to the purchaser at foreclosure only if there has not been a previous assignment of the rent. *Dodson v. Beaty*, 144 S.W.2d 609 (Tex. Civ. App.—Dallas 1940, writ dism'd judgm't cor.); *Standridge v. Vines*, 81 S.W.2d 289 (Tex. Civ. App.—Eastland 1935, no writ); *Hunsucker*, 212 S.W. 514. In *Standridge*, the court stated:

It is immaterial that no constructive notice may be given of the sale, mortgage, assignment, etc. Where not

interdicted by the statute of frauds, the evidence thereof is not required to be in writing. It necessarily follows that the purchaser at the foreclosure sale is charged with knowledge of the law that he gets no title to growing crops and rents if there has been a severance. In other words, a purchaser is under the obligation to ascertain if there has been a severance, and only takes title to the crops and rents if there has been none.

81 S.W.2d at 290.

**Rights of Farm Tenants:** The distinction between crops and the land is the basis for the common-law doctrine of "**emblemments**", an equitable doctrine protecting lessees of farmland.

The doctrine of emblements is the common law right of the tenant, whose lease of uncertain duration has been terminated without his fault and without previous knowledge upon his part, to enter upon the leased premises to cultivate, harvest, and remove the crops planted by him before the termination of the lease.

*Dinwiddie v. Jordan*, 228 S.W. 126 (Tex. Comm'n App. 1921, judgm't adopted); see also *Miller v. Gray*, 149 S.W.2d 582 (Tex. 1941). In *Dinwiddie*, the three elements of emblements: (1) the existence of a tenancy of uncertain duration, (2) the termination of the tenancy by the act of the lessor, and (3) the planting of the crop by the tenant during his period of legal occupancy without notice were met by (a) a five-year lease subject to earlier termination upon specified conditions, (b) a default by the lessor leading to foreclosure of the lessor's mortgage, and (c) the tenant's planting of crops before he received notice of the pending foreclosure sale. The commission of appeals in *Dinwiddie* stated that the tenant not only retained title to the crop but also had a right of entry onto the land to cultivate the crop until maturity and harvest. The court further quoted with approval a decision by the Supreme Court of Nebraska stating that while the tenant's right was a right of ingress and egress and not of possession of the land, the tenant did have a cause of action for any interference by the owner of the land with this right of entry. 228 S.W. at 128.

The doctrine of emblements does not apply when a lease of certain duration expires, and thus the lessee is not entitled to crops planted so late in the lease term that they do not and cannot mature before expiration of the lease. *Miller v. Gray*, 149 S.W.2d 582 (Tex. 1941); *Beken v. Elstner*, 503 S.W.2d 408 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ). In *Beken*, however, the court drew an exception to this rule by stating that a lessee is entitled to the crop if the evidence shows that the lessor knew the crop could not mature during the term of the lease and still consented to or acquiesced in the planting and cultivating of the crop. 503 S.W.2d at 410.

#### **1.5:4 Federally Related Farm and Ranch Mortgages**

*Federal Loan Programs.* Various agencies of the United States Department of Agriculture make, guarantee, or service a significant volume of farm and ranch loans. It is estimated that in Texas, for example, the Farm Credit System accounts for approximately thirty percent of all farm and ranch lending in Texas. A farm or ranch loan that is made, guaranteed or serviced under these federal programs cannot simply be foreclosed upon default by the borrower. Instead, the applicable federal law provides the borrower with significantly greater rights than under Texas foreclosure law and the borrower's rights under federal law must be exhausted before the defaulted loan can be referred to the state office of the General Counsel of the United States Department of Agriculture for foreclosure.

The loans originated and/or serviced under the Farm Credit System, the largest of the farm and ranch lenders in Texas, are governed by the regulations at 7 C.F.R. §§ 1951.901-.911 (2004). Because numerous other agencies under the United States Department of Agriculture make, guarantee or service loans under a variety of federal programs, however, it can be a very difficult process to determine the exact provisions of the federal statutes and regulations applicable to the loan in question.

**Borrower's Rights.** Certain statutes and/or regulations are generally applicable to these federal loan programs. The "borrower's rights" provisions set forth at 12 U.S.C.A. § 2202 *et seq.* (West 2001) are applicable to agricultural loans serviced under the various federal programs. The debt settlement policies and

procedures found at 7 C.F.R. §§ 792.1-.22 (2004) generally apply to all collection efforts involving agricultural loans. Finally, 7 C.F.R. § 1951.911 (2004) generally grants the borrower the right to lease or purchase a ten-acre homestead out of the collateral even in the event of foreclosure of the loan.

The "borrower's rights" granted by 12 U.S.C.A. § 2202 pertain to all "distressed" loans made through a federal lender. Unless the lender reasonably believes that the loan collateral will be destroyed, dissipated, consumed, concealed or permanently removed from the state, the lender cannot proceed with collection or foreclosure without following the procedures set forth to protect the borrower rights. 12 U.S.C.A. § 2202a(j) (West 2001).

A distressed loan is defined as a loan in which the borrower does not have the financial capacity to pay the loan because the loan is past due or there is a high probability of loss to the lender because of inadequate collateralization. See 12 U.S.C.A. § 2202a(a)(3) (West 2001). In situations involving distressed loans made under the Farm Credit System, the regulations at 7 C.F.R. §§ 1951.901-.911 require that prior to any foreclosure action the borrower must be given written notice of eligibility for a restructuring of the loan before the lender can initiate any collection action, accelerate the maturity of the debt, accept a deed in lieu of foreclosure, or foreclose. 7 C.F.R. § 1951.907(c) (2004). The notice advising the borrower of the right to restructure the loan must contain a copy of the lender's distressed loan policy and all the materials necessary for the borrower to submit an application for restructuring the loan. 7 C.F.R. § 1951.907 (2004).

If the borrower files an application to restructure the loan, the lender must use the "Debt And Loan Restructuring System" computer program to determine if a feasible restructure plan is available. 7 C.F.R. § 1951.909(a)(1) (2004). The lender may not accelerate the maturity of the loan until this loan restructure analysis has been completed. If the calculations show that the value of the collateral is equal to or greater than the net recovery value to be derived from foreclosure, as determined in accordance with 7 C.F.R. §§ 1951.909(e), (f) (2004), the lender must make an offer to the borrower to restructure the loan in accordance with 7 C.F.R. § 1951.909(h) (2004). The borrower can appeal

the terms of the proposed restructure offer through mandatory mediation and/or the appellate process set out in 7 C.F.R. §1951.904 (2004), while preserving the right to accept the restructure offer any time within forty-five (45) days after the conclusion of all appeals. Furthermore, if no feasible restructure plan can be worked out, the borrower has the right to buy out the debt at the current market value of the property. Finally, 7 C.F.R. §1951.911 (2004) generally provides that a borrower may retain the 10 acres used as the borrower's principal residence on a lease or purchase basis, notwithstanding the failure to cure the default or restructure the loan.

If no cure, restructuring or buy-out of the defaulted loan occurs and the appeals process is completed, the lender may then refer the loan to the state office of General Counsel of the United States Department of Agriculture for foreclosure. Thereafter, the foreclosure will be conducted in accordance with the terms of the deed of trust, Texas common law, and Chapter 51 of the Texas Property Code.

**Limitations.** These federal statutes and regulations impose much greater delays in proceeding with foreclosure than under Texas law, but the federal government is not bound by Texas' limitations statutes as to enforcement of the deed of trust. The general federal statutes of limitations are 28 U.S.C.A. §§ 2415 and 2416 (West 1994), which provide that any action for money damages founded upon a contract is not barred unless the complaint is filed (i) more than six years after the cause of action, or (ii) more than one year after final decisions have been rendered in the administrative proceedings. However, certain courts of appeals have held that this six-year limitation applies only to action for money damages and not to the government's right to bring a foreclosure action, indicating that there are no limitations on bringing the federal foreclosure action. *Cracco v. Cox*, 414 N.Y.S.2d (404th Dept. 1979) and *Farmers Home Administration v. Muirhead*, 42nd F 3rd 964 (5th Cir.), *cert. denied* 516 U.S. 806 (1995). The Cracco and Muirhead proceedings were challenged in *U.S. v. Peoples Household Furnishing, Inc.*, 75 F 3d 252 (6th Cir. 1996), but most federal courts seem to follow the U.S. Supreme Court decision in *U.S. v. Summerlin*, 310 U.S. 414 (1940), which held that the United States can enforce a foreclosure claim in its

capacity as a sovereign without regard to statutes of limitation.

Additional Resources: See G. Tommy Bastian *Foreclosure Of Farm And Ranch Real Property*, 25th Annual Advanced Real Estate Law Course (2003) and the websites for the Farm Credit Administration at [www.sea.gov](http://www.sea.gov) and the Farm Servicing Agency at [www.fsa.usda.gov](http://www.fsa.usda.gov).

## 1.6 Identifying Obligors' Status

Many aspects of the mortgagor's circumstances may affect foreclosure proceedings. For example, the mortgagor's status as a consumer or as a member of the armed services will require the special attention of the attorney.

### 1.6:1 Consumer

**Consumer Protection in Debt Collection.** Texas and the federal government have adopted debt-collection laws governing the collection of consumer debt by debt collectors. Both the mortgagee and the mortgagee's attorney must be aware of these laws. Debt collectors, including attorneys, may be subject to fines, civil remedies, or both for employing or attempting to use threats, coercion, harassment, abuse, oppression, unfair or unconscionable means, or fraudulent, deceptive, or misleading representations.

### FHA, VA, and Servicer's Loss Mitigation Programs.

#### FHA.

HUD has adopted policies requiring loss mitigation on all FHA loans. See HUD 2000 Mortgagee Letter ML 00-05 "*Loss Mitigation Program*," dated January 19, 2000 and 24 C.F.R. § 203.501. HUD has proposed regulations to impose treble damages on any servicer of a FHA loan who fails to offer loss mitigation to a borrower in default on a FHA loan. 69 F.R. 19906-01, 2004 WL 783027 (F.R.) Apr. 14, 2004. See HUD website at [www.hud.gov](http://www.hud.gov) under the "Foreclosure" menu and the "Related Information" subsection for an article entitled *Relief Options for FHA Homeowners* that described what homeowners can do to obtain a "loss mitigation" or workout from the mortgagee. Also see the HUD website for another article entitled *Help for Homeowners Facing the Loss of Their Home*.

**VA.**

VA's loss mitigation requirements are found in the *VA Servicing Guide*, § 3.01-3.06 and Appendix D of the Servicing Guide. The VA program is referred to as the Servicer Loss Mitigation Program ("SLMP").

**Home Ownership Counseling.**

Home ownership counseling is required on all VA and FHA loans secured by a single-family residence. 12 U.S.C.A. §1701x(c)(5).

**Fannie Mae.**

See Fannie Mae *Single Family Servicing Guide*, VIII § 501-508 for Fannie Mae's loss mitigation policies.

**Freddie Mac.**

See Freddie Mac's *Single Family Servicing Guide*, Vol. II, Ch. 65, A 65 and B65 for Freddie Mac's loss mitigation rules.

**1.6:2 Bankruptcy**

The Bankruptcy Code provides an automatic stay on all actions or proceedings, including nonjudicial foreclosure sales, against the debtor or his mortgaged property. 11 U.S.C.A. § 362(a)(4) (West 2004); see *In re Wheeler*, 5 Bankr. 600 (Bankr. N.D. Ga. 1980) (bankruptcy court invalidated foreclosure sale occurring at 10:05 a.m., chapter 13 petition was filed at 10:34 a.m., and foreclosure sale purchaser's check was not delivered until 11:45 a.m.). *But see In re Butchman*, 4 Bankr. 379 (Bankr. S.D.N.Y. 1980) (foreclosure sale held to be valid because it took place two hours before chapter 13 petition was filed). The court in *Graham v. Pazos De La Torre*, 821 S.W.2d 162 (Tex. App.--Corpus Christi 1991, no writ) set aside a foreclosure sale because at time of sale mortgagor was in bankruptcy though bankruptcy was unknown to mortgage trustee and mortgagee at time of sale. The court also rescinded the resale by foreclosure sale purchaser to a third party and ordered the resale price returned. However, a bankruptcy court has held that a Trustee in bankruptcy may not avoid a foreclosure sale in violation of the automatic stay if the mortgaged property is conveyed at the foreclosure sale purchaser to a good faith purchaser who is unaware of the mortgagor's bankruptcy, relying

on 11 U.S.C.A. section 549(c). The bankruptcy court held that notice of the commencement of the bankruptcy proceedings must be filed in the county's real property records to put foreclosure sale purchasers on notice of the automatic stay *In re Jones*, 172 B.R. 535 (E. D. Tex. 1994).

The stay of action includes a stay of demanding payments, accelerating the debt, posting for or proceeding with foreclosure, filing suit against the debtor, repossessing or otherwise obtaining or perfecting liens against the property of the debtor, exercising any right of offset, and most other collection efforts.

A foreclosure sale conducted in violation of a temporary stay order is not automatically validated by a subsequent termination of the stay. In *Goswami v. Metropolitan Savings & Loan Association*, 751 S.W.2d 487 (Tex. 1988), the Texas Supreme Court held that the bankruptcy court may annul a stay to validate actions taken during the stay or take some action to recognize the invalidity of the stay order. See also *Huddleston v. Texas Commerce Bank—Dallas*, 756 S.W.2d 343 (Tex. App.—Dallas 1988, writ denied) (court held that bankruptcy court's dismissal of bankrupt's petition did not reinstate postpetition foreclosure sale held in violation of bankruptcy stay). The bankruptcy court's order did not specifically annul the automatic stay. In *Huddleston* the first foreclosure sale was held after the mortgagor had transferred the mortgaged property to a corporation that filed a chapter 11 petition on the morning of the foreclosure sale. The mortgagee was unaware of the filing at the time of the foreclosure sale. The bankruptcy was later dismissed as a bad-faith filing, permitting the mortgagee to reforeclose its lien.

A foreclosure sale knowingly made in violation of the automatic stay can expose the mortgagee to liability for actual and punitive damages. 11 U.S.C.A. § 362(h) (West 2004).

**1.6:3 Death of Mortgagor**

**Death Prior to Foreclosure Sale:** If the mortgagor dies and a will is not probated with an independent executor appointed before the foreclosure, the lender runs a significant risk that its deed of trust lien foreclosure sale will be voided. As noted below, a dependent administration may be opened up to four years after the mortgagor's death and a foreclosure

sale during such period set aside. A lender contemplating foreclosing in a case in which the mortgagor is deceased and no administration is pending should postpone the foreclosure sale until after the lender attempts to compel production and probate of the decedent's will. The survivors may attempt to thwart a foreclosure action by filing for a dependent administration, conveniently overlooking or discarding a will providing for independent administration, and the lender may be forced to file a discovery action in the probate court. See Tex. Prob. Code Ann. § 75 (Vernon 2003). However, a different rule applies to the vendor lender, which holds a vendor's lien and superior title. *Walton v. First National Bank of Trenton*, 956 S.W.2d 647 (Tex. App.—Texarkana 1997, writ denied).

### Probate Code Election.

Section 306 of the Tex. Prob. Code Ann. (Vernon 2003) provides that personal representatives of estates shall pay secured claims in different ways, depending on how a creditor elects to treat his claim. Under § 306, there are two kinds of secured claims that are classified and prioritized differently under §§ 320 and 322. A secured creditor may elect to have his claim treated as either: (1) a matured secured claim; or (2) a preferred debt and lien. § 306(a) Tex. Prob. Code Ann. (Vernon 2003). If a secured creditor makes no claim or does not affirmatively elect otherwise within six months after the original grant of letters testamentary, his claim will be treated as a preferred debt and lien. Tex. Prob. Code Ann. (Vernon 2003) §§ 298(a), 306(b); *Cessna Fin. Corp. v. Morrison*, 667 S.W.2d 580, 583-84 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1984, no writ). So, within six months a personal representative will be able to fit a secured claim into one of the two categories set forth in § 306. If the claim is a matured secured claim, the representative will treat it as third class and pay it, to the extent of the value of the collateral, after first- and second-class claims, but before other lower-class claims. Tex. Prob. Code Ann. (Vernon 2003) §§ 306, 320, 322. If there is not enough money in the estate to pay the first- and second-class claims, however, the representative will invade the collateral for the matured secured claim to pay the higher-priority claims. Tex. Prob. Code Ann. (Vernon 2003) § 322; see *Wyatt v. Morse*, 102 S.W.2d 396, 398-99 (Tex. 1937). If the entire claim is not satisfied through the collateral, the representative can

pay the deficiency a lower-class claim out of other assets of the estate. Tex. Prob. Code Ann. (Vernon 2003) § 322; see *Wyatt*, 102 S.W.2d at 398-99. If a claim is a preferred debt and lien, the representative may either pay the debt off or continue making payments as per the terms of the contract that secured the debt. Tex. Prob. Code Ann. (Vernon 2003) § 306(a)(2) and (c). Regardless of which method the representative chooses, the creditor will have priority over all other debts, even first- and second-class claims, to the extent of the value of its collateral. Tex. Prob. Code Ann. (Vernon 2003) § 306(a)(2) and (c); see *Wyatt*, 102 S.W.2d 398-99; *Dallas Joint-Stock Land Bank in Dallas v. Maxey*, 112 S.W.2d 277, 280 (Tex. App. App.—Dallas 1937, no writ). *But see San Antonio Sav. Ass'n v. Beaudry*, 769 S.W.2d 277, 280 (Tex. App.—Dallas 1989, writ denied) holding expenses directly related to preserving, maintaining, and selling collateral may be paid out of the sales proceeds of the property. However, if the entire claim is not satisfied through the collateral, the representative cannot pay any deficiency out of other assets of the estate as he could if the claim were a matured secured one. Tex. Prob. Code Ann. (Vernon 2003) § 306(c); see *Wyatt*, 102 S.W.2d at 398-99. In *Texas Commerce Bank National Ass'n v. Geary*, 938 S.W.2d 205 (Tex. App.—Dallas 1997) *judgm't rev'd on other grounds*, 967 S.W.2d 836 (Tex. 1998) the mortgagee elected preferred debt and lien status due to failure to elect otherwise within six months after original grant of letters testamentary.

**Death Subsequent to Foreclosure Sale:** The death of the mortgagor after a foreclosure sale will not affect the validity of the sale. At the time of death, the mortgagor no longer has an interest in the mortgaged property. See *Smith v. San Antonio Joint Stock Land Bank*, 130 S.W.2d 1070 (Tex. Civ. App.—Eastland 1939, writ ref'd); *Estrada v. Reed*, 98 S.W.2d 1042 (Tex. Civ. App.—Amarillo 1936, writ ref'd).

**Death Before Foreclosure Sale with Dependent Administration:** A nonjudicial foreclosure sale conducted while an administration of the deceased mortgagor's estate is pending is void and passes no title, because the opening of the administration suspends the power of sale under the deed of trust. *Pearce v. Stokes*, 291 S.W.2d 309 (Tex. 1956); *Robertson v. Paul*, 16 Tex. 472 (1856);

*Hury v. Preas*, 673 S.W.2d 949 (Tex. App.—Tyler 1984, writ ref'd n.r.e.); *Bozeman v. Follott*, 556 S.W.2d 608 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.). However, a different rule applies to the vendor lender, which holds a vendor's lien and superior title. *Walton v. First National Bank of Trenton*, 956 S.W.2d 647, 652 (Tex. App.—Texarkana 1997, writ denied). The vendor may elect to rescind the sale and is entitled to possession of the property through a district court trespass to try title action. James R. Norvell, *The Vendor's Lien and Reservation of the Paramount Legal Title—The Rights of Vendors, Vendees, and Subvendees*, 44 TEX. L. REV. 22-24 (1965)

If the mortgagor dies intestate, the administration of the decedent's estate is opened when the probate judge signs an order that grants administration and appoints an administrator and the administrator files the required bond and makes and files the oath. *Bozeman*, 556 S.W.2d 608.

**Probate Court Procedure To Obtain Sale:** A sale during the pendency of a dependent administration may take place only after compliance with the procedures set forth in the Texas Probate Code:

1. Filing the secured creditor's claim with the probate court. See Tex. Prob. Code Ann. §§ 298, 301 (Vernon 2003). If the mortgagee does not wish to pursue the assets in the estate and only wishes to pursue the security for the note, the mortgagee will want to elect preferred debt and lien status. The mortgagee should make that election in the claim. See Tex. Prob. Code Ann. §§ 298, 306 (Vernon 2003). Note that silence of the administrator for thirty days after presentation of the claim to enforce the lien against the mortgaged property is considered a rejection of the claim, and suit must be commenced within ninety days after rejection. See Tex. Prob. Code Ann. §§ 310, 313 (Vernon 2003).

2. Filing an application to sell the mortgaged property. See Tex. Prob. Code Ann. § 338 (Vernon 2003).

**Opening Dependent Administration Within Four Years of Death:** Under *Pearce v. Stokes*, 291 S.W.2d 309 (Tex. 1956), a dependent administration opened within four years of the

mortgagor's death renders voidable a trustee's nonjudicial sale. Other cases related to the foreclosure of property after the death of the mortgagor: *Shell Oil Co. v. Howth*, 159 S.W.2d 483 (Tex. 1942); see also *Rivera v. Morales*, 733 S.W.2d 677 (Tex. App.—San Antonio 1987, writ ref'd n.r.e.) (cancellation of contract for deed set aside).

**Independent Administration:** A trustee under a deed of trust can exercise the power of sale after the death of the mortgagor if the mortgagor's estate is being administered by an independent executor. See *Fischer v. Britten*, 83 S.W.2d 305 (Tex. 1935); *Pearce*, 291 S.W.2d 309; *Freece v. Truskett*, 106 S.W.2d 675 (Tex. Comm'n App. 1937, opinion adopted); *Bozeman*, 556 S.W.2d 608.

**Conversion to Dependent Administration:** Removing the administration from the control of the independent executor and subjecting the estate to regular administration does not negate the prior existence of a valid power of sale conferred under a deed of trust and does not invalidate the acts of the independent executor or change any applicable rules while the executor had independent control of the estate. *Taylor v. Williams*, 108 S.W. 815 (Tex. 1908); *Bozeman*, 556 S.W.2d 608.

**Authority Lost:** Removing the personal representative of the estate of a decedent, either as executor or administrator thereof, deprives the personal representative of the authority to do anything further with respect to the administration of the estate. See *Bozeman*, 556 S.W.2d 608; *Felton v. Birchfield*, 110 S.W.2d 1022 (Tex. Civ. App.—Fort Worth 1937, writ dismissed w.o.j.).

#### 1.6:4 Armed Services Personnel

The Servicemember's Civil Relief Act ("SCRA") formerly known as the Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C.A. sections 501-596, protects military personnel from foreclosure actions arising out loan defaults attributable to military service. SCRA does not extinguish a borrower's debt, it merely suspends the creditor's collection rights while the servicemember is on active duty and for 3 months after discharge from active duty. SCRA applies to Reservists in all military services, National Guardsmen and Public Health service members whose debt was created while a

civilian and before being called to active duty. If an obligation secured by a deed of trust on real property owned by a service member originated before the period of military service and the service member is still on active duty or has been discharged within ninety days before the date of the proposed foreclosure sale, the foreclosure sale is not valid unless conducted pursuant to (i) a court order granted before the foreclosure, or (ii) an agreement under 50 U.S.C.A. § 517 with the service member. 50 U.S.C.A. § 533(c) (West Supp. 2004). In a suit to enforce the deed of trust filed during or within 90 days after the service member's period of military service, a federal court may upon its own motion and shall upon application by the service member when the service member's ability to comply with the obligation is "materially affected by military service," (i) stay the foreclosure proceedings "for such period of time as justice and equity require," or (ii) "adjust the obligation to preserve the interests of all parties" by restructuring the debt. 50 U.S.C.A. § 533(b) (West Supp. 2004). Thus, the court is not to bar enforcement of the mortgage merely because the mortgagor is in the service; rather the purpose of the hearing is to determine whether active service has materially affected the mortgagor's ability to perform the loan, and a mortgagee who can demonstrate otherwise ought to be allowed to proceed with foreclosure. SCRA freezes the statute of limitation for all actions brought by or against a service member while on active duty. 50 U.S.C.A. § 526 (West Supp. 2004).

A person who knowingly conducts or attempts to conduct a foreclosure in violation of 50 U.S.C.A. section 533(c) may be fined and/or imprisoned for up to one year. 50 U.S.C.A. § 533(d)(1) (West Supp. 2004). These penalties are in addition to any other remedies available to the service member, including damages for wrongful conversion and consequential and punitive damages. 50 U.S.C.A. § 533(d)(2) (West Supp. 2004).

Verification of whether the borrower is in fact performing military service can be obtained by faxing (but not by writing or e-mailing) the Department of Defense, Manpower Data Center ("DMDC"), Military Verification, 1600 Wilson Blvd., Suite 400, Arlington Virginia 22209 Attn: Military Verification at Fax: 703-696-4156 Phone: 703-696-5790. The inquiry should provide the name, address and social security

number of the borrower. It is also possible to obtain verification through the DMDC's website, once preclearance is obtained. Mortgagee's may request a password by writing the DMDC on the mortgagee's letterhead. After completing the paperwork to obtain a password, details on how to use the DMDC's website are provided via email.

FHA, VA and Fannie Mae have detailed procedures in their servicing guidelines on servicing loans owed by servicemembers covered by SCRA.

See JA 260 on the Judge Advocate General's School website under "Publications" menu at the "Legal Assistance" sub-menu and under the "2000" section:

[www.jagcnet.army.mil/TJAGLCS](http://www.jagcnet.army.mil/TJAGLCS). Also see "Operation Enduring LAMP" on [www.abanet.org](http://www.abanet.org); and discussions at [www.military.com](http://www.military.com), [www.defenselink.mil](http://www.defenselink.mil), and [www.jagcnet.army.mil](http://www.jagcnet.army.mil).

### 1.7 Identifying the Mortgagee's Role

Just as the mortgagor's circumstances affect the foreclosure proceedings, the mortgagee's status may affect how the parties proceed. In *Jernigan v. Bank One, Texas, N. A.*, 803 S.W.2d 774, 777 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1991, no writ), the court recognized that, under certain circumstances, a promissory note can be transferred without a written assignment or proper endorsement. In such cases possession must be accounted for by proving the transaction through which the note was acquired. If all that the foreclosing mortgagee has is an assignment of the lien, but does not hold the note, a non-judicial sale may be wrongful. *Shepard v. Boone*, 99 S.W.3d 263 (Tex. App.—Eastland 2003, no writ). The capacity in which the note is held is particularly important.

#### 1.7:1 Multiple Noteholders

If more than one noteholder exists, all the noteholders must approve the actions to accelerate and to exercise the power of sale, unless the deed of trust provides to the contrary. *Bomar v. West*, 28 S.W. 519 (Tex. 1894) (holders of separate notes each secured *pari passu*); *Rogers v. Boykin*, 298 S.W.2d 199 (Tex. Civ. App. —Eastland 1956, writ ref'd n.r.e.) (required consent of all holders of single note).

### 1.7:2 Collateral Assignment and/or Endorsement of Note

**Collateral Assignee as Holder.** Section 3.301 of the Texas UCC provides that the holder of an instrument, whether or not he is the owner of the instrument, may enforce payment in his own name. Tex. Bus. & Comm. Code Ann. § 3.301 (Vernon 2002). Under section 3.203, a transfer of a security interest in an instrument vests in the secured party “any right of the transferor to enforce the instrument including any right as a holder in due course.” The meaning of this provision is expounded in section 3.302(e):

If (i) the person entitled to enforce an instrument has only a security interest in the instrument, and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument that, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

*Id.* § 3.302 comment 4. An instrument is defined as a negotiable instrument. *Id.* § 3.104(b) (Vernon 2002). To be a negotiable instrument, the note must contain a promise “to pay a sum certain,” a requirement that limits the negotiability of notes with variable interest rates. *Id.* §§ 3.104, .106.

Texas courts have interpreted these provisions to mean that a secured party may enforce the collaterally endorsed note in its own name and may be a holder in due course to the extent of the debt secured by the pledged promissory note. If the secured note has been collaterally assigned, endorsed, and delivered to a collateral assignee, then the collateral assignee must direct the acceleration and posting for foreclosure of the mortgaged property securing the collateral note. *Lawson v. Gibbs*, 591 S.W.2d 292 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref’d n.r.e.); *Merit Homes, Inc. v. Alltex Mortgage Co.*, 402 S.W.2d 943 (Tex. Civ. App.—Texarkana 1966, writ ref’d n.r.e.) (no endorsement to collateral assignee).

In *Lawson* a borrower named Craig pledged a note executed by Wortham Investments to Main

Bank of Houston to secure a note executed by Craig to Main Bank of Houston. In transferring the Wortham Investments note to the bank, Craig endorsed the note payable to the order of the bank. When the Wortham Investments note subsequently went into default, the bank appointed a substitute trustee and directed the trustee to proceed with foreclosure of the mortgaged property securing the Wortham Investments note. Suit was brought to set aside the foreclosure on the grounds that Craig, not the bank, was the legal owner and holder of the note and, therefore, was the only proper party to appoint a substitute trustee and conduct foreclosure proceedings under the Wortham Investments note.

The court in *Lawson* held that under Texas law the bank became the holder of the Wortham Investments note by reason of Craig’s endorsement and delivery. 591 S.W.2d at 294 (citing former Tex. UCC §§ 3.202(a), .302(a)). The court further stated that, according to (former) section 3.302, a holder of the note may enforce the note in his own name, whether or not he is the owner. The court rejected the argument that even if Craig’s endorsement made the bank a holder of the note, Craig remained the owner of the note and thus was the proper party to direct the sale.

When Craig, as payee of the note, unconditionally indorsed and delivered the note to the bank, the bank acquired the ownership interest of the payee. We hold that the indorsement and delivery of the note to the bank gave it the status of “legal owner and holder.” As that is the definition given of beneficiary [under the deed of trust], and the beneficiary is entitled to appoint a substitute trustee, the appointment by Main Bank of Terrance Baggott as substitute trustee of the deed of trust was valid. Therefore, the trustee’s sale of the property under the terms of the deed of trust, at the direction of the Bank, was valid.

*Id.* The court distinguished its rulings from those in the earlier cases of *Merit Homes, Inc. v. Alltex Mortgage Co.*, 402 S.W.2d 943 (Tex. Civ. App.—Texarkana 1966 writ ref’d n.r.e.), and *Busbice v. Hunt*, 430 S.W.2d 291 (Tex. Civ. App.—Tyler 1968, writ ref’d n.r.e.), on the grounds that in neither of those cases did the

debtor endorse the notes payable to the secured party as part of the collateral transfer.

In those cases had the assignors indorsed and delivered the collaterally assigned notes to the assignees, the collateral assignee would have been the proper party to appoint the substitute trustee under the terms of the deeds of trust, in the capacity of holder. Absent the indorsement the only rights of the collateral assignee in the collateral are those defined in Article 9 of the UCC . . . Thus, had Main Bank been only a collateral assignee of the note, its remedy upon default would be judicial foreclosure of the assigned note under Tex. Bus. & Comm. Code Ann. § 9.501 (Vernon 1968)[now §9.601]. Only by taking that step could it have acquired the rights of owner and holder.

*Lawson*, 591 S.W.2d at 295.

**Collateral Assignee Not as Holder:** Section 9.313(a) provides that a security interest in a promissory note may be perfected by possession of the note. Endorsement of the collaterally pledged note is not required to perfect the secured party's security interest in the pledged note. Tex. Bus. & Comm. Code Ann. § 9.313 (Tex. UCC) (Vernon ).

Holding possession makes the secured party a "transferee" for security, not a "holder." *Estrada v. River Oaks Bank & Trust Co.*, 550 S.W.2d 719, 727 (Tex. Civ. App.— Houston [14th Dist.] 1977, writ ref'd n.r.e.). Section 3.203(c) of the Texas UCC grants the secured party as transferee the specifically enforceable right to have the unqualified endorsement of the transferor. Negotiation takes effect only when the endorsement is made, and until that time there is no presumption that the transferee is the owner.

The collateral assignment (security agreement) gives the transferee the right to bring suit on the collaterally assigned note as assignee. As a mere assignee, the secured party is subject to all defenses and equities to which the notes are subject in the hands of the debtor. Tex. Bus. & Comm. Code Ann. §§ 3.305, .306 (Tex. UCC) (Vernon 2002); *Estrada*, 550 S.W.2d at 728. The assignee is entitled to collect on the collaterally assigned note even though the collaterally assigned note has been lost. After crediting the

proceeds derived from collection on the lost collaterally assigned note, the assignee/creditor is entitled to collect from its borrower the deficiency owing on its loan to the borrower. *Bray v. Cadle Co.*, 880 S.W.2d 813 (Tex. App.— Houston [14<sup>th</sup> Dist.] 1994, writ denied)—the *Bray* court in upholding the collateral assignee's right to collect against its borrower unnecessarily refers to the assignee as a "holder" or "owner" (holder of a lost note?).

Such secured creditors are entitled to have relief from the automatic stay of a bankruptcy of the pledging party, even though at the time of the bankruptcy the secured party does not hold the pledged note by endorsement. See *In re Major Funding Corp.*, 82 Bankr. 443, 449 (Bankr. S.D. Tex. 1987).

In *Carroll v. Kennon*, 734 S.W.2d 34 (Tex. App.—Waco 1987, no writ), the court held that a secured party in possession of a collaterally assigned but not endorsed note was not entitled to enforce payment of the collaterally assigned note without foreclosing on that note. In *Carroll*, after the Hendrickses (the makers of the collaterally assigned note) defaulted, Carroll (the collateral assignee of the defaulted note) foreclosed on the mortgaged property pledged by the Hendrickses to secure the collateral note. Carroll's attorney posted notice of the foreclosure sale, notified the Hendrickses, and mailed notices of the foreclosure sale of the mortgaged property to the Kennons (the collateral assignors of the collateral note). The Kennons sued Carroll for damages. The court held that Carroll was not a holder entitled to enforce payment of the collaterally assigned note in his own name under section 3.301 of the UCC, because the note had not been endorsed, to Carroll. The court held that Carroll's actions amounted to an election to retain the note in satisfaction of the Kennons' indebtedness pursuant to former section 9.505(b) of the UCC (now Texas UCC § 9.620) and that Carroll had not given the Kennons the notice required by that section. (Now Tex. Bus. & Comm. Code Ann. §9.621 (Tex. UCC) (Vernon 2002). The court remanded the case to determine whether the notice of trustee's sale sent to the Kennons put them on notice of Carroll's election to retain the note.

The court in *Carroll* noted that a secured party who disposes of collateral without complying with the notice provisions of the Uniform

Commercial Code is liable for the debtor's actual losses or for the statutory penalty provided in (former) section 9.507(a) [now Texas UCC § 9.625]. The court stated the following method for determining damages:

The Kennons' actual loss, assuming they are entitled to recover any damages under Section 9.507(a), would not be limited just to the difference between the unpaid balances of the two notes. Their actual loss would also include the equity they lost in the 31.25 acres when they were denied the right to redeem the collateral under Section 9.506.

734 S.W.2d at 41.

Serious questions remain unanswered concerning the position of a secured party holding the pledged note by endorsement. Some of these questions are listed below. The creditor should consider whether it is willing to be in the position of holder of the collaterally endorsed note. As holder of the note, the creditor will be the party to institute foreclosure proceedings and demands on the maker of the collaterally endorsed note.

The security agreement (collateral transfer of note and liens) can provide for a consent of the secured party to the debtors foreclosing on the underlying real property collateral and a continuation of the secured party's lien in the proceeds to be derived from any foreclosure on the real property securing the pledge note. Additionally, the security agreement can provide for the debtor to execute a deed of trust on the real property as substitute collateral in lieu of the note if the debtor is the successful bidder at the foreclosure sale. A transfer-for-collection form, designed for use with a previously executed security agreement, can permit the debtor to reacquire the status of the holder of the collateral note for purposes of collection and foreclosure proceedings on the real property security for the collateral note. In such cases the collateral note will need to be endorsed without recourse, but the creditor should retain possession to maintain its security interest.

**Unanswered Questions:** The Texas UCC and the Texas cases leave the following important questions unanswered:

1. Are proceeds received by the secured party at the foreclosure sale of the mortgaged property to be applied as prepayments on the borrower's note or merely held as cash collateral?

2. Does the secured party's taking title to the mortgaged property at the foreclosure sale constitute an offer under section 9.620 of the Texas UCC to accept the mortgaged property in full satisfaction of the borrower's debt?

3. Is the borrower or the secured party entitled to any equity in the foreclosed mortgaged property?

4. Does a bid at the foreclosure of the collaterally assigned deed of trust affect the debt owed by the borrower to the secured party?

## 2. Collecting the Debt

### 2.1 Notices

Before a secured creditor forecloses on mortgaged property, the options available to minimize the loss on the defaulted note should be carefully considered. The creditor will be required to send a variety of notices, depending on the type of note and debtors involved, before proceeding with the collection process. Most loan situations will dictate that, for a demand note, a notice of default be sent or that, for a term loan and installment loan, a notice of intent to accelerate and a subsequent notice of acceleration be sent to the debtors before they are sent the statutorily required notice of foreclosure sale. In the case of consumer debt, the initial communication with the debtor must contain the Miranda-style warning and the statutorily dictated notices provided by the federal Fair Debt Collection Practices Act. In the case of a loan secured by the debtor's residence, the debtor must be provided with written notification by certified mail that the debtor is in default and is given at least twenty days to cure the default before notice of sale can be given. Tex. Prop. Code Ann. § 51.002(d) (Vernon Supp. 2004).

### 2.2 Notice of Default

Demand for payment and notice of acceleration must not be simultaneous. *Williamson v. Dunlap*, 693 S.W.2d 373 (Tex. 1985). Even in the

absence of a specific provision in the loan documents requiring the mortgagee to make demand on the maker to cure a default, the mortgagee must make demand before acceleration so that the maker or the mortgagor (in the case of defaults on deed of trust covenants) has the opportunity to cure the default. *Id.*; *Alien Sales & Servicer v. Ryan*, 525 S.W.2d 863, 866 (Tex. 1975); *Joy Corp. v. Nob Hill North Properties*, 543 S.W.2d 691, 694 (Tex. Civ. App.—Tyler 1976, no writ); *Crow v. Heath*, 516 S.W.2d 225, 228 (Tex. Civ. App.—Corpus Christi 1974, writ ref'd n.r.e.). The notice must clearly inform the mortgagor of the event that is considered by the mortgagee to be a default. Notice specifying one default (e.g., default in the payment of an note installment) is not sufficient to cover other defaults or other defaults occurring after the notified default. Also, if the mortgagee intends to accelerate the maturity of the debt, the notice must unequivocally inform the mortgagor of the mortgagee's intention. *Ogden v. Gibraltar Savings Association*, 640 S.W.2d 232, 234 (Tex. 1982)—statement that "failure to cure such breach on or before [September 16, 1978] may result acceleration of the sums secured by the Deed of Trust and sale of the property standing as security there under", was not "clear and unequivocal notice that Gibraltar would exercise the option, but merely restated the existence of the option originally given in the deed of trust". The mortgage must "bring home to the [mortgagor] that failure to cure will result in acceleration of the note and foreclosure under the power of sale." *Ogden*, 640 S.W.2d 232, 233 (Tex. 1982). In *Purnell v. Follett*, 555 S.W.2d 761 (Tex. Civ. App.—Houston [14th Dist.] 1977, no writ) the court found that notice informing the mortgagor that default in "any of [his] monthly payments" would result in acceleration and the sale of the mortgaged property, was not sufficient notice to the mortgagor that its subsequent failure to pay its taxes would result in acceleration of the note. *Accord Motor & Indus. Fin. Corp. v. Hughes*, 302 S.W.2d 386, 394 (Tex. 1957).

Any grace or cure periods provided the debtor in the loan documents must be honored as a condition to accelerating the loan or exercising the remedies of the deed of trust. *Joy Corp.*, 543 S.W.2d 691. In certain loan transactions, the mortgagee may have granted others, such as junior lienholders or tenants, notice and cure rights.

If the mortgaged property is the debtor's homestead or the debtor's residence, additional consideration should be given to cure rights, consumer debt-collection laws, and limitations on secured debt. Section 51.002(d) of the Texas Property Code requires that the debtor be given twenty days to cure the default before notice of foreclosure sale is given:

Notwithstanding any agreement to the contrary, the mortgage servicer of the debt shall serve a debtor in default under a deed of trust or other contract lien on real property used as the debtor's residence with written notice by certified mail stating that the debtor is in default under the deed of trust or other contract lien and giving the debtor at least 20 days to cure the default before notice of sale is given under Subsection (b).

Tex. Prop. Code Ann. § 51.002(d) (Vernon Supp. 2004). The debtor is entitled to the notice even though the loan originated prior to the passage of the statute. *Rey v. Acosta*, 860 S.W.2d 654 (Tex. App.—El Paso 1993, no writ). Section 51.002(d) of the Texas Property Code is a procedural requirement for accelerating a debt and therefore can be applied retroactively. The notice requirement raises numerous questions that unfortunately will have to be answered through litigation or legislative amendment. The following is a discussion of some of the questions that have already been raised by commentators.

**What is "real property used as the debtor's residence"?**

Section 51.002(d) does not specify when the mortgaged property is to be classified as the debtor's residence. It could be as of the execution of the deed of trust, as of the default, as of the foreclosure sale, or anytime in between. Nor does the statute define what type of properties can constitute the debtor's residence. Second homes and rent properties, such as houses, apartment projects, small self-operated motels, high-rise hotels, office buildings with or without a penthouse, or time-shares, could all possibly be defined as residences. Other questions are raised by this phrase as well. Suppose the owner of a rent house is the sixth owner after the loan was closed. If the term *debtor* includes all persons who have personal liability on the note, is the notice requirement triggered if any one of the

five previous owners used the property as his residence at any time during the term of the loan?

**Who is the debtor in section 51.002(d)?**

Usually the maker and the owner of the mortgaged property are the same person, and usually the maker remains the owner at the time of foreclosure. Does section 51.002(d) require notice by the lender to the maker on the note but not to the owner of the mortgaged property if they are not the same person? Does section 51.002(d) require notice to a “subject to” purchaser? What if the lender is aware of the purchase? Is there a situation when the lender could be held to have constructive knowledge of the purchase, requiring notice? See *National Commerce Bank v. Stiehl*, 866 S.W.2d 706 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1993, no writ) involving multiple notes with different makers.

**When does the twenty-day curative period begin?** Does the twenty-day curative period begin when the certified-mail notice is deposited in the mail or when it is received by the debtor? Counting the 20 days has been clarified by an amendment in 1993 to section 51.002(d) which provides

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 is under Subsection (b) is excluded in computing the 20-day period.

Tex. Prop. Code Ann. § 51.002(d) (Vernon Supp. 2004). In a situation where there are multiple debtors because the mortgaged property has changed hands and the loan has been assumed several times, there may be more than one twenty-day cure period. See *Newman v. Woodhaven National Bank*, 762 S.W.2d 374 (Tex. App.—Fort Worth 1988, no writ) (involving a twenty-day notice sent to debtor after loan ballooned).

**How is the address of the debtor determined?** Is the address of the debtor for purposes of section 51.002(d) “the debtor’s last known address as shown by the records of the holder of the debt” as is the case for the notice

of foreclosure sale provided in section 51.002(e)?

**2.2:1 Consumer Debt-Collection Laws**

The debt will be classified as consumer debt and the notice requirements and restrictions of the Texas Debt Collection Act and the federal Fair Debt Collection Practices Act will apply if the property securing the loan is the debtor’s residence.

The Texas Debt Collection Act (Tex. Fin. Code Ann. §§ 392.001 - .404 (Vernon 1998 & Supp. 2004) defines several of the key terms as follows:

(1) “Consumer” means an individual who has a consumer debt.

(2) “Consumer debt” means an obligation, or an alleged obligation, primarily for personal, family, or household purposes and arising from a transaction or alleged transaction.

(3) “Debt collection” means any action, conduct, or practice in collecting, or in soliciting for collection, consumer debts that are due or alleged to be due a creditor.

(4) “Debt collector” means a person who directly or indirectly engages in debt collection and includes a person who sells or offers to sell forms represented to be a collection system, device, or scheme, intended or calculated to be used to collect consumer debts.

Tex. Fin. Code Ann. § 392.001(1), (2), (5), (6) (Vernon Supp. 2004).

**Prohibited Practices:** Some of the practices that the Texas Debt Collection Act prohibits are the following:

1. Representing or threatening to represent to any person other than the consumer that a consumer is willfully refusing to pay a non-disputed consumer debt when the debt is in dispute and the consumer has notified in writing the debt collector of the dispute. Tex. Fin. Code Ann. § 392.301(a)(3) (Vernon 1998).

2. Threatening to file a charge, complaint, or criminal action against a debtor when the debtor has not violated a criminal law. Tex. Fin. Code Ann. § 392.301(a)(6) (Vernon 1998); see *Brown v. Oaklawn Bank*, 718 S.W.2d 678 (Tex. 1986) (court found creditor-bank in violation of former provision for threatening debtor with criminal prosecution).

3. Threatening that nonpayment of a consumer debt will result in the seizure, repossession, or sale of any of the person's property without proper court proceedings, except that this prohibition does not affect a statutory or contractual right of seizure, repossession, or sale that does not require court proceedings. Tex. Fin. Code Ann. § 392.301(a)(7), (b)(3) (Vernon 1998).

4. Using profane or obscene language or language that is intended to unreasonably abuse the hearer or reader. Tex. Fin. Code Ann. § 392.302(1) (Vernon 1998)

5. Causing a telephone to ring repeatedly or continuously, or making repeated and continuous telephone calls, with the intent to harass a person at the called number. Tex. Fin. Code Ann. § 392.302(4) (Vernon 1998). Failing to disclose clearly in any communication with the debtor that the debt collector is attempting to collect a consumer debt unless the communication is for the purpose of discovering the location of the debtor. Tex. Fin. Code Ann. § 392.304(5) (Vernon 1998)

7. Using a written communication that fails to indicate clearly the name of the debt collector and the debt collector's street address or post office box and telephone number if the written notice refers to a delinquent consumer debt. Tex. Fin. Code Ann. § 392.304(6) (Vernon 1998)

8. Misrepresenting the character, extent, or amount of a consumer debt against, or misrepresenting the consumer debt's status in a judicial or governmental

proceeding. Tex. Fin. Code Ann. § 392.304(8) (Vernon 1998)

9. Representing that a consumer debt may be increased by the addition of attorney's fees, investigation fees, service fees, or other charges if a written contract or statute does not authorize the additional fees or charges. Tex. Fin. Code Ann. § 392.304(12) (Vernon 1998)

10. Representing that a consumer debt will definitely be increased by the addition of attorney's fees, investigation fees, service fees, or other charges if the award of the fees or charges is subject to judicial discretion. Tex. Fin. Code Ann. § 392.304(13) (Vernon 1998)

11. Collecting or attempting to collect interest or a charge, fee, or expense incidental to the obligation the interest or incidental charge, fee, or expense is expressly authorized by the agreement creating the obligation or is legally chargeable to the consumer. Tex. Fin. Code Ann. § 392.303(a)(2) (Vernon 1998)

**Federal Fair Debt Collection Practices Act:** Debt-collection practices are also regulated by the federal Fair Debt Collection Practices Act. 15 U.S.C.A. §§ 1692–1692o (West 1998).

**Attorneys as Debt Collectors:** Before 1986, attorneys were exempt from the FDCPA, but the exemption was voided by statutory amendment. Pub. L. No. 99-361, 100 Stat. 768 (effective July 9, 1986). An attorney is a debt collector if the attorney uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another when the debt was incurred primarily for personal, family or household purposes. See 15 U.S.C.A. § 1692a(5), (6) (West 1998).

In determining whether an attorney "regularly" collects debts, the courts may consider the nature and volume of the attorney's case load. *Crossley v. Lieberman*, 868 F.2d. 566 (3rd Cir 1989) One federal district court has held that an attorney whose collection cases averaged less than two per year over a ten year period and

