IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

In re:	§	
	§	
MAX CAMPBELL	§	**CASE NO. 303-50252**
	§	**Chapter 7**
Debtor,	§	
_____	§	
	§	
MAX CAMPBELL	§	
	§	**Adv. No. 03-05005**
Plaintiff,	§	
v.	§	
	§	
FIRST WESTERN SBLC, INC.	§	
	§	
Defendant	§	

MEMORANDUM OPINION[1]

On October 25, 2004, the Court held a trial on this adversary proceeding to determine (1) whether a bank's lien encumbering a claim of homestead should be avoided or (2) whether the debtor's obligations to the bank should be excepted from discharge under section 523(a)(2)(A) of the Bankruptcy Code. The Court took the matter under advisement at the conclusion of the trial. Accordingly, this opinion shall constitute the Court's findings of fact and conclusions of law as required by Rule 7052 of the Federal Rules of Bankruptcy Procedure, made applicable herein by Rule 9014 of the Federal Rules of Bankruptcy Procedure.

I. JURISIDICTION

The Court has jurisdiction over the subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 157(a) and (b)(1) and 1334(a) and (b). This adversary proceeding

[1] This Memorandum Opinion is not designated for publication and shall not be considered as precedent, except under the respective doctrines of claim preclusion, issue preclusion, the law of the case, or as to other evidentiary doctrines applicable to the specific parties in this proceeding.

involves determination of the validity of a lien, and as such, is a core proceeding, pursuant to 28 U.S.C. §§ 157(b)(2)(B), (K), and (I), upon which the Court may hear and enter appropriate judgments.

II. ARGUMENT OF THE PARTIES

The Debtor asks that the Court avoid the lien securing a debt owed with respect to a contiguous tract of real property. The Debtor asserts that such encumbrance impairs his homestead exemption. In response, the lien holder asserts that the Debtor is estopped from arguing that the lien is invalid because of a homestead designation executed by the Debtor at the time the financing was obtained. Alternatively, the lien holder asserts that the Debtor made false representations and committed actual fraud by designating that the tract of land was not his homestead and induced the lien holder to finance the acquisition of a distinctly separate tract of land.

III. FINDINGS OF FACT

On or about April 15, 1990, Max E. Campbell (the "Debtor") purchased a tract of real property consisting of 80.002 acres in Franklin and Hopkins County, Texas for the purpose of operating a dairy farm (the "Dairy Farm"). The Dairy Farm has as its mailing address Route 2 Box 418E, Mount Vernon, Texas and is not located within the limits of any municipality. The Debtor obtained a loan from Federal Land Bank to purchase the Dairy Farm, and after the purchase, the Debtor moved onto the property. The Debtor initially lived in a mobile home on the property, until construction was complete on his permanent residential structure.

In April 2001, the Debtor bought a piece of commercial property in Mount Pleasant, Texas to operate as a feed store (the "Feed Store"). The Debtor obtained a Small Business

Administration loan from First Western SBLC, Inc. ("First Western") to acquire the property and to provide working capital for the business.

To obtain the loan, First Western required the Debtor to incorporate. The Debtor retained Mr. Bird Old, III to assist with the incorporation, and on April 3, 2001, Freeman Feed, Inc., a Texas corporation, executed a Note in the amount of $333,000.00 payable to First Western for the purchase of the Feed Store. The note is secured by (i) a Deed of Trust, Security Agreement and Assignment of Rents executed by Freeman's Feed, Inc. granting First Western a security interest in and to the Feed Store and related property, (ii) a Deed of Trust, Security Agreement and Assignment of Rents executed by the Debtor granting First Western a security interest in and to 79.8756 acres of the Dairy Farm (the "79 Acre Tract"),[2] and (iii) an Unconditional Guarantee executed by the Debtor. The 79 Acre Tract was appraised at $175,000.00 at the time of the loan.

The Debtor also executed a Homestead Designation and Disclaimer designating one acre within the Dairy Farm as his homestead and acknowledging that the previously defined 79 Acre Tract was not homestead property ("Waiver").

The Feed Store is located at 124 W. 16th Street, Mount Pleasant, Texas and is separate and apart from the Dairy Farm identified above.

In April 1993, the Debtor sold his house to a neighbor, Mr. Poantinga, for $97,500.00. After the sale, the Debtor moved a small camper trailer onto the 79 Acre Tract and continued to reside on the property and operate his dairy business on the remaining

[2] The record is unclear with respect to identification of the 79 Acre Tract. The parties identified the Dairy Farm, at the time of acquisition, as consisting of 80.002 acres and state that one acre was allocated separately for the homestead and ultimately sold. The 79 Acre Tract is identified in First Western's documentation as consisting of 79.8756 acres. If one acre of an 80.002 acre parcel is sold, then the remaining amount of land should be 79.002 acres, not 79.8756 acres. The discrepancy of almost an entire acre is significant given the fact that the bank seeks to enforce a constitutionally prohibited encumbrance.

property. In connection with the sale, First Western released it's lien on the one acre tract by Partial Release of Lien dated March 26, 2003. The Partial Release of Lien references "[a] one (1.00) acre tract or parcel of land lying and being situated in the County of Franklin, State of Texas, more particularly described in Exhibit "A" attached hereto and made a part hereof for all pertinent reasons." Exhibit "A" is not attached to the exhibit provided to the Court.

On June 30, 2003, the Debtor filed for relief under chapter 7 of the Bankruptcy Code. The Debtor valued the 79 Acre Tract at $169,800.00, and electing under the state exemption scheme authorized in the Bankruptcy Code,[3] claimed the property exempt pursuant to Article XVI, Sections 50 and 51 of the Texas Constitution and Section 40.001-002 of the Texas Property Code. The Debtor identified First Western as a secured creditor with a disputed interest in the 79 Acre Tract. First Western did not file a proof claim in the bankruptcy case or object to the claimed homestead exemption. The Debtor valued the Feed Store at $326,000.00 and indicated his intent to surrender the Feed Store to First Western on Schedule A of the Debtor's schedules.

On September 5, 2003, the Debtor initiated this adversary proceeding by filing a Complaint to Avoid Lien objecting to First Western's lien as an impairment of the Debtor's homestead exemption, or alternatively, requesting that First Western be required to satisfy its claim against the Debtor's non-exempt property under the marshalling doctrine. On October 15, 2003, First Western filed its First Amended Answer to Adversary Complaint to Avoid Lien and Original Counterclaim and Complaint to Determine Dischargeability of

[3] Texas permits debtors in bankruptcy proceedings to choose between the federal and state exemption schemes. Election of the state exemption scheme permits the debtor to claim the general exemptions contained in the Texas Property Code, while election of the federal scheme relegates the debtor to the exemptions specified in Section 522(d) of the Bankruptcy Code.

Claim, asserting that the Debtor knowingly made a false representation in connection with securing the Feed Store financing.

At the trial on this matter, the Debtor identified his signature on the Waiver and testified that it was valid. The Debtor did not recall ever being advised as to the legal effect of the document, or having any other independent knowledge or understanding of the legal effect of the designation. The Debtor testified that he never intended to waive his homestead exemption with respect to the Dairy Farm. The Debtor also testified that he is taking care of an infirm relative and not currently living on the 79 Acre Tract, but that he intends to return when he is able. First Western testified that it relied upon the representations made by the Debtor that the 79 Acre Tract was commercial property and not subject to any homestead rights. First Western testified that approval of the Feed Store financing was based on First Western's ability to obtain a security interest in the 79 Acre Tract and the representations made in the Waiver. First Western also testified that the Feed Store generated $250,000.00 upon foreclosure, of which $221,366.00 was applied to pay down the Note, leaving a balance of $128,787.91.

IV. DISCUSSION AND CONCLUSIONS OF LAW

A. Homestead Exemption

In the Debtor's bankruptcy schedules, the 79 Acre Tract was claimed as exempt as a homestead under Texas law. The starting point for determination of all homestead issues is, of course, the stated policy of the State of Texas and the Fifth Circuit, that because homesteads are favored by the law, the courts "must give a liberal construction to the constitutional and statutory provisions that protect homestead exemptions." *Bradley v. Pacific Southwest Bank (In re Bradley)*, 960 F.2d 502, 507 (5th Cir. 1992), cert. denied

Commonwealth Land Title Insurance Co. v. Bradley, 507 U.S. 971, 113 S.Ct. 1412, 122 L.Ed.2d 783 (1993); *Woods v. Alvarado State Bank*, 19 S.W.2d 35, 35 (Tex. 1929) ("The rule that homestead laws are to be liberally construed to effectuate their beneficent purpose is one of general acceptation. There are, of course, authorities to the contrary, but this court at an early date, 1852, declared the rule state to be the one applicable in this state."); *In re Cole*, 205 B.R. 382, 384 (Bankr. E.D.Tex. 1997). The Texas Property Code defines a homestead as follows:

> "(a) If used for the purposes of an urban home or as both an urban home and a place to exercise a calling or business, the homestead of a family or a single, adult person, not otherwise entitled to a homestead shall consist of not more than 10 acres of land which may be in one or more contiguous lots, together with any improvements thereon.
>
> (b) If used for the purposes of a rural home, the homestead shall consist of (1) for a family, not more than 200 acres, which may be in one or more parcels, with the improvements thereon; or (2) for a single, adult person, not otherwise entitled to a homestead, not more than 100 acres, which may be in one or more parcels, with the improvements thereon."

V.T.C.A. §41.002(a) and (b). Furthermore, the Texas Constitution defines the maximum amount and character of a homestead as follows:

> "A homestead, not in a town or city, shall consist of not more than two hundred acres of land, which may be in one or more parcels, with the improvements thereon; the homestead in a city, town or village, shall consist of lot or contiguous lots amounting to not more than 10 acres of land, together with any improvements on the land; provided, that the homestead in a city, town, or village shall be used for the purposes of a home, or as both an urban home and a place to exercise a calling or business, of the homestead claimant, whether a single adult person, or the head of a family; provided also, that any temporary renting of the homestead shall not change the character of the same, when no other homestead has been acquired..."

Article XVI, Section 51 of the Texas Constitution.

The Debtor claims a rural homestead exemption with respect to the 79 Acre Tract. While First Western disputes that the property is impressed with a homestead in general,

the bank does not appear to dispute its characterization as rural rather than urban. Accordingly, the Court accepts the Debtor's characterization of the homestead exemption as rural and will review the issues presented at trial consistent therewith.

It is well settled in Texas law that the Debtor, the person seeking protection of the homestead, has the initial burden of establishing the character of the property as a homestead. *In re Bradley,* 960 F.2d 502, 507 (5th Cir. 1992); *Painewebber Inc. v. Murray*, 260 B.R. 815, 822 (E.D.Tex. 2001). To meet this burden, the Debtor must be able to demonstrate overt acts of homestead usage and an intent to claim the Dairy Farm as his homestead. *Bradley,* 960 F.2d at 507; *In re Kennard,* 970 F.2d 1455, 1458 (5th Cir. 1992) ("Under Texas law, a claimant may establish homestead rights in his land by showing both (i) overt acts of homestead usage and (ii) the intention on the part of the owner to claim the land as a homestead."). Possession and use of land by the one who owns it and who resides upon it makes it the homestead in law and in fact. *Bradley,* 960 F.2d at 507. As long as the claimant can demonstrate that he used the property for homestead purposes, then Texas courts will presume that the claimant has the requisite intent. *Youngblood v. Youngblood*, 76 S.W.2d 759, 761 (1934); *Lifemark Corp. v. Merritt*, 655 S.W.2d 310, 315 (Tex.App.—Houston [14th Dist.] 1983, writ ref'd n.r.e.) (investigation of intent is not necessary when the land is actually put to use as a homestead). The Court finds that the Debtor's actual occupancy of the land since its purchase in 1990 is sufficient to qualify the Dairy Farm as the Debtor's rural homestead at all times prior to the loan. Accordingly, this Court finds that the Debtor has established his homestead right to the Dairy Farm as a matter of law.

Once the claimant has made a *prima facie* case in favor of his homestead rights, the objecting party has the burden of demonstrating that the homestead rights have been

terminated. *In re Perry*, 345 F.3d 303 (5th Cir. 2003). First Western asserts that the Debtor extinguished his homestead interest in the 79 Acre Tract by executing the Waiver or, in the alternative, should be estopped from invoking his state constitutional and statutory homestead rights because the bank relied on the Waiver to its detriment.[4] The Fifth Circuit has already addressed this issue and rejected First Western's argument where the homestead claimant was in actual use and possession of the homestead property at the time the disclaimer or waiver was executed. *Bradley*, 960 F.2d at 510.

In *In re Bradley*, a case with similar material facts, the debtor owned a 130 acre ranch in Westlake, Texas, 15 acres of which was used as her residence. The debtor received a loan unrelated to the property from a local bank and as part of the collateral to secure payment of the note, granted the bank a third lien deed of trust on the ranch, exclusive of the 15-acre residential parcel. The debtor also executed a homestead disclaimer purporting to release the debtor's homestead claim to the ranch, except for the 15-acre residential parcel. A few years later the debtor filed for bankruptcy, elected the state exemption scheme, claimed the entire 130 acre property as a rural homestead, and petitioned the court to disallow the secured interest of the bank against such homestead.

The Fifth Circuit held that a declaration disclaiming a homestead will not bar a claimant from later asserting homestead rights where the claimant was actually using and possessing the property at the time the declaration was made. *Bradley*, 960 F.2d at 510 (referencing *In re Niland*, 825 F.2d 801 (5th Cir. 1987), the Fifth Circuit's previous opinion on the same issue); *accord In re Skinner*, 74 B.R. 571 (Bankr. N.D. Tex. 1987) (similar facts and application of *Niland*). The Fifth Circuit acknowledged that "lenders are subject

[4] Although First Western testified that it relied on the Waiver, the fact that they recorded a lien against the one acre residential parcel that the bank itself acknowledged as the Debtor's homestead undermines that assertion.

to a duty of inquiry. If the circumstances were such that a lender should have known or suspected that a homestead disclaimer was false, then the Texas courts will not enforce the disclaimer against the debtor." *Bradley*, 960 F.2d at 510 (referencing *First Interstate Bank v. Bland*, 810 S.W.2d 277, 283-84 (Tex.App. -- Fort Worth 1991, no writ) where the Fort Worth Court of Appeals stated that a lender is charged with notice of the homestead regardless of "what declarations to the contrary the borrow might make" because "actual possession and use of the property as a home is of so obvious a nature that the lender cannot close his eyes to the facts."). "It is fundamental to Texas homestead law that … lenders must understand that liens cannot be fixed upon [homestead property], and that declarations … to the contrary, however made, must not be relied upon. [Lenders] must further understand that no designation of homestead contrary to the fact will enable parties to evade the law and encumber homesteads with liens forbidden by the [Texas] Constitution." *Skinner*, 74 B.R. at 573 (citing *Niland*).

This case is no different. At the time the Waiver was executed, the Debtor was residing in his house on the Dairy Farm and the entire Dairy Farm, the 79 Acre Tract along with the one-acre residential tract, is one contiguous piece of property, the entirety of which was being used by the Debtor as a rural homestead. Under Texas law, the Waiver, whether relied upon or not by First Western is ineffective to permit an encumbrance on homestead property when the Debtor is in actual possession and use of the property as a homestead.

Furthermore, under Texas's homestead law, homestead rights can only be lost through death, abandonment or alienation. *Bradley*, 960 F.2d at 907; *In re Moody*, 862 F.2d 1194, 1198 (5th Cir. 1989); *Resolution Trust Corp. v. Olivarez*, 29 F.3d 201, 206-207

(5th Cir. 1994). Clearly the first circumstance is inapplicable herein. Secondly, abandonment requires cessation or discontinuance of the use of the property coupled with intent to permanently abandon the homestead. Since, the Debtor has not ever ceased living on or occupying the Dairy Farm and testified that even though he is currently residing elsewhere he intends to return when he is able, the Court finds that the Debtor did not abandon the homestead. The Court does find, however, that the Debtor extinguished its homestead interest in the one acre tract of the Dairy Farm by alienation when that property was sold to his neighbor in April of 1993.

First Western has failed to sustain its burden of proving that the Debtor's homestead right has been terminated. Accordingly, the Debtor's claim of exemption with respect to the Dairy Farm, as amended by the sale of the residence and surrounding property to his neighbor, is valid.

B. Invalidity of First Western's Lien

The Debtor initiated this proceeding as a complaint to avoid First Western's lien as an encumbrance on an exemption under sections 506(d) or 522(f) of the Bankruptcy Code. In light of this Court's finding that the Debtor has a valid homestead interest in the Dairy Farm which predates the First Western's lien, the Debtor is entitled to relief.

Moreover, the lien is void as a matter of Texas Law. Under Texas law, the homestead is exempt from forced sale for the payment of debts, except as specifically allowed by the Texas Constitution. Generally, the only debts which can be secured by a lien on homestead property are original construction or purchase money liens, property taxes, home equity loans, and mechanic's and materialman's liens. First Western's lien on the Dairy Farm to secure repayment of the Feed Store acquisition loan is not the type of

interest that is allowed to encumber the homestead under Texas law. Particularly, the provisions of Article XVI, §50(a)(6) of the Texas Constitution relevant to this matter provide as follows:

> "The homestead of a family, or of a single adult person, shall be, and is herby protected from forced sale, for the payment of all debts except for: …an extension of credit that:
>
> (A) is secured by a voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse;
>
> (B) is of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made;
>
> (C) is without recourse for personal liability against each owner and the spouse of each owner, unless the owner or spouse obtained the extension of credit by actual fraud; …
>
> (G) is payable in advance without penalty or other charge;
>
> (H) is not secured by any additional real or personal property other than the homestead; …
>
> (Q) is made on the condition that: … (vi) the security instruments securing the extension of credit contain a disclosure that the extension of credit is the type of credit defined by Section 50(a)(6), Article XVI, Texas Constitution; … (ix) the owner of the homestead and the lender sign a written acknowledgment as to the fair market value of the homestead property on the date the extension of credit is made; …"

Vernon's Ann. Tex. Const. Art. XVI, §50. Under Texas law, any instrument creating a lien on the homestead which is of the character denounced by the constitutional provisions relating to homesteads, is void regardless of its form. *Ketcham v. First Nat. Bank of New Boston, Texas* 875 S.W.2d 753 (App. 6 Dist. 1994). Accordingly, First Western's lien is void. For the foregoing reasons, the Debtor has met his burden of proving that First Western's liens should be avoided.

C. Standards for Nondischargeability

First Western asks that if their lien is avoided that the obligation be declared non-dischargeable under section 523(a)(2)(A) based upon the Debtor's execution of the Waiver. In an action to determine the dischargeability of a debt, the creditor has the burden of proof under a preponderance of the evidence standard. *Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). "Intertwined with this burden is the basic principle of bankruptcy that exceptions to discharge must be strictly construed against a creditor and liberally construed in favor of a debtor so that the debtor may be afforded a fresh start." *Hudson v. Raggio & Raggio, Inc. (In re Hudson)*, 107 F.3d 355, 356 (5th Cir. 1997); *See also In re Whitaker*, 225 B.R. 131, 139 (Bankr. E.D.La. 1998). Thus, without satisfactory proof of each element of the cause of action pled, judgment must be entered for the debtor.

Section 523(a)(2)(A) provides:

> (a) A discharge under 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —[5]
>
> (2) for money, property, or services, or an extension, renewal, or refinancing of credit, to the extent obtained by [6]...
>
> (A) by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; …

Section 523(a)(2)(A) encompasses similar but distinct causes of action. The Fifth Circuit has distinguished the elements of "actual fraud" from "false pretenses and false

[5] The debt arising from fraud includes liabilities arising from money, property, services, or credit. It also includes liabilities such as treble damages, attorney's fees, and other relief sought that may exceed the value obtained fraudulently by the debtor. *Cohen v. de la Cruz*, 523 U.S. 213, 218, 118 S.Ct. 1212, 1216, 140 L.Ed. 241 (1988).

[6] Under §523(a)(2)(A) it is irrelevant whether the debtor actually received money, property, services, or credit. The Fifth Circuit has held that a debt is nondischargeable if the debtor benefits *in some way* from the money, property, services, or credit obtained through deception. *Matter of Luce*, 960 F.2d 1277, 1283 (5th Cir. 1992).

representations" on the other. *RecoverEdge L.P. v. Pentecost*, 44 F.3d 1284, 1292 (5th Cir.1995).

1. Actual Fraud

To have a debt excepted from discharge pursuant to the "actual fraud" provision in section 523(a)(2)(A) of the Bankruptcy Code, an objecting creditor must prove that (i) the debtor made representations, (ii) at the time such representations were made the debtor knew them to be false, (iii) the debtor made the representations with the intention and purpose to deceive the creditor, (iv) that the creditor justifiably relied on such representation, and (v) that the creditor sustained losses as a proximate result of the representations. *RecoverEdge* 44 F.3d. at 1293, as modified by *Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995).

First Western insisted upon additional collateral to secure the Feed Store financing, and the Debtor's only other asset was his homestead. The Waiver was simply the bank's attempt to obtain the pledge of a portion of the Debtor's homestead. The Debtor may have intended to waive his homestead rights and to encumber it, but under Texas law these encumbrances are prohibited regardless of the parties' intent to encumber when the Debtor was openly residing on and using the subject property as a homestead. *See Bradley*, 960 F.2d 502 (5th Cir. 1992). This rule is based on the recognition that borrowers "will sign anything to obtain money from lenders, and that if not put to a duty of inquiry" this tendency might lead to abusive lending practices. *Niland*, 825 F.2d at 809.

Accordingly, First Western is not justified in relying on the Waiver or any other oral representations made by the Debtor with respect to his homestead and no claim of fraud can be supported.

2. False Pretenses or False Representation

However, a debt may also be declared non-dischargeable if it was obtained by false pretenses or by a false representation. While "false pretenses" and "false representation" both involve intentional conduct intended to create and foster a false impression, the distinction is that a false representation involves an express statement, while a claim of false pretenses may be premised on misleading conduct without an explicit statement. *In re Patten*, 225 B.R. 211, 215 (Bankr. D. Ore. 1998).

In order for a debtor's representation to constitute a false pretense or a false representation it generally must have been (i) a knowing and fraudulent falsehood, (ii) describing past or current facts, and (iii) justifiably relied upon by the other party. *RecoverEdge L.P.*, 44 F.3d at 1292-93 (citing *In re Bercier*, 934 F.2d 689, 692 (5th Cir. 1991) ("[T]o be a false representation or false pretense under §523(a)(2), the 'false representations and false pretenses [must] encompass statements that falsely purport to depict current or past facts")).

As stated above, First Western has not met its burden with respect to relief under section 523 by a preponderance of the evidence. The Waiver failed due to applicable Texas homestead laws, not due to any fraud, false pretense or false representation by the Debtor. First Western should have known, or did know, that the Dairy Farm was a single contiguous parcel and that the Debtor was residing on it. The Bank drafted an ineffective waiver. Under those circumstances, the Court finds that First Western did not sustain its burden and the Court, therefore, concludes that the obligation owed to First Western by the Debtor should not be excepted from discharge under section 523(a)(2)(A) of the Bankruptcy Code.

V. Conclusion

As a result of the foregoing findings, the Court concludes that the Debtor's claim of exemption with respect to the 79 Acre Tract is valid and that First Western's lien thereon is void as an encumbrance against exempt property under section 522(f) of the Bankruptcy Code. In addition, the Court finds that First Western failed to prove the necessary intent to establish fraud by the Debtor. Accordingly, a judgment will be entered granting the Debtor's Complaint to Avoid Lien and denying First Western's counterclaim to have its debt declared non-dischargeable.

Signed on 9/30/2005

Brenda T. Rhoades MD

HONORABLE BRENDA T. RHOADES,
UNITED STATES BANKRUPTCY JUDGE