

IN RE VILLARREAL: A POSSIBLE RAY OF LIGHT FOR CREDITORS IN TEXAS?

Kathryn Gotcher Michaelis*

I. INTRODUCTION

In re Villarreal provides an exciting new avenue in the short term for creditor protection in the realm of Texas homestead law.¹ However, the ruling is unlikely to stand if and when the Texas courts address the issue, given the policy considerations behind Texas homestead protection as well as the resistance to any change that favors creditors.

Throughout its history, Texas has displayed a very strong preference for the protection of the home against creditors' claims. *In re Villarreal* represents a distinct departure from that tradition, and, as long as it remains unaddressed by the Texas Supreme Court, it will provide an excellent argument for a narrow group of creditors seeking to enforce judgments against family homes or businesses. This note argues that Texas will likely take up the issue sometime in the future and overrule this case, reinforcing the state's strong homestead protections.

II. THE PRO-DEBTOR HISTORY OF TEXAS HOMESTEAD LAW

In an almost paternalistic way, Texas has sought from its very beginnings to protect the family home.² The state only allows for a very few instances where a creditor can assert a lien against the home.³ These consensual liens include purchase money, home improvement (also known as a mechanic's lien), home equity, mortgage refinancing, and reverse

*J.D. Candidate, Baylor University School of Law, February 2014. I would like to thank my husband, Jason, my daughter, Nora, and my parents, Joel and Deborah, for their unending love and encouragement in bringing this article to publication. I would also like to thank Professor Bridget Fuselier for her guidance as my advisor on this article.

¹See generally 401 B.R. 823 (Bankr. S.D. Tex. 2009).

²See J. THOMAS OLDHAM, TEXAS HOMESTEAD LAW 18 (3d ed. 2006); see also TEX. CONST. art. XVI, § 50.

³See OLDHAM, *supra* note 2, at 15.

mortgage.⁴ They are the few liens that can lead to a forced sale of the property if the debt is not paid.⁵ In general, non-consensual and other consensual liens cannot be asserted as long as the homestead protection is in place before the lien attaches.⁶ Expansions that provide less protection to the debtor have been few and far between.⁷

A. *Historical Underpinnings and Policy Considerations*

The Economic Panic of 1837, caused by a combination of speculative fever and crop failure, resulted in an unprecedented number of farmers losing their homes and livelihoods after banks repossessed their farms.⁸ “Most Texans were in debt, and the young nation was in economic peril.”⁹ In 1839, the Texas legislature codified protections against the forced sale of homes and incorporated those protections in the Texas Constitution in 1845.¹⁰ “The homestead exemption was looked upon as a necessary measure to offset the economic danger to Texans and Texas.”¹¹ The purpose was threefold:

- (1) to preserve the integrity of the family as the basic element of social organization, and, incidentally, to encourage colonization for in a frontier society each pioneer family was of definite value to the community;
- (2) to provide the debtor with a home for his family and some means to support them and to recoup his economic losses so as to prevent the family from becoming a burdensome charge upon the public;
- (3) to retain in pioneers the feeling of freedom and sense of independence which was deemed necessary to the continued existence of democratic institutions.¹²

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* Notable exceptions include liens for taxes and an owelty of partition judgment. TEX. CONST. art. XVI, § 50.

⁷ See OLDHAM, *supra* note 2, at 18–19 (discussing historical developments in homestead protection).

⁸ TEX. CONST. art. XVI, § 50 interp. commentary (West 1993).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

This move was the first general protection of the home from creditors in any jurisdiction in the United States.¹³

B. General Legal Principles: Establishing and Waiving a Homestead

Texas homestead law creates two different protections for those who qualify: first, when a spouse dies, the survivor has the right to remain on the homestead for life as long as the homestead is not abandoned; and second, most creditors cannot force a sale of a debtor's homestead, even at death, unless certain conditions exist.¹⁴ There are a few limited exceptions that allow creditors who lent the homeowner funds to purchase or improve the property to force a sale of the homestead, as well as an exception that allows federal, state, and local governments to force a sale for collection of unpaid taxes.¹⁵

To create homestead rights, a person must intend that the place be his home for an indefinite period and take an affirmative action consistent with that intention.¹⁶ The act could be moving into the property or some other act that evidences the necessary intent.¹⁷ Additionally, a party may only have one homestead.¹⁸ Once established, the homestead character is only extinguished if abandonment is established by clear and convincing evidence by the party attempting to prove abandonment.¹⁹

¹³OLDHAM, *supra* note 2, at 18.

¹⁴*Id.* at 17.

¹⁵*Id.*

¹⁶*Id.* at 15. *See* Gregory v. Sunbelt Sav., F.S.B., 835 S.W.2d 155, 158 (Tex. App.—Dallas 1992, writ denied); Van Brunt v. BancTexas Quorum, N.A., 804 S.W.2d 117, 122 (Tex. App.—Dallas 1989, no writ); Dodd v. Harper, 670 S.W.2d 646, 649 (Tex. App.—Houston [1st Dist.] 1983, no writ); Lifemark Corp. v. Merritt, 655 S.W.2d 310, 314 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e.); Braden Steel Corp. v. McClure, 603 S.W.2d 288, 292–93 (Tex. Civ. App.—Amarillo 1980, no writ); Sims v. Beeson, 545 S.W.2d 262, 263 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.); Prince v. N. State Bank of Amarillo, 484 S.W.2d 405, 409 (Tex. Civ. App.—Amarillo 1972, writ ref'd n.r.e.); Blackwell v. Lasseter, 203 S.W. 619, 621 (Tex. Civ. App.—El Paso 1918), *aff'd* 227 S.W. 944 (Tex. Comm'n App. 1921, judgm't adopted).

¹⁷OLDHAM, *supra* note 2, at 15; *see also* Tex. Commerce Bank—Irving v. McCreary, 677 S.W.2d 643, 645 (Tex. App.—Dallas 1984, no writ); Stewart v. Clark, 677 S.W.2d 246, 250 (Tex. App.—Corpus Christi 1984, no writ); *Sims*, 545 S.W.2d at 263–64; Bartels v. Huff, 67 S.W.2d 411, 412 (Tex. Civ. App.—San Antonio 1933, writ ref'd).

¹⁸TEX. CONST. art. XVI, § 51; Achilles v. Willis, 16 S.W. 746, 746 (Tex. 1891).

¹⁹*See* Huffington v. Upchurch, 532 S.W.2d 576, 579–80 (Tex. 1976); Rancho Oil Co. v. Powell, 175 S.W.2d 960, 963 (Tex. 1943); West v. Austin Nat'l Bank, 427 S.W.2d 906, 912 (Tex. Civ. App.—San Antonio 1968, writ ref'd n.r.e.); Ritz v. First Nat'l Bank of Pecos, 234 S.W. 425,

Because abandonment of the homestead is difficult to establish, a creditor in search of collateral will seek to establish other claims, making concepts such as waiver of the homestead more enticing. If a person were to intentionally relinquish a known right that would constitute a waiver.²⁰ Generally, a waiver of homestead rights is not enforceable, but estoppel may be a narrow exception.²¹ Misrepresentations by a homestead claimant may, under the proper circumstances, create a reason for a court to disallow a claim of the homestead exemption.²² Estoppel is a very limited exception to the non-waiver rule because Texas does not want creditors intentionally covering their eyes to disclaim knowledge that the land is a homestead even if it has been disclaimed as such.²³ In Texas, the law is established:

[W]hen the physical facts open to observation lead to a conclusion that the property in question is not the homestead of the mortgagor, and its use is not inconsistent with the representations made that the property is disclaimed as a homestead, and these representations were intended to be and were actually relied upon by the lender, then the owner is estopped from asserting a homestead claim in derogation of the mortgage to secure the loan.²⁴

Generally, courts will not allow an estoppel defense when the claimant only owns one piece of property and that property is being used as the claimant's homestead at the time of the creation the lien.²⁵ The same holds true when the debtor owns multiple pieces of property, but only one could be used as a homestead.²⁶ Courts do allow estoppel under the "ambiguous

427–28 (Tex. Civ. App.—El Paso 1921, no writ); *see also* Republic Nat'l Life Ins. Co. v. U.S. Fire Ins. Co., 589 S.W.2d 737, 739–40 (Tex. Civ. App.—Dallas 1979), *rev'd on other grounds*, 602 S.W.2d 527 (Tex. 1980).

²⁰Mass. Bonding & Ins. Co. v. Orkin Exterminating Co., 416 S.W.2d 396, 401 (Tex. 1967).

²¹*See* OLDHAM, *supra* note 2, at 103; *see also* Lincoln v. Bennett, 156 S.W.2d 504, 505 (Tex. 1941); First Interstate Bank of Bedford v. Bland, 810 S.W.2d 277, 283–84 (Tex. App.—Fort Worth 1991, no writ).

²²*See* Lincoln, 156 S.W.2d at 505.

²³First Interstate Bank of Bedford, 810 S.W.2d at 283–84.

²⁴Shearer v. Allied Live Oak Bank, 758 S.W.2d 940, 945 (Tex. App.—Corpus Christi 1988, writ denied) (citing Prince v. N. State Bank of Amarillo, 484 S.W.2d 405, 411 (Tex. Civ. App.—Amarillo 1972, writ ref'd n.r.e.)); *see also* NCNB Tex. Nat'l Bank v. Carpenter, 849 S.W.2d 875, 881 (Tex. App.—Fort Worth 1993, no writ) (citing First Interstate Bank of Bedford, 810 S.W.2d at 286).

²⁵First Interstate Bank of Bedford, 810 S.W.2d at 283.

²⁶*Id.* at 284.

possession” principle.²⁷ However, the general rule is that this principle only applies when the claimant owns multiple properties that could have homestead character or if the claimant only owns one parcel of land but is not living on it when disclaimer is made.²⁸

One example of such a situation is if a landowner were to apply for a personal loan at his local bank. While applying, the landowner tells the banker that he has a home in town where he resides as well as a parcel of land outside the city limits with a hunting cabin on it that he uses recreationally, which he would like to use as collateral. In reality, the landowner is living in the cabin while renting out the house in town. When the banker inspects the property, he sees no signs that anyone is living in the cabin. Since the banker’s observations comport with the statements the landowner has made, the banker should be entitled to rely on those statements. Should the banker actually rely upon those statements in making the loan to the landowner, the landowner should be estopped from asserting a homestead claim on the collateral property.

III. THE CASE AT ISSUE: *IN RE VILLARREAL*

In re Villarreal was a Texas bankruptcy case that made its way to the Fifth Circuit in 2010.²⁹ The Villarreal family moved into their place of business, Greg’s Ballroom, in 2005 after their home was foreclosed upon.³⁰ Their living area inside the business was behind a black curtain inaccessible to visitors, and few knew that they resided in that space.³¹ In 2007, Mr. Villarreal settled lawsuits with a promissory note secured by a deed of trust on Greg’s Ballroom.³² “The deed stated, ‘No part of the property is used for residential purposes and is not, in whole or in part the homestead of Grantors. Grantors acknowledge and represent that the debt evidenced by the Note is used for business purposes for value received by Grantors.’”³³ The Villarreals later defaulted, and the lien was foreclosed on.³⁴ At that

²⁷ *Id.*

²⁸ *Id.* See generally *Alexander v. Wilson*, 77 S.W.2d 873 (Tex. 1935); *Miles Homes of Tex., Inc., v. Brubaker*, 649 S.W.2d 791 (Tex. App.—San Antonio 1983, writ ref’d n.r.e.).

²⁹ See *In re Villarreal*, 402 F. App’x 28, 29 (5th Cir. 2010).

³⁰ *Id.*

³¹ *Id.* at 29–30.

³² *Id.* at 30.

³³ *Id.*

³⁴ *Id.*

time, the Villarreal's tried to assert homestead status; while those proceedings were pending, they filed for Chapter 13 bankruptcy.³⁵

Following hearings, the bankruptcy court determined that Greg's Ballroom was the Villarreal's valid homestead since, as of 2005, they had used it as their sole and continuous residence.³⁶ The bankruptcy court recognized that liens are generally not enforceable against homesteads under Texas law except in a few authorized instances, which this case does not fit within.³⁷ However, the bankruptcy court also determined that Texas law allows a certain narrow class of homestead claimants to be equitably estopped from protecting their homesteads from foreclosure.³⁸ Specifically, when a homestead claimant is living on the property as his or her homestead, he or she can be equitably estopped from protecting the property as homestead if his or her "acts were [not] such as to put a reasonable prudent person on notice that the tract constituted a part of the homestead."³⁹ The bankruptcy court decided that this rule was consistent with the "ambiguous possession" doctrine articulated by Texas courts: when a claimant owns "only one piece of property, but does not occupy it" and the "visible circumstances" on the property are consistent with the owner's disclaimer of the property as his or her homestead, the owner may be estopped from later claiming the property as his or her homestead.⁴⁰

The bankruptcy court acknowledged that its decision was in conflict with other decisions:

The general rule that Texas courts have adopted unanimously in this situation where the claimant owns only one piece of property and occupies it at the time of the mortgage is that "the claimant is not estopped to set up the homestead exemption notwithstanding the declarations in the mortgage contract."⁴¹

³⁵ *Id.*

³⁶ *In re Villarreal*, 401 B.R. 823, 832–33 (Bankr. S.D. Tex. 2009).

³⁷ *Id.* at 833.

³⁸ *Id.* at 834.

³⁹ *Id.* at 834–35 (quoting *Prince v. N. State Bank of Amarillo*, 484 S.W.2d 405, 411 (Tex. Civ. App.—Amarillo 1972, writ ref'd n.r.e.)).

⁴⁰ *Id.* at 835 (citing *First Interstate Bank of Bedford v. Bland*, 810 S.W.2d 277, 284, 287 (Tex. App.—Fort Worth 1991, no writ.)).

⁴¹ *Id.* at 834 (quoting *First Interstate Bank of Bedford*, 810 S.W.2d at 283 (citations omitted)).

For instance, suppose a landowner who only owns a home in town where he resides and no other real estate applies for a personal loan. He puts forth the property as collateral and denies that he resides there to the banker. The banker could relatively easily check the property records or other sources to ascertain where the landowner lives and if he owns other property. One would expect that if a landowner only owns one piece of property, he will likely claim the property as homestead. The law places the burden upon the lender to perform his due diligence, even in the face of an applicant's untruths.⁴² However, the court thought the tension was reconcilable because under the rules for estoppel, the claimant's occupation of the homestead makes "use of the property as a home . . . so obvious [in] nature" that the lender must have had notice it was the claimant's homestead.⁴³ Because the Villarreal's occupancy of the premises was not so obvious as to put the lender on notice, the court held that the rules against estoppel did not apply, and the debtors were equitably estopped from asserting homestead status.⁴⁴

The case was appealed to the Fifth Circuit Court of Appeals.⁴⁵ After resolving all other factual and legal issues of the case, the court turned to the estoppel issue.⁴⁶ The court discussed a series of cases that state no estoppel can arise in favor of a lender who has attempted to secure a lien on homestead in actual use and possession of the family when the husband and wife made representations orally or in writing that the property was not the family's homestead.⁴⁷ The court also discussed a series of cases that supported the bankruptcy court's decision "that a homestead claimant can be estopped from asserting the homestead protection if he or she does not

⁴² See *Tex. Land & Loan Co. v. Blalock*, 13 S.W. 12, 13 (Tex. 1890).

⁴³ *In re Villarreal*, 401 B.R. at 834 (quoting *First Interstate Bank of Bedford*, 810 S.W.2d at 283–84 (citations omitted)).

⁴⁴ *Id.* at 836.

⁴⁵ *In re Villarreal*, 402 F. App'x 28, 29 (5th Cir. 2010).

⁴⁶ *Id.* at 32.

⁴⁷ *Id.* 32–33 (discussing: *Tex. Land & Loan Co.*, 13 S.W. at 13; *Rutland Sav. Bank v. Isbell*, 154 S.W.2d 442, 445 (Tex. 1941) ("Since the courts below have found that the John D. Isbell family were actually living on the 34 acres as a homestead at that time, the lender should not have relied upon the affidavit at all, and therefore no estoppel can arise."); *Parrish v. Hawes*, 66 S.W. 209, 212 (Tex. 1902) ("stating that once a homestead is established 'all persons must take notice, and hence declarations . . . contrary thereto cannot be relied on'"); *In re Niland*, 825 F.2d 801, 808 (5th Cir. 1987) ("[A] homestead claimant is not estopped to assert his homestead rights in property on the basis of declarations made to the contrary if, at the time of the declarations, the claimant was in actual use and possession of the property.")).

live on the property in a manner to give a reasonable prudent person notice that he or she was using the property as a homestead.⁴⁸ Due to the tension between the two lines of cases, the Fifth Circuit then certified the question to the Texas Supreme Court as to whether the bankruptcy court's interpretation on the issue was consistent with Texas homestead law.⁴⁹ The case was slated for oral argument in March of 2011, but was dismissed for lack of subject matter jurisdiction for being moot one week before arguments were to begin.⁵⁰

IV. THE EFFECT OF *IN RE VILLARREAL* ON DEBTORS AND CREDITORS

In light of the policy considerations behind the creation of the homestead protection as well as recent changes in similar states, *In re Villarreal* is an important case lending itself to creditor protection for as long as the holding stands. The case does represent a valid point in that without the extension of the "ambiguous possession" doctrine put forth by the court, there is potential for debtors to abuse the system.⁵¹

Considering the recent limitations placed on homestead protection under bankruptcy law, it is not surprising that the bankruptcy court made the decision that it did.⁵² However, it is unlikely that Texas will allow this ruling to stand, given the difficulty in expanding opportunities to grant

⁴⁸*Id.* at 33 (discussing: *Alexander v. Wilson*, 77 S.W.2d 873, 874 (Tex. 1935) (stating that "unless the visible circumstances existing at the time were of such import as to apprise [the mortgagee] of the fact that the [property] was the home of the mortgagors," the mortgagors could be estopped from asserting the homestead protection for the property"); *Lincoln v. Bennett*, 156 S.W.2d 504, 505 (Tex. 1941) (stating "liens could be enforced against homesteads where 'the owners, . . . so using it that its status is dubious at the time the mortgage is executed, represent that it is not their homestead.'"); *Prince v. N. State Bank of Amarillo*, 484 S.W.2d 405, 411 (Tex. Civ. App.—Amarillo 1972, writ ref'd n.r.e.) (stating that "if a homestead claimant was living on the property at the same time that he or she disclaimed the homestead protection, 'the determining factor [for whether the homestead protection will be enforced] is whether the claimant's acts were such as to put a reasonable prudent person on notice that the tract constituted a part of the homestead.'")).

⁴⁹*Id.* at 34.

⁵⁰Order dismissing cause number 10-0940, *Gregorio Villarreal; Estela Villarreal v. Trustee David W. Showalter*, as moot (Tex. March 2, 2011) (motion to dismiss for lack of subject matter jurisdiction granted).

⁵¹*See generally In re Villarreal*, 401 B.R. 823 (Bankr. S.D. Tex. 2009). *See also supra* cases discussed at note 48; *but see supra* cases discussed at note 47.

⁵²*See infra* Part IV.B.1.

consensual liens, as well as recent developments in other pro-debtor jurisdictions.⁵³

A. *The Immediate Future*

Legislators designed the constitutional provision to encourage immigration by providing settlers a haven from prior creditors.⁵⁴ Many early immigrants to Texas had lost their homes and property during the financially devastating Panic of 1837.⁵⁵ The homestead exemption encouraged this influx of new citizens by assuring that these settlers would get a fresh start in life, free from the fear that old creditors could take away their family's new home and necessities.⁵⁶

However, over time the courts developed the “ambiguous possession” doctrine to prevent abuse of the system by debtors.⁵⁷ “Ambiguous possession” has allowed for estoppel of homestead claims in two situations: (1) where the claimant owns multiple pieces of property to which homestead status could attach and disclaims a certain parcel as homestead; or (2) where the claimant only owns one piece of property, but the claimant was not actually living on the land in question at the time the representations were made.⁵⁸ In both of these situations, courts recognize there is nothing to put the creditor on notice that the land is being used as a homestead.⁵⁹

The extension proposed by *In re Villarreal* is merely an extension of the need to prevent system-wide abuse. The court justified this extension by reasoning that, in the case that was at bar, there were no circumstances to put the creditor on notice that the business had homestead character.⁶⁰ Generally, if a claimant only owns one piece of land and is occupying it as a homestead, it is obvious to the interested observer.⁶¹ The court recognized

⁵³ See *infra* Part IV.B.2.

⁵⁴ See TEX. CONST. art. XVI, § 50 interp. commentary (West 1993).

⁵⁵ *Id.* See also OLDHAM, *supra* note 2, at 18.

⁵⁶ See TEX. CONST. art. XVI, § 50 interp. commentary (West 1993).

⁵⁷ See *First Interstate Bank of Bedford v. Bland*, 810 S.W.2d 277, 284–85 (Tex. App.—Fort Worth 1991, no writ) (citing *Shearer v. Allied Live Oak Bank*, 758 S.W.2d 940, 945 (Tex. App.—Corpus Christi 1988, writ denied)).

⁵⁸ *Id.* at 284.

⁵⁹ See *id.*

⁶⁰ *In re Villarreal*, 401 B.R. 823, 836 (Bankr. S.D. Tex. 2009).

⁶¹ See *Tex. Land & Loan Co. v. Blalock*, 13 S.W. 12, 13 (Tex. 1890).

that if actions similar to the Villarreal's were allowed to result in homestead protection, then other families would make such representations and occupy their family businesses as a dwelling.⁶² The law generally places a burden on the creditor to open his eyes, ascertain as much as he objectively can, and rely upon his own observations over any conflicting statements the debtor may claim.⁶³ The court in *In re Villarreal* is drawing a distinction. Regardless of the presumption that if a person only owns one piece of property then it is likely his homestead, if the use of the property and good faith observations of the creditor comport with the statements of the landowner that the property is not his homestead, the creditor should be entitled to rely upon those statements.⁶⁴

From the first quarter of 2008 to the first quarter of 2011, bankruptcy petitions for small businesses across the country increased by 68.45%.⁶⁵ If one of a debtor's largest assets is the building where his business is located—and he also resides at his business because he does not have another property to claim as homestead—it makes sense that he would attempt to use that protection on a business while still using the property as collateral. Without a decision such as the one in *In re Villarreal*, debtors can choose not to disclose residential use of a building when it is being used both residentially and commercially and still be afforded homestead protection, even when there is no way for the creditor to be aware of the residential use. Based on this argument, *In re Villarreal* provides precedent to protect creditors in bankruptcy court from such fraudulent actions.

B. What Will Happen When Texas Addresses the Issue?

Because it is likely that creditors will attempt to use the *Villarreal* case as a tool against certain debtors in bankruptcy cases, it is also likely that Texas will be forced to address the issue at some point in the near future. Texas has different considerations at stake than the bankruptcy court, as evidenced by recent changes in federal bankruptcy law, the pro-debtor history of Texas homestead law, and other states' pro-debtor history.⁶⁶

⁶² See *In re Villarreal*, 401 B.R. at 835–36.

⁶³ *Tex. Land & Loan Co.*, 13 S.W. at 13.

⁶⁴ *In re Villarreal*, 401 B.R. at 835–36.

⁶⁵ *Equifax National Analysis Reveals Myriad of Small Business Bankruptcy Trends*, EQUIFAX INC. (Aug. 24, 2011), <http://investor.equifax.com/releasedetail.cfm?ReleaseID=751534>.

⁶⁶ *Infra* Part IV.b.

1. Recent Changes in Bankruptcy Law

Recent changes to bankruptcy law have sought to minimize the protection that debtors get from homestead law, so it is unsurprising that the bankruptcy court's ruling in *In re Villarreal* would shift in the pro-creditor direction.⁶⁷ Bankruptcy courts have made it clear in the last decade that they are very concerned about debtors abusing the protections offered under Texas homestead law — and other states, for that matter.⁶⁸

When a debtor files for bankruptcy, he or she is able to exit bankruptcy owning certain exempt property.⁶⁹ The federal bankruptcy code and the individual debtor's state of residence may permit a debtor to choose between federal exemptions or exemptions specified in the law of his home state.⁷⁰ Texas allows debtors such an option.⁷¹ Because Texas affords such strong homestead protection and many debtors' greatest asset is a piece of real estate that would qualify for such protection, the vast majority of Texas debtors choose the state exemptions.⁷²

Before the recent bankruptcy reforms, residents of other states without such generous homestead provisions could sell all of their assets, move to Florida or Texas, buy a piece of real estate that would qualify for homestead protection, and then file for bankruptcy.⁷³ Because Texas bases homestead protection on acreage rather than fluctuating property values, a debtor could use all of his or her assets to buy the property and protect his or her entire

⁶⁷ See OLDHAM, *supra* note 2, at 16 (explaining 2005 changes to federal bankruptcy law and how they impact Texas homestead protection).

⁶⁸ See, e.g., *In re Thaw*, 496 B.R. 842, 851–52 (Bankr. E.D. Tex. 2013) (finding that the debtor abused Texas homestead protections by purposefully funneling non-exempt assets into his homestead to make it difficult for his creditors to trace them in an attempt to protect those assets). Texas and Florida are two recognized havens for debtors due to a lack of a limit on the monetary value of the homestead protection. See TEX. CONST. art. XVI, § 50; FLA. CONST. art. X, § 4.

⁶⁹ OLDHAM, *supra* note 2, at 16.

⁷⁰ *Id.*

⁷¹ See *id.*

⁷² *Id.*

⁷³ See *In re Blair*, 334 B.R. 374, 378 (Bankr. N.D. Tex. 2005) (explaining that one purpose of the Bankruptcy Abuse Prevention and Consumer Protection Act “was to prevent out of state residents from moving to certain states in order to file for bankruptcy under more advantageous state homestead exemption laws”); OLDHAM, *supra* note 2, at 16 (discussing residency and homestead ownership time requirements under the new law); see also *infra* Part IV.B.2 (comparing Texas and Florida homestead law).

net worth.⁷⁴ In response to these abuses of the system, Congress passed sweeping changes to the bankruptcy code that make it harder for debtors to qualify for the state homestead provisions.⁷⁵ To claim the Texas homestead exemption in a bankruptcy proceeding now, the claimant must have been a Texas resident for two years prior to filing.⁷⁶ The exemption is capped at \$125,000 if the claimant has not had a homestead for at least 1,215 days.⁷⁷ The cap also takes effect if the debtor's debt arises from a violation of federal or state securities law; fraud, deceit, or manipulation of a fiduciary duty; or any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding five years.⁷⁸

Generally, the debtor is entitled to retain exempted property after the bankruptcy process is complete.⁷⁹ However, the changes now also provide certain exceptions in which a debtor's exempt property can be seized to satisfy a debt; for example, domestic support obligations can be used.⁸⁰

Congress wants a debtor to be able to get a "fresh start" through the bankruptcy process if it is needed, but not at the expense of creditors through abuse of the system.⁸¹ The bankruptcy court in the *Villarreal* case would likely have had this perspective in mind. The court is supposed to interpret the bankruptcy code in accordance with Congress's intentions, so it is unsurprising that it would interpret Texas homestead provisions in harmony with the overall policy considerations at play in the bankruptcy process.

2. Recent Developments in Florida, a Comparable Pro-Debtor Homestead State

As a comparison, one can look to recent developments in Florida law for indications as to what Texas may do if the issue ever makes it to the Texas Supreme Court. Florida enacted its homestead protections, modeled

⁷⁴ See TEX. CONST. art. XVI, § 51 (describing the acreage limits for urban and rural homestead).

⁷⁵ OLDHAM, *supra* note 2, at 16.

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ See *Grogan v. Garner*, 498 U.S. 279, 282–84 (1991).

them on those of Texas⁸² in 1843, and codified them as part of the state constitution in 1868.⁸³ It provides the same protections for surviving spouses and for debtors against forced sale of the homestead by creditors.⁸⁴ The policy considerations are also substantially similar to those of Texas:

First, it protects individuals from utter destitution, which relieves the state's burden of supporting destitute families. Secondly, the homestead exemption increases family stability by providing a refuge from economic misfortune, which, in turn, enhances the welfare of the state. Finally, it encourages property ownership and individual financial independence. In light of these goals, Florida courts have consistently applied the homestead exemption liberally in favor of the homestead claimant. Further, while the financial wealth of the homestead claimant and the value of the homestead could theoretically be used to decide whether policy goals are implicated in a particular case, Florida courts have consistently prohibited the consideration of such factors.⁸⁵

Florida also recognizes the same exceptions to homestead protection for forced-sale judgments based on: (1) taxes or assessments; (2) the purchase of property; or (3) the improvement or repair of the property.⁸⁶ Florida courts have construed these exceptions strictly and have declined to extend them multiple times in the past,⁸⁷ including as recently as 1992 in a case involving forfeiture of a residence for state-law RICO violations.⁸⁸

⁸²Joseph W. McKnight, *Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle*, 86 SW. HIST. Q. 369, 396 n.81 (1983) (noting that Mississippi, Georgia, and Florida adopted version of Texas's 1839 homestead law).

⁸³Dennis J. Wall, *Homestead and the Process of History: The Proposed Changes in Article X, Section 4*, 6 FLA. ST. U. L. REV. 877, 891 (1978).

⁸⁴Compare FLA. CONST. art. X, § 4, with TEX. CONST. art. XVI, §§ 50, 52; see *Jones v. Carpenter*, 106 So. 127, 130 (Fla. 1925); see also FLA. STAT. ANN. §§ 732.401, 732.4015 (West Supp. 2013); *Hill v. First Nat'l Bank of Marianna*, 84 So. 190, 192 (Fla. 1920) (citing *Carter's Adm'rs v. Carter*, 20 Fla. 558, 561-71 (1884)).

⁸⁵Greta K. Kolcon, *Common Law Equity Defeats Florida's Homestead Exemption*, 68 FLA. B.J. 54, 54 (1994).

⁸⁶*Id.* at 54-55.

⁸⁷See, e.g., *Wilhelm v. Locklar*, 35 So. 6, 6-7 (Fla. 1903).

⁸⁸*Butterworth v. Caggiano*, 605 So. 2d 56, 57-58 (Fla. 1992).

Recent developments in Florida homestead law, which is substantially similar to Texas homestead law, have reaffirmed the strongly pro-debtor nature of homestead protection. One might think that the homestead protection is too paternalistic and possibly outdated, but the courts have indicated otherwise. In *Chames v. DeMayo*, the Florida Supreme Court considered whether it should abandon the long-standing precedent that Florida's exemption from forced sale of a homestead cannot be waived.⁸⁹ It declined to do so, stating that a waiver of the exemption in an unsecured agreement is unenforceable.⁹⁰ The decision analyzed other permissible waiver situations, such as a spouse's waiver of homestead rights under the Florida Constitution.⁹¹ "The rights of a surviving spouse to . . . homestead . . . may be waived, wholly or partly, before or after marriage, by a written contract, agreement, or waiver, signed by the waiving party in the presence of two subscribing witnesses."⁹²

The opinion distinguishes a waiver in a mortgage and one in an unsecured instrument:

Requiring that a waiver of the homestead exemption be made in the context of a mortgage assures that the waiver is made knowingly, intelligently, and voluntarily. . . . A mortgage assures that the waiver of the homestead exemption, like the waiver of other rights, is made with eyes wide open . . .⁹³

However, referencing various cases, the court stated that it continued to refuse "to find an exception to the protection from forced sale outside of those expressly stated."⁹⁴ The court affirmed the holdings of *Carter's Administrators v. Carter*⁹⁵ and *Sherbill v. Miller Manufacturing Co.*,⁹⁶ prohibiting homestead waivers in an otherwise unsecured instrument:

We agree with Judge Wells's statement in her dissent to the original opinion issued below that if we were to recede

⁸⁹972 So. 2d 850, 852 (Fla. 2007).

⁹⁰*Id.*

⁹¹*Id.* at 854–55.

⁹²FLA. STAT. ANN. § 732.702(1) (West 2010).

⁹³*Chames*, 972 So. 2d at 861.

⁹⁴*Id.* at 855, 862.

⁹⁵*See generally* 20 Fla. 558 (1884).

⁹⁶89 So. 2d 28, 31 (Fla. 1956).

from *Carter* and *Sherbill*, “[T]he waiver of the homestead exemption will become an everyday part of contract language for everything from the hiring of counsel to purchasing cellular telephone services. The average citizen, who is of course charged with reading the contracts he or she signs . . . often fails to read or understand boilerplate language detailed in consumer purchase contracts, language which the contracts themselves often permit to be modified upon no more than notification in a monthly statement or bill . . . [S]uch consumers may lose their homes because of a “voluntary divestiture” of their homestead rights for nothing more than failure to pay a telephone bill. This inevitably will result in whittling away this century old constitutional exemption until it becomes little more than a distant memory.”⁹⁷

This statement clearly sets out the pro-debtor view of homestead rights in states such as Florida and Texas, and presents a valid concern in protecting creditors from losing their homes.

When one examines the decisions that Florida has made in this area, especially the policy considerations articulated above, it is obvious that the paternalistic endeavor to protect the naïve debtor is still alive and well. The body of case law in this area has overwhelmingly been in favor of the debtor, and the courts are loath to change that slant.⁹⁸ In light of the overwhelming similarities of Texas and Florida homestead law, it is likely that Texas will rule in a similar way when it chooses to address the *Villarreal* issue. While the situation articulated above is different from the debtor who is trying to game the system by misleading the lender and then attempting to claim homestead protection, it shows that pro-homestead states view the debtor as weaker than the lender and will continue to put the burden upon the lender in homestead controversies. Texas has drawn a hard line in the sand: ownership of only one piece of property means that the lender is not entitled to rely upon the debtor’s waiver of homestead, and the state has made no exception for property that is being used at least partially for commercial purposes.⁹⁹

⁹⁷ *Chames*, 972 So. 2d at 862.

⁹⁸ See, e.g., *Snyder v. Davis*, 699 So. 2d 999, 1000 (Fla. 1997); *In re Gilley*, 236 B.R. 441, 445 (Bankr. M.D. Fla. 1999); *In re Ehnle*, 124 B.R. 361, 363–64 (Bankr. M.D. Fla. 1991).

⁹⁹ See cases cited *supra* note 47.

3. The Fight for Reverse Mortgages and Home Equity Loans in Texas

Reverse mortgages and home equity loans are the most recently adopted exceptions to Texas homestead protection,¹⁰⁰ but they did not come about without a hard-fought battle on both sides which included courts of appeals cases and confrontation in both the United States and the Texas legislatures.

From the inception of the homestead protections in the Texas Constitution all the way up to the 1990s, the only consensual lien exemptions from homestead protection were for purchase or improvement money.¹⁰¹ All other consensual liens were disallowed.¹⁰² Refinancing of mortgages was not even allowed until 1995.¹⁰³ This limited the credit options that certain less-than-perfect debtors were afforded since they could not use their homesteads as collateral to secure favorable terms with creditors.¹⁰⁴

As the banking industry evolved, new lending options became available to the public that were unavailable to Texas residents as a result of homestead protections in place at that time. Home equity is that portion of a home's value in excess of any mortgage or secondary loans on the home.¹⁰⁵ Home equity loans are loans provided out of the equity of the home, the proceeds of which do not necessarily have to be applied to improving the homestead.¹⁰⁶ Reverse mortgages are loans available to people over sixty-one years of age.¹⁰⁷ No payments are due until the borrower dies, moves, or sells the house or otherwise defaults.¹⁰⁸ Interest accrues on the loan from the day it is made until it is paid, generally when the property is sold.¹⁰⁹ Any remaining funds go back to the borrower.¹¹⁰

While the issue of whether homestead exemptions should be expanded to include other consensual liens was debated over the years, the issue

¹⁰⁰ See OLDHAM, *supra* note 2, at 16–18.

¹⁰¹ *Id.* at 16.

¹⁰² *Id.* at 15.

¹⁰³ See TEX. CONST. art. XVI, § 50 (1876, amended 1973 and 1995).

¹⁰⁴ See OLDHAM, *supra* note 2, at 17–18.

¹⁰⁵ House Research Org. Report No. 75-18, Constitutional Amendments, at 18 (Sept. 5, 1997).

¹⁰⁶ OLDHAM, *supra* note 2, at 16.

¹⁰⁷ *Id.* at 17.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

became hotly contested in the aftermath of the Alternative Mortgage Transaction Parity Act of 1982.¹¹¹ The Parity Act authorized federally chartered savings banks to make nontraditional loans, including reverse mortgages and line-of-credit conversion mortgages.¹¹² The Parity Act contained a broad preemption clause, which stated that the Act's provisions should prevail "notwithstanding any State constitution, law, or regulation."¹¹³

There was no evidence that Congress even took the idiosyncrasies of Texas homestead law into account. Congress had provided a three-year "opt out" mechanism for all states adversely affected by the Parity Act.¹¹⁴ Several states took advantage of the opt-out, but Texas did not.¹¹⁵ The measure did not become an issue until 1987. In 1987, Congress authorized the Secretary of Housing and Urban Development to carry out a nationwide demonstration program of federally insured home-equity conversion mortgages for the elderly.¹¹⁶ When Texas lenders declined to participate, citing the state's homestead laws, the Federal Home Loan Bank Board wrote an opinion letter.¹¹⁷ The Board took the position (later confirmed by the Office of Thrift Supervision (OTS)) that federal law preempted the

¹¹¹ 12 U.S.C. §§ 3801–05 (1988).

¹¹² *See id.* §§ 3801–02 (stating policy rationale for enactment of legislation encouraging 'alternative mortgage transactions' and defining scope of statute); *see also* *First Gibraltar Bank, FSB v. Morales*, 815 F. Supp. 1008, 1009 n.3 (W.D. Tex. 1993) (interpreting phrase 'alternative mortgage transactions' to include reverse mortgages and line-of-credit conversion mortgages (citing 12 U.S.C. § 3802(l) (1988))), *rev'd*, 19 F.3d 1032 (5th Cir. 1994), *vacated with substitute opinion*, 42 F.3d 895 (5th Cir. 1995).

¹¹³ 12 U.S.C. § 3803(c) (1988).

¹¹⁴ *See id.* § 3804(a) (allowing states to avoid federal preemption by vote expressly stating that voters do not want to be affected by preemption mechanism set forth in § 3803(c)).

¹¹⁵ Alternative Mortgage Transaction Parity (regulation D), 76 Fed. Reg. 44,226, 44,227 n.8 (July 22, 2011) (to be codified at 12 C.F.R. pt. 1004 (2011)); *see also* *First Gibraltar Bank*, 19 F.3d at 1043–44 ("The states were given a three-year period during which to "opt out" of the Parity Act's operation, 12 U.S.C. § 3804, but the state of Texas does not argue that it did so."); *see also* Tex. Att'y Gen. Op. No. JM-1269 (1990) ("The Parity Act thus makes applicable to state lenders certain valid regulations issued under other law by a federal regulatory agency. It expressly preempts contrary provisions in state constitutions, laws, or regulations, except for states that opted out of its provisions by October 15, 1985." (citations omitted)).

¹¹⁶ 12 U.S.C. § 1715z-20 (1988).

¹¹⁷ Letter from Jack D. Smith, Deputy General Counsel, Federal Home Loan Bank Board, to John A. Maxim, Jr., Associate General Counsel, United States Department of Housing and Urban Development 11–12 (Aug. 4, 1989).

Texas constitutional prohibition on equity lending.¹¹⁸ A Texas Attorney General opinion disagreed and continued to fight for the Texas prohibition on equity lending.¹¹⁹

First Gibraltar Bank, FSB v. Morales illustrated the dichotomy between the resistance to change in Texas homestead law and evolving federal acceptance of relatively new lending tools. The State prevailed at the trial level by arguing that an OTS regulation incorporated Texas law defining secured loans and, by implication, also incorporated the homestead prohibition.¹²⁰ In 1994, the Fifth Circuit reversed.¹²¹ An amicus curiae brief by the OTS persuaded the court to reject the district court's interpretation of its regulation.¹²² The United States Supreme Court denied certiorari.¹²³

By that time, however, Texas had taken the fight to Congress. United States Representative Henry B. Gonzalez attached a rider to the proposed Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994,¹²⁴ which specifically preserved the Texas constitutional ban on equity lending.¹²⁵ The preemptive federal provision acquired a Texas homestead exception, and as a result, the Fifth Circuit vacated its earlier decision in *First Gibraltar Bank* and affirmed the district court's ruling.¹²⁶

After a failed effort in 1995,¹²⁷ the measure to amend the Constitution and allow home equity loans and reverse mortgages in Texas finally passed in 1997.¹²⁸ However, even with the inclusion of both home equity loans and reverse mortgages in the constitution as homestead exemptions, both

¹¹⁸ *Id.*

¹¹⁹ Tex. Att'y Gen. Op. No. JM-1269 (1990).

¹²⁰ *First Gibraltar Bank, FSB v. Morales*, 815 F. Supp. 1008, 1014 (W.D. Tex. 1993), *rev'd*, 19 F.3d 1032 (5th Cir. 1994), *vacated with substitute opinion*, 42 F.3d 895 (5th Cir. 1995).

¹²¹ *First Gibraltar Bank, FSB v. Morales*, 19 F.3d 1032, 1053 (5th Cir. 1994), *vacated with substitute opinion*, 42 F.3d 895 (5th Cir. 1995).

¹²² *See id.* at 1035–36 (singling out OTS as amicus curiae and confirming judicial deference to agency interpretation of statutes unless interpretation is arbitrary and capricious).

¹²³ *Morales v. First Gibraltar Bank, FSB*, 513 U.S. 876, 876 (1994) (order denying certiorari).

¹²⁴ Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (codified as amended in scattered sections of 12 U.S.C.).

¹²⁵ *Id.* § 102(b)(5) (amending Home Owners' Loan Act of 1933, 12 U.S.C. § 1462a (1994)).

¹²⁶ *See First Gibraltar Bank, FSB v. Morales*, 42 F.3d 895, 896 (5th Cir. 1995) (holding that amendment to Riegle-Neal Interstate Banking and Branching Efficiency Act precluded preemption of Texas homestead exemption by OTS regulations).

¹²⁷ *See* Tex. S.J. Res. 25, 74th Leg., R.S. (1995).

¹²⁸ *See* Tex. H.R.J. Res. 31, 75th Leg., R.S., 1997 Tex. Gen. Laws 6739–46 (current version at TEX. CONST. art. XVI, § 50).

options carry multiple conditions that must be met in order to qualify as a valid lien.¹²⁹

4. A Note of Caution on the Texas Legislature's View of Homestead

While the courts in Texas have reiterated that in light of the policy considerations behind homestead protections, homestead rights are to be construed broadly in favor of the debtor, the Texas legislature has made changes in the last few decades that seem to show a leaning towards creditor protection. In light of socioeconomic changes of the last century, it would seem that if the legislature felt the same as the courts it would make certain changes to protect the homestead rather than further limiting the protection it provides.

The Panic of 1837 and the recent recession were surprisingly similar and would bring to mind the same public policy considerations.¹³⁰ Both economic crises were brought about by speculative fever in bad investments compounded by problems with major drought throughout the country.¹³¹ One of the major considerations in the 1800s was not only preventing homelessness, but preventing the loss of the farm which was the source of the family livelihood.¹³² However, socioeconomic developments have resulted in an evolution of the family livelihood. The majority of families no longer depend on an agricultural lifestyle to meet their needs.¹³³ If a family owns its source of income at all it is most often a family business of some sort, probably located within the city limits.

¹²⁹ See TEX. CONST. art. XVI, § 50(a)(6); J. Alton Alsup, *Texas' New and Improved Reverse Mortgage*, 68 TEX. B.J. 1076, 1076 (2005).

¹³⁰ See TEX. CONST. art. XVI, § 50 interp. commentary (West 1993).

¹³¹ See *id.*; ALASDAIR ROBERTS, AMERICA'S FIRST GREAT DEPRESSION: ECONOMIC CRISIS AND POLITICAL DISORDER AFTER THE PANIC OF 1837 19 (2012); H. Helm Clayton, *The Influence of Rainfall on Commerce and Politics*, 60 POPULAR SCI. MONTHLY 158, 164 (1901); Jesse McKinley, *Severe Drought Adds to Hardships in California*, N. Y. TIMES, Feb. 21, 2009, http://www.nytimes.com/2009/02/22/world/americas/22iht-22mendota.20347700.html?_r=0; Brian Domitrovic, *The Weak Dollar Caused the Great Recession*, FORBES, Mar. 13, 2012, <http://www.forbes.com/sites/briandomitrovic/2012/03/13/the-weak-dollar-caused-the-great-recession/>.

¹³² See TEX. CONST. art. XVI, § 50 interp. commentary (West 1993).

¹³³ See *Farm Family Income*, Farm Bill Forum Comment Summary & Background, USDA, 1, http://www.usda.gov/documents/FARM_FAMILY_INCOME.pdf.

Currently, rural homesteads are afforded protection for 200 acres of land that do not have to be contiguous as long as those acres are being used as a residence or for the family maintenance.¹³⁴ Urban homesteads are only afforded ten acres of protection.¹³⁵ Additionally, protection for the urban homestead extends to a place where a person “exercises a calling” or a business homestead.¹³⁶ The urban homestead can include one “residential” homestead and one “business” homestead as long as the total acreage does not exceed ten acres.¹³⁷

In 2000, the Texas Legislature amended the Texas Constitution to limit the protection that is given to the business homestead.¹³⁸ The residential homestead and the business homestead must now be contiguous.¹³⁹ Also, the business homestead cannot exist without a residential homestead.¹⁴⁰

As a result of these amendments, two families, each with their home on one parcel of land and their place of business on another, may find themselves in entirely different situations due to the rural/urban classification. The family located in the rural setting will likely have homestead protection for both parcels of land (assuming the land does not exceed the acreage limit), while the family in the urban setting will only have protection for their home, allowing creditors to seize their place of business.¹⁴¹ Given the societal developments discussed above, it would seem that these legislative changes are out of line with the stated policy considerations of Texas homestead law.

A similar problem can also arise when part of a rural homestead is absorbed by the ever-advancing city limits. “[B]y virtue of the Constitution the character of the homestead would be changed by the changed conditions from rural to urban without regard to the question of incorporation.”¹⁴² As a result of circumstances outside of the family’s control, the homestead

¹³⁴ See TEX. CONST. art. XVI, § 50; OLDHAM, *supra* note 2, at 18.

¹³⁵ OLDHAM, *supra* note 2, at 19.

¹³⁶ *Id.* at 143.

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ For further discussion on this issue, see generally Christopher John Kern, *Goodbye Texas Urban Business Homestead: An Analysis of the November 1999 Amendment to Article XVI, Section 51 of the Texas Constitution*, 52 BAYLOR L. REV. 663 (2000).

¹⁴² *M.H. Lauchheimer & Sons v. Saunders*, 76 S.W. 750, 752 (Tex. 1903).

protection is drastically decreased.¹⁴³ The total acreage protected is reduced from 200 acres to ten acres, and the parcels of land must now be contiguous.¹⁴⁴

V. WHAT *IN RE VILLARREAL* MEANS FOR TEXAS LAWYERS GOING FORWARD

Texas courts have shown time and time again that the pro-debtor policies behind the creation of homestead protection in Texas are still a major consideration in cases where the homestead is an issue. The courts make it difficult for debtors to waive their homestead rights, even in situations where both the creditor and debtor have freely contracted to do so. However, societal and economic changes have led to circumstances where debtors may find ways around the system and leave even diligent creditors with no protection. The *In re Villarreal* case provides a marked departure from Texas case law and takes pressure off of the creditor in a situation where he could not have discovered the homestead nature of the property. The case may provide some leverage for creditors in Texas in the short term where strict application of case law would lead to an unjust result. However, when Texas courts address this issue, they will likely disapprove of the bankruptcy court's decision based on long-held notions about homestead protections. As a final note, the bankruptcy court's interpretation in that case seems to be more in line with the more recent amendments to homestead protections in the Constitution. While the Texas courts may still wish to provide as much homestead protection as possible, they are still limited by the amendments that the legislature may make to the constitution and must abide by those limitations.

¹⁴³ See *id.* at 751–52.

¹⁴⁴ TEX. CONST. art. XVI, § 51.