PRACTICING FAMILY LAW IN A DEPRESSED ECONOMY

PART I: YOUR LAW PRACTICE AND YOUR CLIENTS

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CHAPTER 10

CURRICULUM VITAE OF RICHARD R. ORSINGER

Education: Washington & Lee University, Lexington, Virginia (1968-70)
University of Texas (B.A., with Honors, 1972)
University of Texas School of Law (J.D., 1975)

Licensed: Texas Supreme Court (1975); U.S. District Court, Western District of Texas (1977-1992; 2000-present); U.S. District Court, Southern District of Texas (1979); U.S. Court of Appeals, Fifth Circuit (1979); U.S. Supreme Court (1981)

Board Certified: Texas Board of Legal Specialization Family Law (1980), Civil Appellate Law (1987)

Organizations and Committees:

Chair, Family Law Section, State Bar of Texas (1999-2000)
Chair, Appellate Practice & Advocacy Section, State Bar of Texas (1996-97)
Chair, Continuing Legal Education Committee, State Bar of Texas (2000-02)
Vice-Chair, Continuing Legal Education Committee, State Bar of Texas (2002-03)
Member, Supreme Court Advisory Committee on Rules of Civil Procedure (1994-2011); Chair, Subcommittee on Rules 16-165a
Member, Pattern Jury Charge Committee (Family Law), State Bar of Texas (1987-2000)
Supreme Court Liaison, Texas Judicial Committee on Information Technology (2001-2005)
Tx. Bd. of Legal Specialization, Civil Appellate Law Advisory Commission (Member and Civil Appellate Law Exam Committee (1990-2006; Chair 1991-1995); Family Law Advisory Commission (1987-1993)
Member, Supreme Court Task Force on Jury Charges (1992-93)
Member, Supreme Court Advisory Committee on Child Support and Visitation Guidelines (1989, 1991; Co-Chair 1992-93; Chair 1994-98)
Member, Board of Directors, Texas Legal Resource Center on Child Abuse & Neglect, Inc. (1991-93)
President, Texas Academy of Family Law Specialists (1990-91)
President, San Antonio Family Lawyers Association (1989-90)
Associate, American Board of Trial Advocates
Fellow, American Academy of Matrimonial Lawyers
Director, San Antonio Bar Association (1997-1998)
Member, San Antonio, Dallas and Houston Bar Associations

Professional Activities and Honors:

Listed as Texas' Top Family Lawyer, Texas Lawyer's *Go-To-Guide* (2007)
Listed as one of Texas' Top 100 Lawyers, and Top 50 Lawyers in South Texas, *Texas Monthly* Super Lawyers Survey (2003-2009)
Texas Academy of Family Law Specialists' *Sam Emison Award* (2003) for significant contributions to the practice of family law in Texas
Association for Continuing Legal Excellence Best Program Award for *Enron: The Legal Issues* (2002)
State Bar of Texas *Presidential Citation* "for innovative leadership and relentless pursuit of excellence for continuing legal education" (June, 2001)
State Bar of Texas Family Law Section's *Dan R. Price Award* for outstanding contributions to family law (2001)
State Bar of Texas *Gene Cavin Award for Excellence in Continuing Legal Education* (1996)
State Bar of Texas *Certificate of Merit*, June 1995, June 1996, June 1997 & June 2004
Listed in the BEST LAWYERS IN AMERICA: Family Law (1987-2009); Appellate Law (2007-2009)

Continuing Legal Education and Administration:

Course Director, State Bar of Texas:
- Practice Before the Supreme Court of Texas Course (2002 - 2005 & 2007)
- *Enron, The Legal Issues* (Co-director, March, 2002) [Won national ACLEA Award]
- Advanced Expert Witness Course (2001, 2002, 2003,

2004)
- 1999 Impact of the New Rules of Discovery
- 1998 Advanced Civil Appellate Practice Course
- 1991 Advanced Evidence and Discovery
- Computer Workshop at Advanced Family Law (1990-94) and Advanced Civil Trial (1990-91)
- 1987 Advanced Family Law Course

Course Director, Texas Academy of Family Law Specialists First Annual Trial Institute, Las Vegas, Nevada (1987)

BOOKS AND JOURNAL ARTICLES

—Editor-in-Chief of the State Bar of Texas' TEXAS SUPREME COURT PRACTICE MANUAL (2005)
---Chief Editor of the State Bar of Texas Family Law Section's EXPERT WITNESS MANUAL (Vols. II & III) (1999)
---Author of Vol. 6 of McDonald Texas Civil Practice, on Texas Civil Appellate Practice, published by Bancroft-Whitney Co. (1992) (900 + pages)
---*A Guide to Proceedings Under the Texas Parent Notification Statute and Rules,* SOUTH TEXAS LAW REVIEW (2000) (co-authored)
---*Obligations of the Trial Lawyer Under Texas Law Toward the Client Relating to an Appeal,* 41 SOUTH TEXAS LAW REVIEW 111 (1999)
---*Asserting Claims for Intentionally or Recklessly Causing Severe Emotional Distress, in Connection With a Divorce*, 25 ST. MARY'S L.J. 1253 (1994), republished in the AMERICAN JOURNAL OF FAMILY LAW (Fall 1994) and Texas Family Law Service *NewsAlert* (Oct. & Dec., 1994 and Feb., 1995)
---Chapter 21 on *Business Interests* in Bancroft-Whitney's TEXAS FAMILY LAW SERVICE (Speer's 6th ed.)
---*Characterization of Marital Property*, 39 BAY. L. REV. 909 (1988) (co-authored)
---*Fitting a Round Peg Into A Square Hole: Section 3.63, Texas Family Code, and the Marriage That Crosses States Lines*, 13 ST. MARY'S L.J. 477 (1982)

SELECTED CLE ARTICLES AND SPEECHES

State Bar of Texas' [SBOT] **Advanced Family Law Course**: Intra and Inter Family Transactions (1983); Handling the Appeal: Procedures and Pitfalls (1984); Methods and Tools of Discovery (1985); Characterization and Reimbursement (1986); Trusts and Family Law (1986); The Family Law Case in the Appellate Court (1987); Post-Divorce Division of Property (1988); Marital Agreements: Enforcement and Defense (1989); Marital Liabilities (1990); Rules of Procedure (1991); Valuation Overview (1992); Deposition Use in Trial: Cassette Tapes, Video, Audio, Reading and Editing (1993); The Great Debate: Dividing Goodwill on Divorce (1994); Characterization (1995); Ordinary Reimbursement and Creative Theories of Reimbursement (1996); Qualifying and Rejecting Expert Witnesses (1997); New Developments in Civil Procedure and Evidence (1998); The Expert Witness Manual (1999); Reimbursement in the 21st Century (2000); Personal Goodwill vs. Commercial Goodwill: A Case Study (2000); What Representing the Judge or Contributing to Her Campaign Can Mean to Your Client: Proposed New Disqualification and Recusal Rules (2001); Tax Workshop: The Fundamentals (2001); Blue Sky or Book Value? Complex Issues in Business Valuation (2001); Private Justice: Arbitration as an Alternative to the Courthouse (2002); International & Cross Border Issues (2002); Premarital and Marital Agreements: Representing the Non-Monied Spouse (2003); Those Other Texas Codes: Things the Family Lawyer Needs to Know About Codifications Outside the Family Code (2004); Pearls of Wisdom From Thirty Years of Practicing Family Law (2005); The Road Ahead: Long-Term Financial Planning in Connection With Divorce (2006); A New Approach to Distinguishing Enterprise Goodwill From Personal Goodwill (2007); The Law of Interpreting Contracts: How to Draft Contracts to Avoid or Win Litigation (2008); Effect of Choice of Entities: How Organizational Law, Accounting, and Tax Law for Entities Affect Marital Property Law (2008)

SBOT's **Marriage Dissolution Course**: Property Problems Created by Crossing State Lines (1982); Child Snatching and Interfering with Possess'n: Remedies (1986); Family Law and the Family Business: Proprietorships, Partnerships and Corporations (1987); Appellate Practice (Family Law) (1990); Discovery in Custody and Property Cases (1991); Discovery (1993); Identifying and Dealing With Illegal, Unethical and Harassing Practices (1994); Gender Issues in the Everyday Practice of Family Law (1995); Dialogue on Common Evidence Problems (1995); Handling the Divorce Involving Trusts or Family Limited Partnerships (1998); The Expert Witness Manual (1999); Focus on Experts: Close-up Interviews on Procedure, Mental Health and Financial Experts (2000); Activities in the Trial Court During Appeal and After Remand (2002)

UT School of Law: Trusts in Texas Law: What Are the Community Rights in Separately Created Trusts? (1985); Partnerships and Family Law (1986); Proving Up Separate and Community Property Claims Through Tracing (1987); Appealing Non-Jury Cases in State Court (1991); The New (Proposed) Texas Rules of Appellate Procedure (1995); The Effective Motion for Rehearing (1996); Intellectual Property (1997); Preservation of Error Update (1997); TRAPs Under the New T.R.A.P. (1998); Judicial Perspectives on Appellate Practice (2000)

SBOT's **Advanced Evidence & Discovery Course**: Successful Mandamus Approaches in Discovery (1988); Mandamus (1989); Preservation of Privileges, Exemptions and Objections (1990); Business and Public Records (1993); Grab Bag: Evidence & Discovery (1993); Common Evidence Problems (1994); Managing Documents--The Technology (1996); Evidence Grab Bag (1997-1998); Making and Meeting Objections (1998 & 1999); Evidentiary Issues Surrounding Expert Witnesses (1999); Predicates and Objections (2000 & 2001); Building Blocks of Evidence (2002); Strategies in Making a Daubert Attack (2002); Predicates and Objections (2002); Building Blocks of Evidence (2003); Predicates & Objections (High Tech Emphasis) (2003)

SBOT's **Advanced Civil Appellate Practice Course**: Handling the Appeal from a Bench Trial in a Civil Case (1989); Appeal of Non-Jury Trials (1990); Successful Challenges to Legal/Factual Sufficiency (1991); In the Sup. Ct.: Reversing the Court of Appeals (1992); Brief Writing: Creatively Crafting for the Reader (1993); Interlocutory and Accelerated Appeals (1994); Non-Jury Appeals (1995); Technology and the Courtroom of the Future (1996); Are Non-Jury Trials Ever "Appealing"? (1998); Enforcing the Judgment, Including While on Appeal (1998); Judges vs. Juries: A Debate (2000); Appellate Squares (2000); Texas Supreme Court Trends (2002); New Appellate Rules and New Trial Rules (2003); *Supreme Court Trends* (2004); Recent Developments in the *Daubert* Swamp (2005); Hot Topics in Litigation: Restitution/Unjust Enrichment (2006); The Law of Interpreting Contracts (2007); Judicial Review of Arbitration Rulings: Problems and Possible Alternatives (2008)

Various CLE Providers: SBOT Advanced Civil Trial Course: Judgment Enforcement, Turnover and Contempt (1990-1991), Offering and Excluding Evidence (1995), New Appellate Rules (1997), The Communications Revolution: Portability, The Internet and the Practice of Law (1998), Daubert With Emphasis on Commercial Litigation, Damages, and the NonScientific Expert (2000), Rules/Legislation Preview (State Perspective) (2002); College of Advanced Judicial Studies: Evidentiary Issues (2001); El Paso Family Law Bar Ass'n: Foreign Law and Foreign Evidence (2001);

American Institute of Certified Public Accounts: Admissibility of Lay and Expert Testimony; General Acceptance Versus Daubert (2002); Texas and Louisiana Associations of Defense Counsel: Use of Fact Witnesses, Lay Opinion, and Expert Testimony; When and How to Raise a Daubert Challenge (2002); SBOT In-House Counsel Course: Marital Property Rights in Corporate Benefits for High-Level Employees (2002); SBOT 19th Annual Litigation Update Institute: Distinguishing Fact Testimony, Lay Opinion & Expert Testimony; Raising a Daubert Challenge (2003); State Bar College Spring Training: Current Events in Family Law (2003); SBOT Practice Before the Supreme Court: Texas Supreme Court Trends (2003); SBOT 26th Annual Advanced Civil Trial: Distinguishing Fact Testimony, Lay Opinion & Expert Testimony; Challenging Qualifications, Reliability, and Underlying Data (2003); SBOT New Frontiers in Marital Property: Busting Trusts Upon Divorce (2003); American Academy of Psychiatry and the Law: Daubert, Kumho Tire and the Forensic Child Expert (2003); AICPA-AAML National Conference on Divorce: Cutting Edge Issues–New Alimony Theories; Measuring Personal Goodwill (2006); New Frontiers` - Distinguishing Enterprise Goodwill from Personal Goodwill; Judicial Conference (2006); SBOT New Frontiers in Marital Property Law: Tracing, Reimbursement and Economic Contribution Claims In Brokerage Accounts (2007)

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Born: San Antonio, Texas, May 2, 1981

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University of Texas School of Law, Austin, Texas J.D., 2007

Licenses: State Bar of Texas (2007)

CLE Articles

The Ethics of ADR Negotiation and Settlement
Marriage Dissolution Institute, Galveston, 2008

Effect of Choice of Entities: How Organizational Law, Accounting, and Tax Law for Entities Affect Marital Property Law
Co-authored with Richard R. Orsinger and Patrice L. Ferguson
Advanced Family Law Course, San Antonio, 2008

Trusts, Family Law, & the Contract-Property Dichotomy
Co-presented with Harold C. Zuflacht
Marriage Dissolution Institute, Fort Worth, 2009

Property Puzzles: 30 Characterization Rules, Explanations & Examples
Co-authored with Richard R. Orsinger and R. Scott Downing
Family Law on the Front Lines, 2009
Advanced Family Law Course, Dallas, 2009

Practicing Family Law in a Depressed Economy - Part I: Your Law Practice and Your Clients
Co-authored with Richard R. Orsinger
Co-presented with Richard R. Orsinger
Advanced Family Law Course, Dallas, 2009

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I. OVERVIEW. We are in the worst recession in seventy years, and it has the potential to become an economic depression. As family lawyers, this impacts us in three ways: it affects our clients, who have less wealth and more debt; it affects our law practices, which are threatened with declining income; and it affects our personal lives, where we have to increase our work hours to maintain old income levels, adjust to reduced personal expenditures and diminished retirement security, and deal with spare time resulting from lack of work. Part I of this Article discusses these three domains. Part II of this Article discusses all aspects of the economy in depth.

II. PROTECTING YOUR LAW PRACTICE. One economist recently said on the radio that "a business stays in business by making more money than it spends." Since most of us are in business, this idea is an important one for us. Because we can control our expenses more easily than we can control our income, we'll begin our discussion with expenses.

A. Reducing Expenses. Whether you're as big as General Motors, or as small as a solo practitioner, the key to surviving an economic downturn is to control or reduce expenses. If you don't control your expenses proactively, the economy will make you do that reactively. Here is a list of expenses for a typical law firm:

- Employee compensation
- Employee benefits
- Rent
- Computer Services
- Practice Aids (reporters, formbooks, codes, etc.)
- Office Supplies
- Entertainment
- Marketing

A "profit margin" is the percentage that profit comprises total revenue. The converse of a profit margin is the ratio of expense to revenue. As the profit margin increases, the ratio of expense to revenue will decrease. A healthy law practice will have profit margin and expense-to-revenue percentages approaching 50%.

1. Employee Compensation. In a deflationary economy such as the one we have now, the purchasing power of the dollar increase as time passes. That means that the same salary can buy more goods and services. Smaller raises, or even no raises, can be justified from an economic point of view, because even on the same salary the employee's purchasing power is increasing. With the number of unemployed rising, the business owner may be able to replace an existing employee with a new employee that would be happy to have a job at a lower salary than the employee being replaced. It would be a bad business decision to replace a good employee with a new employee just to reduce salary expense. However, it may make business sense to replace a bad employee, or a marginal employee, with a new employee at a lower salary. Many businesses that do not want to lay-off employees can simply not replace an employee who resigns, and the work load of the departing employee can be distributed among the remaining employees.

If the workload is diminished enough, the business owner could reduce the work week by one hour per day, or could change some full-time positions into part-time positions. Administrative jobs, such as bookkeeping, could be terminated and the tasks outsourced. A receptionist job could be replaced by converting to a voice mail system, or having paralegals answer the phone.

If your business has a history of paying bonuses, a discretionary bonus system can be converted into a performance-based bonus system. For example, bonuses for employees who bill their time or services can be tied to hours billed or fees collected. Salaried employees, like associate attorneys, will then have a direct input into their compensation, with the more profitable employees being rewarded for their higher profitability. That way the employees are contributing to their own bonuses.

A prevalent approach to performance-based bonuses focuses entirely on an "objective" measure of the value an employee adds to the business: quantity of billable hours. This insular fixation ignores another more "subjective"—yet equally integral—component of value: quality of work done. An employee must excel at both of these two components in some balanced proportion in order to do an amount of work that is valuable enough to justify additional compensation. Effort expended to do work is like a gas; it expands to fit its container. Thus, cinching bonuses solely to billable hours encourages either over-billing (through employees devoting too much time to projects that do not warrant it) or carelessness (through employees taking on too many projects and not having sufficient time to competently complete them). These consequences are inevitable and unsustainable, and obviously ethically improper. A system that sets a lower quantitative threshold and a higher qualitative threshold can avoid these problems, but ultimately requires assessments both objective and subjective, both mandatory and discretionary. A practice that seeks to earn revenue by focusing on increasing billable hours, at the expense of paying only cursory attention to the quality of work produced in those hours, is destined to fail.

2. Employee Benefits. Employers well know that the cost of employee benefits, particularly medical insurance, has been increasing at a greater rate than other costs. Many businesses are shifting some of the cost of medical insurance coverage to employees, by having them pay a portion of the insurance premiums. Many health insurers can provide a "cafeteria plan," where the employee has the ability to choose the deductible that fits their insurance needs. Instead of paying the full cost of medical insurance, the employer can pay a set amount, and allow each employee to decide how that insurance money should be applied. Some employees may prefer to have a Health Savings Account (HSA) instead of regular insurance, in which event the employer-provided premium can be contributed to the HSA.

3. Employee Turnover. Employee turnover is bad. In hard economic times, employees who might otherwise stay with the job may have to move due to outside factors, like a spouse's unemployment. If you have to replace a valuable employee, you will lose the former employee's contribution to revenue during the replacement period, and you will lose the productivity of everyone involved in training the new employee.

One factor in keeping a work force happy is to make employees feel secure about their paychecks and about their jobs. Assume there will be negative speculation and gossip over any indications that the firm may be having cash flow problems. The better practice is to never be late on paychecks.

When an employee is terminated, they can apply for unemployment benefits. "Chargebacks" are the amount of unemployment benefits that affect the former employer's tax rate, and are computed by adding the total of regular unemployment benefits and half of the extended benefits paid to a claimant.

4. Rent. If your lease comes up for renewal during a bad commercial real estate market, it presents an opportunity to reduce rental expense. You can search for an older building, or a less desirable location, or downsize offices in a new lease space. Commercial brokers can do this searching for you, and even negotiate terms with the new landlord, and their fees are customarily charged to the new landlord. Office-sharing presents the opportunity to share overhead with other lawyers, each of whom pays part of the salary and benefits of common employees like a receptionist, and part of the rent on the common areas like the reception area, library, and break-room. Speaking of a library, in this day of Westlaw and Lexis, and the State Bar of Texas' "On Line Library," the library can be eliminated and the rent on that space can be eliminated.

5. Computer Services & Practice Aids. The cost of computing power continues to drop. Hard disk space is one of the cheapest commodities in the world. In big offices, a computer network based on a computer server model is necessary, but for smaller offices a peer-to-peer network may meet your needs without the necessity of buying and servicing an expensive network server. The peer-to-peer network is less vulnerable to catastrophic failure that results when the server fails, because each individual computer continues to function even when one computer on the network fails.

You can outsource your email system to an off-site email service provider at a nominal cost, usually billed as a fixed dollar price per email account.

The State Bar's On Line Library costs $295.00 per year, and gives you access to all State Bar of Texas CLE articles dating back to 1998, which you can download as a pdf file and print or search on your computer.

You can have a flat fee contract with Westlaw or Lexis that gives you a fixed library cost per month. The sales representative can give you a recommendation as to which databases best suit your research needs. Westlaw has multiple family law packages. Westlaw offers a Family Law Core package, which includes the annotated Family Code, family law forms, the family law section of Texas Jurisprudence and ALR, and various other research aids tailored to family law practitioners. Other packages include additional features: the Family Law Counselor package adds multistate records (such as People Finder and Asset Locator), and the Family Law Expert package features multistate records, administrative materials, family law journals, and law reviews. The "Lawrev-pro" database permits you to search all American law school reviews and journals for an economical price.

Westlaw and Lexis also offer reports that can track the amount of on-line usage on a client-by-client basis, which allows you to charge a pro rata part of your Westlaw or Lexis bill to the client who receives the benefit of that service. Out-of-plan research can be billed to the client whose case called for the out-of-plan charges.

6. CLE Expense. Continuing legal education is a necessary part of practicing law. To remain licensed, Texas lawyers must have 15 hours of CLE per year, of which at least 3 hours must be ethics credit. Up to 5 of those 15 hours may "be self-study" credit, but at least 10 hours must be "participatory credit" earned at a formal course or seminar. To maintain Family Law Specialization, the Texas Board of Legal Specialization requires 100 CLE hours in a 5 year period, of which 15 may be self-study. The following chart lists the cost per hour of various family law CLE courses:

Advanced Family Law Course	$24.12/hr
Family Law Boot Camp	$31.25/hr
Marriage Dissolution Institute	$37.35/hr
Marriage Dissolution Boot Camp	$23.75/hr
New Frontiers in Marital Property Law	$82.78/hr
Advanced Family Law Drafting Course	$45.00/hr

The biggest cost of CLE is not the registration fee or cost of food and lodging; it is the time out of the office which generates no fee income. For this reason, many lawyers meet their CLE requirements and needs by attending local CLE functions, or getting participatory credit through the State Bar's on-line CLE offerings, which permits you to get CLE and CLE credit while sitting at your computer at the office. The State Bar offers telephone CLE events of an hour in length, and the State Bar allows you to participate in some CLE events "live" through an Internet connection. The variety of CLE offerings from the State Bar can be reviewed at <www.texasbarcle .com>.

B. Fees. One of the most important considerations in a troubled economy is ensuring the timely and complete collection of receivables. The most effective thing you can do to increase fee income is to reduce non-fee producing professional activities and other pro bono work and use that free time representing clients for a fee. However, there are several other methods which can help increase fee income. Underlying this issue is the important balance between maintaining financial viability on the one hand, and remaining able to attract clients on the other. This section addresses these two topics and interplay between them.

1. Initial Interview. Some lawyers charge for an initial interview, others do not. A free initial interview may serve as an inducement for potential clients to come to your office. You probably can't prove that without trying both approaches over time and seeing how revenue is affected. The problem is that, by interviewing one party to a dispute, you preclude yourself from representing the opposing party, and you get no compensation for that loss of potential business or for your time spent in the interview. Additionally, some case law indicates that even without charging a fee or getting a signed employment agreement you may be sued for negligence by this person who never paid you a dime.

2. Retainer. The retainer serves as a filter, to separate out those potential clients who are not serious about hiring you. It also serves as a fund for you to bill against. There are two broad categories of retainers: "classic" and "special." *In re Pannebaker Custom Cabinet Corp.*, 198 B.R. 453, 459 (Bankr. M.D. Pa. 1996).

a. Classic Retainer. With a "classic retainer," also referred to as a "true," "general," or "earned-on-receipt" retainer, the client agrees to pay a fixed sum in exchange for the attorney's promised *availability* to perform future services that may arise during a specific period of time or for a specified matter. *Id.;* 7 Am.Jur.2d Attorneys at Law § 249 (2009) (emphasis added). The classic retainer is earned by the lawyer when paid, and need not be held in trust.

b. Special Retainer: Security. A special retainer comes in three main types: "security" retainers, "advance fee" or "advance payment" retainers, and "evergreen" retainers. With a "security retainer," the attorney holds the funds to secure payment of fees incurred for future services. *Id.* These funds do not constitute a present payment, but instead remain the property of the client until the attorney applies them to charges for services actually rendered, normally at the time or after a bill is sent. *Id.* In Texas, the general rule is that, unless proven otherwise, a retainer constitutes funds held in trust for the benefit of the debtor, i.e., a security retainer. *See In re Office Products of America, Inc.*, 136 B.R. 964, 970 (Bankr. W.D. Tex. 1992) *(cited by Pannebaker,* 198 B.R. at 459).

c. Special Retainer: Advance Fee/Advance Payment. With an "advance fee retainer," the attorney receives payment in advance for contemplated legal services and depletes the prepaid "balance" as services are rendered. *Id.* Advance fee retainers differ from security retainers in that ownership of the funds is intended to pass to the attorney at the time of the payment. *Id.* In other words, an advance fee retainer is a present payment to the lawyer in exchange for the commitment to provide legal services in the future, while a security retainer is ***not*** a present payment, and merely streamlines payment for future legal services *when they are incurred.* At least one jurisdiction has recognized that, because the overriding principle governing the appropriate type of retainer is the protection of the client's interest, advance fee retainers are permissible, but rarely justified. *See Dowling v. Chicago Options Associates, Inc.*, 226 Il1.2d 277, 292, 875 N.E.2d 1012, 1021 (Ill. 2007). One Northern District Bankruptcy Court Judge interpreting Texas law held that a retainer remains property of the client until the attorney "applies it" to charges for services actually rendered. *In re Dixon*, 143 B.R. 671, 677 (Bankr. N.D. Tex. 1992). This holding vitiates the distinction between advance fee retainers and security retainers, collapsing the former into the latter. In other words, advance payment retainers may not be allowed in Texas.

Some authorities use the term "advance fee" (as opposed to "advance fee retainer") to signify what is, in effect, a classic retainer. *See* Tex. Comm. on Prof l Ethics, Op. 431, 49 Tex. B.J. 1084 (1986) (a true retainer "is not a payment for services. It is an advance fee to secure a lawyer's services, and – remunerate him for loss of the opportunity to accept other employment.") *(cited by Cluck v. Commission for Lawyer Discipline*, 214 S.W.3d 736, 739 (Tex. App.–Austin 2007, no pet.)). These authorities state that, "[i]f a fee is not paid to secure the lawyer's availability and to compensate him for lost opportunities, then it is a prepayment for services and not a true retainer." *Id.* at 740 *(citing* Ethics Op. 431). Thus, under these authorities, an advance fee is distinct from a prepayment for services, and a prepayment for services (which includes security retainers, advance fee retainers, and evergreen retainers) is ***not*** a true retainer. Furthermore, money that constitutes the prepayment of a fee belongs to the client until the services are rendered and must be held in a trust account. Tex. Disciplinary R. Prof l Conduct 1.14 cmt. 2 *(cited by Cluck*, 214 S.W.2d at 740). Therefore, this line of authorities reaches the same conclusion as *Dixon* that any type of "retainer" other than a classic retainer (i.e. an advance fee to secure a lawyer's service and compensate them for loss of opportunity to accept other employment) may ***not*** be a present payment, remains the property of the client, and must be held in trust by the attorney.

d. Special Retainer: Evergreen. An "evergreen" retainer is a retainer that must be replenished after it is drawn down. When the funds in the client's trust account fall below the required balance, the client must replenish the retainer balance to its full amount. For example, if the initial evergreen retainer is $10,000.00, and replenishment is required when the trust balance falls below 50%, and in the first billing period the attorney bills $2,000.00, then the attorney would transfer $2,000.00 from the trust account into their operating account, and the client would not need to pay any additional funds at that time. If during the next billing period the attorney bills $3,500.00, s/he would transfer that sum out of the trust account into the operating account, and the client would be required to replenish the retainer to its full amount by paying the attorney $5,500.00. The threshold for a full replenishment can range from *complete* depletion of the retainer to *any* depletion of the retainer.

An evergreen retainer is designed to minimize an attorney's risk of non-payment if the client's financial position deteriorates, their estate becomes illiquid, or are otherwise unable or unwilling to pay the bill.

e. Default Rule for Type of Retainer. The general rule is that, unless shown to be otherwise, a retainer constitutes funds held in trust for the benefit of the debtor, i.e., a security retainer. *Pannebaker*, 198 B.R. at 459 *(citing In re Office Products of America*, *Inc.,* 136 B.R. 964, 970 (Bankr. W.D. Tex. 1992); *In re Printing Dimensions, Inc*., 153 B.R. 715, 719 (Bankr. D. Md. 1993)). The burden rests with the professional to establish that a retainer is a classic, flat-fee retainer or an advance payment retainer,. *Id.* at 459-60 *(citing In re Mondie Forge Co.*, 154 B.R. 232, 238 (Bankr. N.D. Ohio 1993).

f. Interim Deposits. Apart from the initial retainer, an attorney is also permitted to request a trial deposit, which is the payment of additional funds to cover preparation for trial and trying of the case. *See In re A.R.,* 236 S.W.3d 460, 47980 (Tex. App.--Dallas 2007, no pet.). The trial deposit may be either an increase of or an addition to the initial retainer, and may provide for any of the different procedures used for those types of retainers. The purpose of a trial deposit is to ensure that the attorney is promptly and completely paid their fees for preparing and trying the case, which often exceed (sometimes substantially) in only one billing cycle the total amount of the retainer balance. Additional deposits can be required for other services, such a depositions, hearings, mediation, and so on.

g. Non-Refundability of Retainers. In Texas, only classic retainers may be nonrefundable. *See* Tex. Comm. on Prof 1 Ethics, Op. 431, 49 Tex. B.J. 1084 (1986) ("A fee is not earned simply because it is designated as non-refundable. If the (true) retainer is not excessive, it will be deemed earned at the time it is received, and may be deposited in the attorney's account.") *(cited by Cluck v. Commission for Lawyer Discipline*, 214 S.W.3d 736, 739 (Tex. App.--Austin 2007, no pet.)). As explained *supra,* in order to be a classic or "true" retainer, the payment must be for the purposes of securing an attorney's services, and remunerate them for loss of the opportunity to accept other employment. *Id.* Essentially, if the attorney's services are billed against the payment, it is not a classic retainer, and may be a refundable or advance payment. *See Cluck*, 214 S.W.3d at 739-40; Tex. Disciplinary R. Prof I Conduct 1.15(d) ("Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as...refunding any *advance payments* of fee that has not been earned." (emphasis added).

h. Retainers in a Depressed Economy. Different types of retainers serve different ends in different circumstances, and an attorney must balance their retainer requirement against their client's willingness and ability to comply with it.

With regard to ensuring the timely and complete collection of receivables, each type of retainer has its own benefits and detriments. Classic retainers are nonrefundable and may be deposited into an attorney's operating account upon receipt. Classic retainers are not widely used in the family law field, however, and, unless the lawyer is uniquely qualified, many clients will not agree to pay a significant amount of money simply to induce the lawyer to take the case.
As discussed *supra,* there are different types of special retainers, but for each, the retainer is a prepayment for future expenses that must be held in trust and may only be moved to the attorney's operating account as fees are incurred. These types of retainers are generally favored by family lawyers, but variations exist in the requirements for replenishment.

The first variation is an initial retainer, expiring when it is exhausted, after which the client pays fees to the attorney each time those fees are billed. Only security and advance fee retainers can be used in this way. This arrangement is attractive to many clients because a significant amount of their money is not sequestered in an account for which they receive no interest for most of the duration of the case. However, this method is less attractive to attorneys because it subverts the primary utility of a retainer as a guarantee that they will be paid promptly for the work that they do, covering only a small portion of the potential fees for a case.

The second variation is a retainer that persists through the entire representation, and attorney fees and costs are billed against it at regular intervals. After that retainer is depleted below a certain threshold, the client must replenish it in full. These retainers carry the benefit to the attorney of assuring that there are enough accessible funds to pay their fees for a particular billing period, and ease the burden on the client of paying fees each cycle and the client has to write fewer checks, to the extent that the replenishment threshold has not been crossed.

The third variation is a special case of the second, where the client must pay the initial retainer and replenish whatever portions are used in full each billing cycle. On a month-by-month basis, this procedure closely resembles the more traditional payment schedule where the client pays each invoice for legal work billed during that period. This variation serves a dual function as both a guarantee that the attorney will be paid promptly for the work that s/he does, and as a reserve out of which to pay fees at the end of the case. In this way, this retainer is a hybrid of both classes of evergreen retainers discussed *supra.*

The complexity of the case, the demeanor of the client and the size, and liquidity of the estate are all factors which must be considered in determining which type of retainer is appropriate for a particular case. The decision of what type of retainer to use can affect the type of client your practice attracts, and can significantly impact your ability to collect fees and retain a viable practice in troubled times.

3. Credit Cards. Accepting credit cards as a form of payment can help attract new business as well as aid in the collection of accounts receivable. A lawyer must first open a merchant services account at a bank, which usually involves some paperwork and a minimal setup fee. The lawyer may choose which types of cards will be accepted during the application process. Different cards have different discount fees (i.e. the percentage of each transaction paid to the merchant account provider), usually ranging from 1.95% to 4.0%. There are also various interchange fees associated with a merchant account that vary depending on the risk involved with the transaction, and some merchant service contracts prohibit passing these fees on to the client.

Because lawyers must strictly segregate funds held in trust that are unearned from funds in their operating account, payment of these fees and the transfer of funds from the merchant service provider must be closely managed. One approach is to open an IOLTA account specifically designated solely for credit card transactions into which all funds charged by the client are deposited. From this account, funds can be separately transferred to either the client's trust account or the firm's operating account as appropriate.

4. Hourly Rates. While attorneys typically dread lowering their hourly rates, doing so in a distressed economy can give an attorney a competitive advantage over their competitors. An attorney should ascertain the prevailing hourly rate in the relevant market for professionals of similar skill, expertise, and experience, and determine whether lowering their rate to or below that value would benefit their practice. It is important, though, to actually calculate the difference a drop in hourly rates can have. For example, if a lawyer charges $100/hour, but only has enough business to bill 35 hours/week, they will bill about $3,500 per week. If lowering their hourly fee by 15% (to $85/hour) would increase their case load enough to generate a 14% increase (5 extra hours) in their billable time per week, then they will make only about $3,400 per week. This change resulted in doing more work for less money. The underlying principle is that more work is not always better, and the intuitive reaction to a lackluster economy might not always result in positive gains. Keep a close eye on the percentages, and make sure that any reduction in billing rate increased time billed enough so that overall revenue goes up.

5. Flat Fees. Taking a flat fee in a family law case is dangerous, because settlement decisions are not necessarily driven by rational considerations, and because the client may not respect reasonable limits when phone calls are free and when it costs them nothing to have a motion filed. However, if the flat fee is high enough, the risk of overrunning the fee must be weighed against the reward of an early settlement.

6. Contingent Fees. A contingent fee agreement (also referred to as a "contingency fee agreement") is a contract "for attorney services...that depends upon the success or failure in an effort to enforce a supposed right." 23 Williston on Contracts § 62:4 (citing *Jeffries v. Mutual Life Ins. Co. of New York*, 110 U.S. 305, 4 S. Ct. 8, 28 L. Ed. 156 (1884)). These types of agreements exist primarily to accomplish two goals:

(1) to allow a party who is unable to pay an attorney at the beginning of a case to secure representation by arranging to pay the attorney at the end of the case; and

(2) to compensate the attorney with a higher fee than they would receive under an hourly billing method for incurring the risk of receiving *no fee whatsoever* if the case is lost.

See Arthur Andersen & Co. v. Perry Equipment Corp., 945 S.W.2d 812, 818 (Tex. 1997); *see also In re Polybutylene Plumbing Litigation,* 23 S.W.3d 428, 436 (Tex. App.--Houston [1st Dist.] 2000, pet. denied).

Generally, contingent fees are valid under Texas law. Tex. Disciplinary R. Prof. Conduct 1.04(d), *reprinted* in Tex. Gov't. Code, tit. 2, subtit. G app. A, Art. 10, § 9, Rule 1.04(d) (State Bar Rules, art. X, § 9). However, the unique dynamic of family law cases reverses this general rule. Contingent fee agreements are problematic in family law cases because they:

(1) tend to promote divorce in violation of the public policy of Texas; and

(2) may be inconsistent with a lawyer's obligation to encourage reconciliation.

Tex. Disciplinary R. Prof. Conduct 1.04 cmt. 9. For these reasons, "contingent fee arrangements in domestic relations cases are rarely justified."

While no case has specifically stated what rare set of circumstances would justify a contingent fee in a domestic relations case, several cases have listed circumstances in which contingent fee agreements are *not* justified. One such case is *Piro v. Sarofim,* in which the trial court's Findings of Fact and Conclusions of Law were reprinted in full. *See Piro v. Sarofim,* No. 01-00-00398-CV, 2002 WL 538741, at *7 (Tex. App.--Houston [1st Dist.] April 11, 2002, no pet.). The trial court found that the contingent fee agreement was invalid, in part, for three reasons:

(1) the attorneys did not adequately describe the method to be used to calculate the fee;

(2) the attorneys did not fully and fairly disclose all important information to the client prior to entering into the contract, including the fact that contingent fees in divorce cases are ***rarely justified***; and

(3) the reduction of one attorney's hourly rates used for the accounting of the charges for his service was illusory because the retainer was high and another attorney did a large portion of the work.

Id. at *7-*8. After this opinion was issued, the parties settled and the Court of Appeals vacated the appeal, but declined to withdraw this April 11, 2002 opinion. *Piro v. Sarofim,* 80 S.W.3d 717, 721 (Tex. App.--Houston [1st Dist.] 2002, no pet.).

In many other jurisdictions, contingent fee agreements in family law cases are void. See, e.g., *King v. Young, Berkman, Berman & Karpf, P.A.*, 709 So.2d 572, 573-74 (Fla. 3d DCA), *review denied,* 725 So.2d 1111 (Fla. 1998) (contingent fee in domestic litigation specifically prohibited by state bar rules); *Stoller v. Onuszko* (1973), 10 Ill.App.3d 598, 599-600, 295 N.E.2d 118, 119 ("It is against public policy for attorneys to enter into contingent fee contracts in divorce actions."); *Rogers v. Webb,* 558 N.W.2d 155, 156 (Iowa 1997) ("It is clearly unethical for an attorney to undertake a contingent fee arrangement in a domestic relations case. Any contract providing for one is void as against public policy."); *State ex rel. Oklahoma Bar Assn., v. Fagin,* 848 P.2d 11, 14

(Okla. 1992) (OK rule of professional conduct "forbids *'any fee in* a domestic relations matter, the payment *or amount of which is contingent* upon the result obtained.'" (emphasis in original)); *In re Hill,* 261 Or. 573, 574, 495 P.2d 261, 262 (1972) (contingent fees in divorce proceedings invalid).

In addition to Texas' justifications that contingent fees promote divorce and are inconsistent with the attorney's duty to encourage reconciliation, other jurisdictions have found further grounds on which to invalidate contingent fees. One such basis is that there is no longer the need to allow contingent fees so that a spouse who is unable to pay an attorney at the beginning of a case may secure representation by arranging to pay the attorney at the end of the case; many states–including Texas–provide a statutory mechanism whereby the non- monied spouse can receive interim fees to pay their attorney. *See, e.g., Barelli v. Levin,* 144 Ind. App. 576, 247 N.E.2d 847, 853 (1969); Tex. Fam. Code § 6.502(a)(4). Thus, the first goal of contingent fee agreements mentioned above has been foreclosed in domestic relations cases, and contingent fees cannot be justified on the lawyer's risk alone.

Texas law strongly discourages contingent fee agreements in family law cases, but it does not categorically prohibit them. If a lawyer is going to enter into one of these agreements, s/he must make sure that they adequately describe the method used to calculate the contingent fee, advise the client that contingent fee agreements in Texas are rarely justified, and require that the client consult with an independent attorney before agreeing to the contingent fee. The fee agreement should be laden with disclaimers, and all parties should sign it, as well as the independent third-party attorney.

7. Attorney's Lien. Another effective tool for securing payment of fees is an "attorney's lien." An attorney's lien is a "security interest in property of the client recovered for the client though the lawyer's efforts." Restatement (Third) of the Law Governing Lawyers (2009) § 43(1). The Texas Disciplinary Rules of Professional Conduct provide:

A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien granted by law to secure the lawyer's fee or expenses; and

(2) contract in a civil case with a client for a contingent fee that is permissible under Rule 1.04.

Tex. Disciplinary R. Prof'l Conduct 1.08(h), *reprinted in* Tex. Gov't Code Ann., tit. 2, subtit. G app. A (Vernon 2005) (Tex. State Bar R. art X, § 9). The Texas Commission on Professional Ethics has also approved the use of attorney's liens in certain limited situations:

> If an attorney, when representing a client in a property dispute, acquires an undivided fee simple interest in the disputed property in good faith and with the client's consent, then there is no violation of DR 5-103 [now Rule 1.08(h)]. The attorney's acquisition of an interest in the property is equivalent to contracting for a contingent fee which is allowed by DR 5-103(A)(2) [now Rule 1.04].

Tex. Comm. on Prof'l Ethics, Op. 449, 51 Tex. B.J. 165 (1988). The use of this form of attorney's lien has been approved by the San Antonio Court of Appeals to secure a contingent fee. *See In re Slusser*, 136 S.W.3d 245, 249 (Tex. App.--San Antonio 2004) (orig. proceeding). But this seeming "equivalence" of attorney's liens and contingent fees might deserve some thought from family law practitioners; in family law cases, contingent fee arrangements are rarely justified. Tex. Disciplinary R. Prof'l Conduct 1.04 cmt. 9.

Only one reported case has addressed attorney's liens in the context of a family law case. *See*

Stephenson v. Leboeuf, 16 S.W.3d 829 (Tex. App.--Houston [14th Dist.] 2000, pet. denied). In *Stephenson*, the attorney represented client in her divorce. *Id*. at 834. The client signed a promissory note for the payment of attorney's fees which was secured by a deed of trust on the client's house. *Id*. As part of the property settlement, the client's spouse received the house on which the lien attached, and was to give the client a note secured by another deed of trust on the house, which note would be used to pay the attorney's fees. *Id*. *Stephenson* is a fascinating opinion addressing a multitude of issues ranging from attorney-client relationships to fiduciary duty, discharge of debt in bankruptcy, trial amendments, and awards of attorney's fees, but for the purposes of attorney's liens, the court concluded that the type of lien acquired in this case was proper under Rule 1.08(h). *Id*. at 838.

Stephenson is a specific judicial endorsement of the use of attorney's liens in divorces. The appellate court in that case considered the property in the property division to be "disputed property."

The Restatement provides that an attorney's lien may attach to other property of the client which is not recovered through the representation, but only if (1) attachment is provided by law, (2) the contract is enforceable, (3) the client has adequate information about the terms of the contract, (4) the terms and circumstances of the agreement are fair and reasonable to the client, and (5) the client consents after being encouraged and given the opportunity to seek independent legal advice. *See* Restatement (Third) of the Law Governing Lawyers §§ 43(4), 18, 126.

C. Unbundling Legal Services. "Unbundling," also called "discrete tasks representation," or "limited scope legal assistance," is an arrangement where a lawyer agrees to perform legal services for a client that are more limited than full representation. The advantage to the client is a reduction in fees. The disadvantage is that the client may forego receiving important legal advice or the lawyer may not learn important information that would lead to important legal advice. A risk to lawyers is that a client, seeking to avoid legal fees, may have an unsatisfactory result and may later blame the lawyer for negligence for failing to do something the lawyer was not hired to do. This latter concern keeps many lawyers from unbundling their legal services. Three styles of unbundling are: coaching (advising a client on what to seek without negotiating on the client's behalf), ghostwriting (drafting pleadings or contracts without revealing the lawyer's involvement), and limited participation (appearing for one court proceeding like a motion–without agreeing to handle other court proceedings). The ethics of ghostwriting and whether courts will respect limited participation in court proceedings, are issues being worked out around the nation. The American Bar Association has published a *Handbook on Limited Scope Legal Assistance,* which discussed unbundling. *See* <http://www.abanet.org/litigationitaskforces/modest/report.pdf>.

If you do limited representation, be sure that you and the client understand what you are agreeing to do and not do. If you get that in writing it may avoid a swearing match if the client botches the case or the transaction and later sues.

D. Outsourcing/Insourcing. Costs can also be contained by either outsourcing or insourcing certain tasks. With regards to the former, some services performed by a firm's dedicated employees can be delegated to an outside source. For example, if a firm employs a "runner" to file court documents, the firm may eliminate this position and hire a courier service to perform the same job if doing so would cost less than the amount to employ the runner. With regard to the latter, some tasks which usually entail hiring an external specialist can be handled in- house. For example, if a lawyer usually employs forensic CPA's to review documents, the lawyer may choose to review documents himself/herself, if it is within his/her ability to do so.

E. Barter. Some clients may not have cash to pay legal fees, but may instead possess items or be willing to do work that would be of value to the lawyer. In this Nation's history, when the currency was rare, people would trade goods and services directly without relying on currency as medium of exchange. While it might seem antiquated to draft a pleading for someone in exchange for them painting your house, it is important to remember that practicing law is a service that requires training and skill, just as painting houses, or repairing cars, or preparing meals are. While money is a great convenience, money is not, and never has been indispensable to the practice of law.

F. Turning Down Unpaid Work. Abraham Lincoln is reputed to have said, "A lawyer's time is his stock-in-trade." [Richard says:] In 1989, when I left a law firm and for the first time opened up my office as a sole practitioner, I asked Houston family lawyer Don Royall about taking cases, "in the lean times," when you needed the retainer to make your car payment but you knew the client wouldn't pay the balance of the fee. Don said, "If I'm going to make no money, I'd rather make no money fishing than I would make no money representing somebody." I resolved to follow Don's advice. I weakened during Desert Shield, the six month buildup to Desert Storm, which hit San Antonio like a ton of bricks. My telephone didn't ring for weeks at a time. I did every bit of billable work I could do, organized my files, straightened up my office, and still ran out of things to do. I weakened, and took some child support and visitation cases that I knew couldn't pay more than the retainer. After America won "the Mother of all Battles" in record time, my case load eventually picked up. But I was still dogged by the nonpaying clients I'd taken, who expected first class treatment despite a mounting receivable. I had to work their cases for no fee, while other clients needed work on their cases and had positive balances in my trust account. I vowed "never again."

Somebody gave me a test to use, when I was tempted for whatever reason to take or continue to work a case for no fee. They said, "Go home and ask your wife if she would write this prospective client a check for 5, 10 or 15 thousand dollars. If you can convince her to do so, then go ahead and work the case for no fee."

G. Withdrawing From Representation. In its most revered and commonly proclaimed form, the impetus for choosing a career in the practice of law is a desire to help solve others' problems and improve their lives, to do good and better society, to "pursue a common calling in the spirit of public service." The Texas Lawyer's Creed-A Mandate for Professionalism, Order of Adoption (adopted by the Supreme Court of Texas and the Texas Court of Criminal Appeals Nov. 7, 1989), *reprinted in* Texas Rules of Court 759, 761 (West 2009). As a result, the professional bond that forms between an attorney and their client, especially in the practice of family law, can be a strong one. For some lawyers, this bond makes it difficult to withdraw from representation, even when the client is not complying with the fee agreement.

However, "[w]e must always be mindful that the practice of law is a profession." *Id.* One of the essential characteristics of being a professional is receiving compensation for the work we do. Thus, despite the bonds we share with our clients, relationships and duties that we willingly take on and sometimes even seek out, it is our prerogative, and often our imperative, to withdraw from a case in which we are not being paid.

The Disciplinary Rules of Professional Conduct list several bases upon which an attorney may justify withdrawal:

1. the withdrawal can be accomplished without material adverse effect on the interests of the client;

2. the client persists in a course of action

involving the lawyer's services that the lawyer reasonably believes may be criminal or fraudulent;

3. the client has used the lawyer's services to perpetrate a crime or fraud;

4. a client insists upon pursuing an objective that the lawyer considers repugnant or imprudent or with which the lawyer has fundamental disagreement;

5. the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services, including an obligation to pay the lawyer's fee as agreed, and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

6. the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

7. other good cause for withdrawal exists.

Tex. Disciplinary R. Prof. Conduct 1.15(b), *reprinted in* Tex. Gov't. Code, tit. 2, subtit. G app. A, Art. 10, § 9, Rule 1.15 (State Bar Rules, art. X, § 9). Note that each of these reasons is framed around some adverse action of the client, not around the desires of the attorney. Thus, the client must actually do something to justify withdrawal by their attorney, and the attorney may not terminate the representation at will for just any reason, or no reason at all. This focus on the client is also embodied in the Rule that a lawyer must continue to represent a client and may not withdraw, even if good cause is shown, if the court so orders. Tex. Disciplinary R. Prof. Conduct 1.15(c). Finally, after the lawyer withdraws, they must take steps to the extent reasonably practicable to protect the client's interest, including giving reasonable notice to the client of the withdrawal, allowing time for the client to employ other counsel, surrendering papers and property in the lawyer's possession, and refunding any advance payment of fees that have not been earned. Tex. Disciplinary R. Prof. Conduct 1.15(d).

H. Accounts Receivable. An essential business practice for any attorney during economically troubled times is paying close attention to the money that they are owed and the steps that are being taken to collect it. The attorneys at a firm should meet frequently, preferably once each week, to monitor the status of the accounts receivable for each of the cases being handled by the firm. Many firms already conduct regular meetings to discuss the status of the legal work on the cases, to formulate strategies, and to assign various tasks. Adapting these meetings to incorporate financial matters is simple, efficient, and effective. Frequently addressing the condition of each case's receivable will allow attorneys to detect any potential problems with payment before they become too large to successfully manage, and will provide more options for rectifying the problem than discovering it later would allow.

I. Client Bankruptcy. One of the more salient reasons for not allowing receivables to build up is the danger of client bankruptcy. When a client who owes outstanding legal fees files for bankruptcy protection, the attorney to whom they owe those fees is relegated to the role of a creditor in bankruptcy, and must endure the delay and uncertainty of the bankruptcy process in order to collect the debt. Furthermore, continuing to represent a client against whom the attorney has filed a claim in the bankruptcy may potentially create a conflict of interest. For some clients, bankruptcy is an inevitability, and being able to recognize that fact early on and take steps to mitigate it is extremely important in a depressed economy.

J. Interim Fees. The award and collection of interim attorney's fees continues to be an issue in family law cases.

1. Authority to Award Interim Fees. Texas Family Code § 6.502(a)(4) provides for the award of interim fees in a suit for divorce. Such an order is considered to be temporary spousal support, and is therefore enforceable by contempt. Tex. Fam. Code § 6.506; *Ex Parte Kimsey,* 915 S.W.2d 523, 525 (Tex. App.--El Paso 1995, orig. proceeding) (holding that "it matters not whether the trial court awards alimony *pendente lite* to the wife in order to provide her sufficient funds with which to pay her attorney or whether the court orders, as temporary spousal support, that the monies will be paid directly to the attorney for the wife's benefit...[I]n each instance, the wife is recouping the benefit of the support award.... [A]ccordingly, we find that Relator has not been imprisoned for failure to pay a debt.")

Additionally, Section 105.001 of the Family Code provides for the award of interim fees in a suit affecting the parent-child relationship. Tex. Fam. Code §105.001(a)(5). This section also establishes that the court has the authority to award interim fees in a suit for modification brought under Chapter 156 of the Family Code. *See Hughey v. Hughey,* 923 S.W.2d 778, 780-81 (Tex. App.--Tyler 1996, writ denied); Tex. Fam. Code §§101.031 & 101.032. While Section 156.006(a) governs temporary orders in suits for modification, the dictates of Section 105.001 apply to an award of interim fees in a modification. *See Hughey,* 923 S.W.2d at 780-81 ("We find nothing in Chapter 105 that would preclude its application to an original suit under Chapter 156"). Therefore, in any suit affecting the parent-child relationship, the award of interim attorney's must be "for the safety and welfare of the child." Tex. Fam. Code §105.001(a); *see Saxton v. Daggett,* 864 S.W.2d 729, 736 (Tex. App.--Houston [1st Dist.] 1993, orig. proceeding) ("Section [105.001] does not authorize a trial court, in a suit affecting the parent-child relationship, to make a temporary order for payment of reasonable attorney's fees for a purpose *other than* the safety and welfare of the child." (emphasis in original)). Such an order is not appealable, and is considered temporary child support for the safety and welfare of the child, and thus would be enforceable by contempt. Tex. Fam. Code §105.001(e) and (f).

2. Enforcing Interim Fees by Sanctions. In *Baluch v. O'Donnell,* 763 S.W.2d 8, 10 (Tex. App.--Dallas 1988, orig. proceeding), the trial court ordered the alleged husband in a divorce proceeding to pay $25,000 interim attorney's fees to the wife's lawyers. When the husband failed to do so, the trial court struck his pleadings. The court of appeal granted mandamus, saying that the sanction could not be justified as a discovery sanction because it did not further one of the purposes that discovery sanctions were intended to further, and there was no other basis to support the trial court's order. Judge O'Connell recused himself from the case, which was reassigned to Judge Miller. Judge Miller refused to set the case for trial until Baluch paid the interim fees. Baluch sought mandamus again and, in *Baluch v. Miller,* 774 S.W.2d 299 (Tex. App.--Dallas, orig. proceeding), the court of appeals again issued mandamus, saying that Judge Miller had "exceeded her authority" in refusing to set the case for trial. In contrast, *Shirley v. Montgomery,* 768 S.W.2d 430, 432-33 (Tex. App.--Houston [14th Dist.] 1989, orig. proceeding), the trial court artfully framed the sanction for failure to pay interim fees to an attorney ad litem as a discovery issue because the funds were to be used for discovery expenses–and mandamus was denied. The Fourteenth Court of Appeals came down against sanctions as a remedy in the case of *In re N.R C.,* 94 S.W.3d 799 (Tex. App.--Houston [14th Dist.] 2002, pet. denied). In a suit to terminate parental rights, the trial court appointed an attorney ad litem for the child. The trial court ordered each party to deposit $2,500 with the ad litem as security, but the mother failed to do so. The trial court granted the ad litem a judgment for attorney's fees, and further prohibited the mother from presenting at trial witnesses on her behalf other than herself. The Court of Appeals reversed, saying the ruling barring witnesses was tantamount to a death penalty sanction which did not meet the constitutional requirements of *TransAmerican Natural Gas v. Powell,* 811 S.W.2d 913 (Tex. 1991). In the case of *In re Flores,* 135 S.W.3d 863 (Tex. App.--Houston [1st Dist. 2004], orig. proceeding), the father had filed a motion to modify the divorce decree. The trial court ordered interim attorneys' fees paid to the mother, but the father did not pay them. The trial court then granted a motion to strike the trial setting. The court of appeals granted mandamus relief, agreeing with the Dallas Court of Appeals' opinion in *Baluch v. Miller.* The court held that there was no authority for the trial court to refuse to proceed.

3. Enforcing Attorney Fee Awards by Contempt. In Texas, a court cannot imprison a person for not paying a debt. Tex. Const. Art. I, §18. However, courts have consistently recognized that obligations incurred for the support of children and spouses do not constitute a "debt" for purposes of contempt. *Ex Parte Kimsey* at 525 (Tex. App.--El Paso 1995, no writ.) (holding that "[t]he obligation which the law imposes on spouses to support one another and on parents is not considered a `debt' within Article I, section 18, but a legal duty arising out of the status of the parties").

Kimsey involved a court order rendered during a temporary hearing held in a divorce proceeding. The court mandated that Husband pay the sum of $50,000 in interim attorney's fees into the registry of the court, to be paid "[a]s additional spousal support." *Id.* at 524. Because the Family Code allows for orders requiring temporary support payments (in terms of both child support and spousal support) to be enforceable by contempt, the El Paso Court of Appeals held that "an order of contempt arising from the failure to pay those obligations may be enforced by incarceration without running afoul of the constitutional prohibition." *Id.* at 526.

However, in *Ex parte Hightower,* 877 S.W.2d 17 (Tex. App.--Dallas, writ dism'd w.o.j.), the Court held that unpaid fees and expenses of an attorney ad litem appointed for the child in a suit for modification of visitation were not to be considered "child support" for purposes of the constitutional prohibition of imprisonment for debt. Therefore, it was held that trial court's enforcement of payment of fees and expenses by contempt violated the Texas Constitution.

Similarly, in *In the Matter of Moers,* 104 S.W.3d 609, 611 (Tex. App.--Houston [1st Dist.] 2003, orig. proceeding), the court held that attorney's fees incurred in suits to modify could not be characterized as "child support" for purposes of contempt. The First Court of Appeals, citing *Hightower,* distinguished fees awarded in suits brought to enforce child support from fees awarded in suits brought to modify child support because of consequences which arise from characterizing fees as child support. Based on the long-standing principal that courts are to exercise their contempt power with great caution, the appellate court in *Moers* sought to "limit any extension of the 'duty to support' to services and costs required for enforcing child support." *Id.* at 612. In so doing, the court noted that because "a decree that awards attorney's fees characterized as child support could result in garnishment of the obligor's wages and loss of the obligor's professional licenses in a suit brought to enforce the decree...[the] court imposes potentially serious consequences on the obligor." *Id.*

Incidentally, in *Moers,* the court distinguished its particular set of facts and final ruling from that noted in *Ex parte Kimsey.* In Footnote 1, the *Moers* court noted that "[i]n *Ex parte Kimsey,* 915. S.W.2d 523 (Tex. App.--El Paso 1995, no writ), the court opined in a footnote that nonpayment of ad litem fees is enforceable by contempt. We note, however, that *Kimsey* dealt with contempt in the nonpayment of attorney's fees required by a temporary order. Because temporary orders have their own rules and regulations that are not applicable to parent-child modification orders, we find *Kimsey* distinguishable on its facts. To the extent that *Kimsey* holds that attorney's fees may be characterized as child support in a suit to modify the parent-child relationship, we respectfully disagree with our sister court."

In line with these rulings, the Fourteenth Court of Appeals, in *In re Jih,* 2003 WL 22707113 (Tex. App.--Houston [14th Dist.] 2003, pet. denied) (memorandum opinion), determined that a trial court could not enforce an award of attorney's fees in divorce action by contempt where child support was not ordered. The trial court originally assessed the sum of $15,000 against relator for discovery costs. At a later hearing, the trial court found relator in contempt for failure to pay $15,000 in discovery costs, and assessed $6,275 in attorney's fees against relator. Because it was determined that no child (or spousal) support was ordered, the contempt order issued against relator for failure to pay attorney's fees was found to be void.

In *Kogel v. Robertson,* 2005 WL 3234627, *10 (Tex. App.--Austin 2005) (memorandum opinion), the court of appeals held it was error for the trial court, in awarding attorney's fees in a child custody modification case, to incorrectly characterize a portion of each fee award as being "in the nature of child support," thus impermissibly subjecting the appellant to fine or confinement for failure to pay a debt.

K. Expanding Your Client Base.

1. Marketing. Twenty years ago, only plaintiffs' lawyers advertised, and then only through a limited array of media: buses, billboards, yellow pages, late-night television, and the like. Today, lawyers of all types market in a wide variety of different places, and magazines especially have provided lawyers unique opportunities to market themselves. Trade publications such as *Texas Lawyer,* as well as more mainstream magazines like *Texas Monthly,* frequently publish special editions that ostensibly serve as surveys and rankings, but which also operate as excellent vehicles for marketing.

If you are as busy as you want to be, with the quality of cases you want, then don't advertise. Otherwise, marketing your practice can help expand your client base, focus that base on particular segments of the populace, reinforce your referral network, and heighten your exposure and reputation among your peers. Effective places to market consist of old staples such as television, yellow pages, and billboards, but now also include radio, newspapers, trade publications, local and state-wide magazines, and on the internet through a firm website, banner ads on blogs and law-related websites, as well as through search engines and social networking sites.

One useful method for budgeting marketing is to allocate a certain, defined percentage of gross receipts for marketing expenses, and to consistently spend that amount. This percentage should be determined by reference to various factors: quantifiable ones such as the average rates for ads in the market in which the lawyer practices and the type of demographic targeted by the lawyer, and unquantifiable ones such as the importance and necessity of marketing to the particular lawyer and the effectiveness of marketing in a particular community. This percentage will be different for different lawyers in different places, but more important than the *amount* of money spent is the *consistency* with which it is spent. One of the most basic principles of rhetoric as applied to the practice of law is that judges and juries are more likely to remember concepts and ideas that are repeated to them multiple times, between the upper and lower limits of over-saturation and insufficiency, respectively. The same principle applies to marketing: potential clients in need of a family lawyer are more inclined to remember your name if they have encountered it multiple times in a variety of places.

During economic downturns, the natural impulse of many practitioners is to reduced “non-necessary” expenditures, and frequently, their marketing budget is one of the first expenses to be cut. However, because the true efficacy of marketing lies in repetition, reducing the amount of money spent on marketing can dramatically reduce its effectiveness, decreasing the influx of new clients in turn. Maintaining a constant proportion between marketing expenditures and gross receipts ties those expenditures to a variable with which they are already inextricably intertwined. Effective marketing increases the number of clients, which increases gross receipts, which increases the money spent on marketing, which again increases the number of clients, and so on. Artificially decreasing marketing expenditures asynchronously with gross receipts disrupts this mutual amplification, taking them out of phase with each other and harming both.

In addition to *amount,* the other essential element of marketing is *content.* Different types of ads are effective with and appropriate for different target clientele, and the content of a lawyer’s marketing must be tailored for their likely potential clients. Marketing firms are skilled at designing and disseminating effective and appropriate advertisements for lawyers, but the lawyer must lay an active role in the design of these advertisements. Too often, lawyers pay large sums of money to marketing firms that may not understand all the nuances of the practice of family law and the sensibilities of the typical family law client, and who end up producing an ineffective or inappropriate ad because the lawyer did not provide proper guidance or remained passive throughout the process. Look at other lawyers’ advertisements that catch your attention and try to pick out the elements that make them effective. Show drafts of your ads to friends, family and other laymen and solicit their opinions. Most importantly, look objectively at your ad and ask yourself “If I knew nothing about the law but needed a family lawyer, would I want to hire this person? Do they look trustworthy? Do they look competent? Do they look like someone I would want in my corner?” Viewing your own advertisements with a critical eye is imperative to effective marketing.

With regards to marketing your firm using a website, the following index reflects the top ten highest scoring law firm websites in a recent study on internet presence. Visiting these websites can provide helpful ideas for how to design an informative and attractive internet presence:

Jones Day (Score: 81)	www.jonesday.com
Mayer Brown (Score: 77)	www.mayerbrown.com
DLA Piper (Score: 76)	www.dlapiper.com
Baker & McKenzie (Score: 74)	www.bakernet.com
McDermott Will & Emery (Score: 73)	www.mwe.com
Greenberg Traurig, P.A. (Score: 68)	www.gtlaw.com
Morrison & Foerster (Score: 68)	www.mofo.com
Morgan Lewis & Bockius (Score: 66)	www.morganlewis.com
Skadden Arps Slate Meagher & Flom (Score: 61)	www.skadden.com
Wilmer Hale (Score: 59)	www.wilmerhale.com
Kirkland & Ellis (Score: 59)	www.kirkland.com

09-4 Law Off. Mgmt. & Admin. Rep. 2, Institute of Management and Administration Inc., (April 2009) (websites scored by Muzeview LLC (www.muzeview.com) based on several factors including: search engine positioning; web site “stickiness”; popularity; content ranking; size; traffic; and social media). While each of these international law firms dwarfs even the largest Texas family law firm, valuable lessons that can be learned from critically analyzing their approach to web marketing. One salient example is the URL.

Despite the fact that some of these firms have as many as five name partners, not one of the URLs is more than 11 characters, and most are 8 characters or fewer. Intuitively, it is easier for a potential client to remember or enter a URL like: "www.orsinger.com" than: www.orsinger familylawattorney.com."

There are also several marketing opportunities that can be exploited on a limited budget. *See* Cuyler, Aviva, Small Marketing Steps with Big Impact, 26 NO. 3 GPSoIo 10 (April/May 2009). The process of taking advantage of the easiest opportunities first is referred to in marketing as "picking the low-hanging fruit," and includes tactics such as fostering social ties with your referral network. One excellent idea for free marketing proposed by David V. Lorenzo in How to Market a Small Law Firm for Less Than $500 (available at: www.small firmsuccess.org/files/How to Market a Small Law Firm for Less Than $500.pdf) is to take advantage of news media:

> Every day, there are news items in the newspaper and on television and radio that fall into your area of expertise. Your local newspaper editor is always looking for expert commentary on these topics. A news story without a quote is not a true news story.
>
> Fax and mail a press release every month to local editors and reporters who cover relevant stories. Include a business card or two with your full contact information – including your home and mobile telephone numbers. The editors will most likely throw away the press release, but some will save your contact information.

Id. Lorenzo also suggests that attorneys write and speak for free, and this marketing method, along with its benefits and drawbacks, is discussed more thoroughly in the CLE section of this article.

L. Internal Fraud. In an economic downturn, financial desperation could cause an employee to steal from the business. Existing financial controls should be evaluated to be sure they are tight enough. Recommended procedures include segregating related functions so that they are not performed by one person. For example, the person signing checks should not also balance the check book. Another technique is surprise audits that focus on high- risk areas such as expense reports, payroll checks, purchases, cash deposits, accounts receivable, etc. You might consider tighter controls for overtime expenses, especially if you pay time-and-a-half for overtime work or if you permit employees to work outside of the office.

Internal fraud can extend to padding time slips to increase fee income. That is both unethical and illegal (former Associate U.S. Attorney General Webster Hubbell was sentenced to 21 months' imprisonment for mail fraud in overcharging clients).

Internal fraud can also extend to using clients' credit cards or bank information to steal money from clients. The sensitivity of information in a divorce practice might be a hiring consideration, and under the Business & Commerce Code, law firms have a duty to protect sensitive financial information of clients. *See* Tex. Bus. & Comm. Code ch. 48; Gordon, Stephen H., New Duties to Protect Client Information, San Antonio Lawyer, May-June 2007. A computer network manager can restrict access to certain folders on the network server. Some client records could be kept under lock and key.

Insurance is available to cover the risk of embezzlement and theft from clients.

M. Line of Credit. An old joke describes a banker as someone who loans you his umbrella when the sun is shining and takes it away when it starts to rain. A line of credit can be used to smooth out irregular cash flows, by borrowing and repaying, reborrowing and re-repaying, etc. The best time to get a line of credit is before you need it.

N. Client Evaluation. As Trautz & Pinnington write, "it is a myth that it is always better to have more clients. What is critical to success is to have more of the *right clients*." An integral part of remaining afloat in rough economic seas is to make certain that your clients are as committed as you are to honoring the employment contract and will pay your invoices promptly and in full.

One of the most effective ways to assess whether or not a prospective client is the right or wrong type for your practice is the process of client evaluation. The chief goal of client evaluation is to maximize the number of good clients and minimize the number of problem clients. In a normal economic climate, a firm can afford to take the risk on representing clients who might possibly cause problems in the future, but in leaner times, selecting conscientious clients is critical. On the other hand, in a depressed economy, some firms may need to take on more improvident representations in order to maintain a positive cash flow. In this circumstance, a lawyer must be attuned to the risks and ramifications of different problems they might face with a particular client, and make an educated decision on which risks are acceptable, and which risks are not.

Client evaluation should begin at the initial consultation with the prospective client and continue throughout the entire course of the representation, with the attorney employing a systematic set of factors to ensure uniformity. The list of factors for effective client evaluation has been adapted from R. Hal Moorman's incredibly insightful article Don't Come to My Office with Suing Me on Your Mind: Ethical Engagement Letters, 25th Annual Advanced Tax Law Course, State Bar of Texas (2007), which in turn was taken from Frank N. Ikard, Jr.'s article Negotiating Fee Contracts and Recovering Fees in Fiduciary Litigation, Advanced Planning and Probate Course, State Bar of Texas (2003).

1. Compatibility. The lawyer must determine whether the prospective client's personality, approach, and goals are compatible with the attorney's personality and the general ethos of the firm. The first impressions a lawyer gets about a prospective client will inevitably, to some extent, color the relationship with that client going forward. While these impressions are not immutable, they are typically very resistant to change, and relationships that begins on uncertain grounds have a tendency to get worse–not better–over time. It can be a grave mistake to ignore indications that a particular client and particular lawyer will not get along. Unhappy lawyers are reluctant to interact with antagonistic clients, and unhappy clients are less likely to strictly comply with their fee agreement.

2. Veracity. The lawyer must determine whether the prospective client is telling them the truth in the initial consultation. It might not be feasible or possible to verify the accuracy of this information, so the lawyer's intuition will necessarily play an important role in this determination. The venerable attorney-client privilege exists not only to protect confidential communications, but also to *encourage* them, so the lawyer should explain to the client that the only way to fully protect the client's interests is for there to be complete candor in those communications. A client who will lie to or withhold important facts from their lawyer may also be more inclined to refuse to pay fees.

3. Litigiousness. The lawyer must determine whether the prospective client is too eager or too reluctant to go to trial. The preferred outcome of any lawsuit is the amicable, efficient, and inexpensive resolution to the dispute. But not all cases–and not all clients–are amenable to this alternative. If a client is unwilling to incur the expense and endure the stress of trial despite the fact that their financial position and the merits of their claim warrant it, then their attorney will lose out on a legitimate and possibly lucrative source of income. Conversely, if a client relentlessly craves litigation regardless of whether they can fund or justify it, their lawyer may be forced to waste valuable time and damage their reputation with their peers. A good client should not be afraid to go to trial, but also should not be recklessly litigious.

4. Reasonableness. The lawyer must determine whether the prospective client has reasonable expectations and a reasonable demeanor, which of course is easier said that done. Some clients will present well at first, but become unbalanced later on. Ascertaining reasonableness is perhaps the most difficult–and the most important–aspect of client evaluation, but it is also the facet of the client that is the most susceptible to influence by the lawyer. Inform the client of their realistic prospects from the very beginning, but understand that certainty in the legal field is rare. Obviously, making guarantees or promises about the outcome, or claiming to have a special advantage over other lawyers in any way not related to advocacy skills or experience, dangerously skews the client's perspective. Fostering unreasonable expectations may help sign up clients today, but, over the long term, always generates a net loss. Often, the reasonableness of a client will reflect the reasonableness of the attorney counseling them.

5. Motive. The lawyer must determine whether the prospective client's motives for resorting to the justice system to resolve their dispute comports with the lawyer's sense of what's right. This aspect of client evaluation is intertwined with veracity, litigiousness, and reasonableness, but do not necessarily correlate with them. For example, a client may have pure motives, but might still lie to the attorney in order to accomplish their goals, or force the attorney to try the case, or make unreasonable demands on the attorney's time. Conversely, a client may be honest, conscientious, and reasonable, but may be inappropriately seeking legal redress. A client with proper motives will not necessarily be good or bad, but a client with improper motives will create an ethical problem with regards to representation, so ascertaining a client's motives is an essential part of the evaluation process.

6. Influence. The lawyer must determine whether the prospective client is subject to the influence of an extrinsic source, such as their spouse (current or former) or parents. Not all extrinsic influences are detrimental, but they have the potential to complicate the attorney-client relationship. The attorney owes a duty to the client themself, and if that client's perspectives and decisions are controlled by someone to whom the attorney owes no duty, it may prove difficult for the attorney to protect the client's interests. This difficulty is especially pronounced when the person influencing the client is active in communicating with and instructing the attorney. These situations are further complicated when that person is also funding the litigation, and the responsibility the lawyer may feel they owe to the person paying their bill may conflict with the actual duty the lawyer owes to the client.

7. Financial Ability. Finally, the lawyer must determine whether the prospective client has sufficient resources to fund the litigation. While it is impossible for a lawyer to estimate their total fees for any particular case, experience provides a gauge by which the lawyer may make a general, tentative, abstract estimate of what different types of litigation can cost. Overestimating is always better than underestimating, but it becomes very difficult to manage a client's expectations when they are left to make their own inexperienced, uneducated guess about how much they may have to pay. Furthermore, while it seems obvious to lawyers, some clients do not realize that often, the total fees will exceed the amount of the retainer. The lawyer must not only determine whether the client has the financial ability to pay fees throughout the duration of the case, but must also advise the client on the extent of the financial commitment they are making.

III. USING SPARE TIME. When the economy slows down and the influx of clients decreases, a lawyer may be faced with more free time than s/he has in the past. However, non- billable time need not be wasted or unproductive time.

A. Marketing and Networking. Many of the techniques described in section II.K.1. *supra* for marketing can be pursued when there is a dearth of client work to do. Also, additional free time can be used to maintain social contacts within an attorney's referral network.

B. Continuing Education. If you don't have enough work to fill your entire day, you can take part of that time and put it into continuing education–either learning or teaching and writing. Maybe you'd like to get comfortable writing and probating wills. Maybe you could learn the skills to represent a friend who has a business. There are also various writing opportunities. Local bar associations typically have a newsletter with some CLE content. The Family Law Section report is always in need of good articles.

There are local bar committees, State Bar Committees, and ABA Committees. Serving on committees can be very informative and rewarding. You get out of a committee in proportion to what you put into it. If you show up at committee meetings with no preparation and don't volunteer for any projects, you may as well not be on the committee. If you work on projects and show up prepared, you may develop both friendships and referral sources.

If you would like to start giving CLE speeches, find out from the State Bar of Texas or law schools who the course directors are for the upcoming courses, and send them a letter advising them of your interest and providing a resume and maybe even an example of a past article you have written. Local bars are another place to develop CLE skill and experience.

If you work for a lawyer or law firm with ties to CLE, they can promote your inclusion on a course faculty. If you don't, you will have to do something to come to the attention of people who plan courses, be they course directors or planning committee members. Maybe your law school alma mater will give you your first state-wide speech. Maybe a local bar family law section will get you started with local CLE, and somebody hears you talk and suggests your name at a planning meeting. Maybe working on a committee with someone with CLE ties will get your name advanced as a recruit. Every planning committee is looking for some "new faces."

C. Other Activities. Other activities that can be rewarding when there is not much work to do include spending increased time with family and friends, concentrating on personal health and fitness, being active in a religious community, focusing on personal growth, doing pro bono or committee work, enjoying recreational activities, and participating in politics or other civic pursuits.

IV. CONTROLLING LITIGATION COSTS. Reducing litigation costs leaves the client with more money to pay attorneys' fees. Delegating tasks to lower- priced professionals outside your office reduces the amount of legal work you need to be paid for. When it comes to case preparation, buying a Ford instead of a Ferrari may be the best investment of your client's litigation dollars.

A. Written Discovery & Depositions. Depositions can be costly and time-consuming, and much of the information derived from them may *be* discovered more efficiently through less expensive means. In lieu of depositions, an attorney can tailor broad interrogatories and requests for disclosure, which will compel the opposing party to reveal the essential components of their position and legal theories. An attorney can also economize discovery by crafting thorough, yet precise, requests for production.

B. Mental Health Experts. The State of Texas licenses social workers, marriage and family therapists (MFT), professional counselors (LPC), master's-level psychologists ("psychological associates"), doctorate-level psychologists, psychiatrists, and other health care professionals. Each of these professionals can be an expert witness in a family law case, and each will charge within a different range of fees. Thus, the available financial resources of the client, as well as the particular issues of the case, will determine which type of professional would be an appropriate expert witness.

1. Social Workers. Chapter 505 of the Occupations Code governs social workers. According to Section 505.0025, "the practice of social work is the application of social work theory, knowledge, methods, ethics, and the professional use of self to restore or enhance social, psychosocial, or biopsychosocial functioning of individuals, couples, families, groups, organizations, or communities." The practice of social work "may include the provision of individual, conjoint, family, and group psychotherapy using the Diagnostic and Statistical Manual of Mental Disorders, the International Classification of Diseases, and other diagnostic classification systems in assessment, diagnosis, treatment, and other activities by a person licensed under this chapter." Under the statute, "social worker" means a person who holds any license issued by the board under Chapter 505, and includes a "licensed baccalaureate social worker," "licensed clinical social worker," "licensed master social worker," and "licensed social worker." Tex. Occ. Code § 505.002.

2. Marriage and Family Therapists. Chapter 502 of the Occupations Code governs marriage and family therapy, which means "providing professional therapy services to individuals, families, or married couples, alone or in groups, that involve applying family systems theories and techniques. The term includes the evaluation and remediation of cognitive, affective, behavioral, or relational dysfunction in the context of marriage or family systems." Tex. Occ. Code § 502.002. A "licensed marriage and family therapist" is a person who offers marriage and family therapy for compensation. A "licensed marriage and family therapist associate" is someone who offers to provide marriage and family therapy for compensation under the supervision of a board-approved supervisor.

3. Professional Counselors. Chapter 503 of the Occupations Code, the "Licensed Professional Counselor Act, governs the licensing of LPCs. Section 503.003 defines the "practice of professional counseling" to mean "the application of mental health, psychotherapeutic, and human development principles to: (1) facilitate human development and adjustment throughout life; (2) prevent, assess, evaluate, and treat mental, emotional, or behavioral disorders and associated distresses that interfere with mental health; (3) conduct assessments and evaluations to establish treatment goals and objectives; and (4) plan, implement, and evaluate treatment plans using counseling treatment interventions that include: (A) counseling; (B) assessment; (C) consulting; and (D) referral. The terms in this definition are themselves given a special meaning in the statute. "The term [assessment] does not include the use of standardized projective techniques or permit the diagnosis of a physical condition or disorder." Tex. Occ. Code §503.003(b)(1). Thus, LPCs can administer the MMPI, but not the Rorschach, the Thematic Apperception Test, or a sentence completion test.

4. Psychologists. The licensing of psychologists is governed by Chapter 501 of the Occupations Code. According to Section 501.003, the practice of psychology (1) encompasses providing or offering to provide services to an individual or group, including providing computerized procedures, that include the application of established principles, methods, and procedures of describing, explaining, and ameliorating behavior; (2) addresses normal behavior and involves evaluating, preventing, and re-mediating psychological, emotional, mental, interpersonal, learning, and behavioral disorders of individuals or groups, as well as the psychological disorders that accompany medical problems, organizational structures, stress, and health; (3) includes: (A) using projective techniques, neuropsychological testing, counseling, career counseling, psychotherapy, hypnosis for health care purposes, hypnotherapy, and biofeedback; and (B) evaluating and treating mental or emotional disorders and disabilities by psychological techniques and procedures; and (4) is based on: (A) a systematic body of knowledge and principles acquired in an organized program of graduate study; and (B) the standards of ethics established by the profession. As distinguished from LPCs, psychologists can administer both objective and subjective psychological tests. A psychological associate (PA) is a licensed practitioner who holds a master's degree from an accredited university or college in a program that is primarily psychological in nature. *Id §* 501.259. A PA must practice under the supervision of a licensed psychologist.

5. Psychiatrists. Psychiatrists are medical doctors who specialize in the treatment, study and prevention of mental disorders. Medical Doctors are governed by Chapters 151-160 of the Occupations Code. Section 155.003 requires American-educated medical licensees to complete 60 hours of undergraduate education acceptable to the University of Texas toward a BA or BS degree, plus medical school. (Applicants educated in other countries have other requirements.) In addition to conducting testing and counseling as psychologists may do, psychiatrists may prescribe psychiatric medication, conduct physical examinations, and order and interpret laboratory tests, including computed tomography (CT) or computed axial tomography (CAT), and magnetic resonance imaging (MRI).

C. Financial Experts. The same principle that governs the use of mental health experts in a family law case applies to the various strata of financial experts. While these different levels of training and expertise are not as clearly delineated, there are a variety of financial experts who are qualified to testify at trial, including an entity's bookkeeper, the client's personal accountant, and forensic accountants.

D. Alternate Forms of Tracing. Line-item tracing of commingled funds is probably the most costly forensic expense in a divorce. There are alternate forms of tracing, recognized by Texas case law, that trace at an aggregate level, and can save a lot of accounting fees. An especially cost-effective form of tracing commingled funds is the family expense method. Alternative forms of tracing are discussed in Richard Orsinger's Tracing Workshop Article elsewhere in this coursebook.

E. Mediation. With regards to minimizing the costs of litigation, mediation is often a very effective tool. However, determining the proper time for mediation requires care; an attorney must balance the cost-reducing aspects of mediating a case early against the fact that all cases require some time for the central issues of contention to crystalize. Conversely, mediating too late can negate much of the expense-saving incentive to settle.

F. Arbitrating Specific Issues. In certain situations, arbitrating the specific contested issues can help reduce costs. If the parties agree on most issues and only dispute a select few, the parties can agree to resolve them through arbitration in lieu of trying the whole case in court. In addition, impasses in settlement negotiations can also sometimes be resolved through arbitration; the ability to continue negotiating a settlement after the resolution of those issues by the arbitrator is a feature that distinguishes this method from seeking a determination in court.

V. PERSONAL LIABILITY. Liability can be divided into contractual or quasi- contractual liability, on the one hand, and tortious liability, on the other. All liability is either direct or vicarious.

A. Direct Liability. A person is directly liable if they are held responsible for his own acts, whether it is breaching a contract or committing a tort. If liability is established, then the injured party can collect their damages from all of the defendant's non-exempt property. Acts can trigger statutory liability as well, such as when the spouses sign a joint federal income tax return, and each becomes jointly and severally for any tax liabilities for the taxable year. I.R.C. § 6013(d). *See In Re Hollis,* 7 Tex. Fam. Law Rptr. 303 (May 1990).

B. Vicarious Liability. One person can be held liable for the wrongful acts of another in situations of vicarious liability. Various legal principles exist which establish vicarious liability, including respondeat superior, agency, partnership/joint venture, joint adventure, conspiracy and disregarding the corporate fiction, to name a few. These are discussed below. For an example, see *Traweek v. Larkin,* 708 S.W.2d 942 (Tex. App.--Tyler 1986, writ ref d n.r.e.) (tort victim unsuccessful in seeking to impose personal liability on wife for tortious act of husband). There are also special rules of vicarious liability for the acts of family members.

1. Liability for Necessaries. Spouses and parents in Texas are affected by a special statute, section 2.501(a) of the Texas Family Code, which gives each spouse the duty to support the other spouse, and gives each parent the duty to support their children. Section 2.501(b) provides that "a spouse or parent who fails to discharge the duty of support is liable to any person who provides necessaries to those to whom support is owed." Tex. Fam. Code § 2.501.

2. Vicarious Liability for Acts of Other Spouse. There are situations where one spouse might be vicariously liable for the acts of the other spouse. There are also situations where the other spouse can suffer an adverse judgment for which the first spouse is not *personally* liable, but where community property assets can be taken to satisfy the judgment. In *State Farm Lloyds, Inc. v. Williams,* 791 S.W.2d 542, 548 (Tex. App.--Dallas 1990, writ denied), the court wrote that a judgment against a spouse's interest in community property, where that spouse is not personally liable, is really a judgment in rem against community property assets. *Id.* at 542.

In addition to the ordinary legal bases for imposing vicarious liability upon someone not directly liable in tort or contract, under one Supreme Court decision spouses have a special basis for vicarious contractual liability for the acts or omissions of the other spouse.

3. The *Cockerham* Case. In the case of *Cockerham v. Cockerham,* 527 S.W.2d 167 (Tex. 1975), a majority of the Supreme Court joined in an opinion which spoke of "a joint liability" of spouses. The majority opinion in *Cockerham* appeared to announce a rule of vicarious liability between spouses which was different from the rules of vicarious liability between non-spouses. Three justices dissented.

Absent some rule of law to the contrary, when a person acts he creates liability (if at all) only for himself. Where the person is married, he may also subject his spouse's interest in certain community property to liability. But even so, the acts of one spouse do not ordinarily create personal liability for the other spouse. In some situations, however, a liability incurred by one spouse can also be a liability of the other spouse. For example, under section 2.501 of the Family Code, a spouse who fails to discharge his duty of support is liable to any person who provides necessaries to his spouse. Tex. Fam. Code § 2.501; *see also Gabel v. Blackburn Oper. Corp.,* 442 S.W.2d 818, 820 (Tex. App.--Amarillo 1969, no writ). If the spouses are general partners, they are jointly and severally liable for debts of the partnership. If one spouse is acting as agent for the other, the other spouse may be liable under the principles of agency. Interspousal relationships that can give rise to joint tortious liability are examined in Orsinger, Intra and Inter Family Transactions, State Bar of Texas Advanced Family Law Course J-2 –5 (1983).

However, the majority opinion in *Cockerham* appeared to soften the normal requirements for vicarious liability where spouses are concerned. According to the Court's majority, the question of whether a debt is a debt of only the contracting spouse or is instead a debt of both spouses is to be determined by examining "the totality of the circumstances in which the debt arose." Id. at 171. Of "particular importance" in *Cockerham* was evidence that the non-contracting husband had given "implied assent" to his wife's incurring debts in connection with her dress shop. The fact that the husband acquiesced in the wife's operation of a dress shop, and received the benefit of business losses on a joint tax return, and a few other factors, were sufficient for a majority of the Court to find personal liability on the part of the husband. Three judges dissented, arguing that, except for necessaries of the other spouse, a non-contracting spouse should be liable "only to the extent and under the same rules of law that would make a non-family party liable." *Id.* at 175 (J. Reavley, dissenting). *See also Humphrey v. Taylor,* 673 S.W.2d 954 (Tex. App.--Tyler 1984, no writ) (source of repayment contemplated by the creditor, as well as the other spouse's attitude toward the debt, indicates whether the debt is joint or not).

a. Family Code Section 3.201, on Spousal Liability. Texas Family Code Section 3.201 relates to the liability of spouses:

(a) A person is personally liable for the acts of the person's spouse only if:

(1) the spouse acts as an agent for the other person; or

(2) the spouse incurs a debt for necessaries as provided by [Section 2.501].

(b) Except as provided by this subchapter, community property is not subject to a liability that arises from an act of a spouse.

(c) A spouse does not act as an agent for the other spouse solely because of the marriage relationship.

Tex. Fam. Code § 3.201.

Section 3.201 appears to eliminate any possibility that a different rule of vicarious personal liability exists for spouses than for persons who are not married to each other. Under Section 3.201, a spouse is only liable for the acts of the other spouse if the rule of necessaries comes into play, or if an agency relationship exists between the spouses. The statute indicates that the marriage relationship does not, of itself, make one spouse the agent of the other. In the Authors' estimation, Section 3.201 confirms into law the reasoning of the dissenters in *Cockerham.*

See State Farm Lloyds, Inc. v. Williams, 791 S.W.2d 542, 547-49 (Tex. App.--Dallas 1990, writ denied), for a discussion of this statute. A trial court was reversed for refusing to give an instruction based on the predecessor statute to section 3.201 in conjunction with a suit wherein the creditor of a man sued to have his ex-wife declared jointly and severally liable on her former husband's debt. *Carr v. Houston Business Forms, Inc.,* 794 S.W.2d 849 (Tex. App.--Houston [14th Dist.] 1990, no writ).

4. Parental Liability for Acts of Child. Under Chapter 41 of the Family Code, a parent (or person having the duty to control and discipline the child) is liable for property damage proximately caused by the negligent conduct of his child, if the child's conduct is reasonably attributable to the failure of the parent (or person with the duty of control) to exercise control. Tex. Fam. Code § 41.001(1). Liability also exists for property damage proximately caused by the wilful and malicious conduct of a child at least 10 but under 18 years of age. Tex. Fam. Code § 41.001(2). Liability is capped, however, at $25,000.00 per act, plus court costs and attorney's fees. Tex. Fam. Code §41.002.

VI. MARITAL PROPERTY LIABILITY. Texas' rules of marital property liability are set out in Family Code Section 3.202. Published appellate opinions reflect that lawyers and judges who understand these concepts when stated abstractly have difficulty applying these concepts practically to particular fact situations. In some instances this difficulty appears to result from a failure to distinguish the concept of "community credit" from the concept of "marital property liability." *See* McKnight, *Annual Survey of Texas Family Law,* 37 Sw. L.J. 65, 77 (1983), *quoted in Latimer v. City National Bank of Colorado City,* 715 S.W.2d 825, 827 (Tex. App.--Eastland 1986, no writ). In other instances this inability appears to be a consequence of the desired result controlling the legal reasoning.

A. What's Liable for What? Family Code Section 3.202 provides:

(a) A spouse's separate property is not subject to liabilities of the other spouse unless both spouses are liable by other rules of law.

(b) Unless both spouses are personally liable as provided by this subchapter, the community property subject to a spouse's sole management, control, and disposition is not subject to:

(1) any liabilities that the other spouse incurred before marriage; or

(2) any nontortious liabilities that the other spouse incurs during marriage.

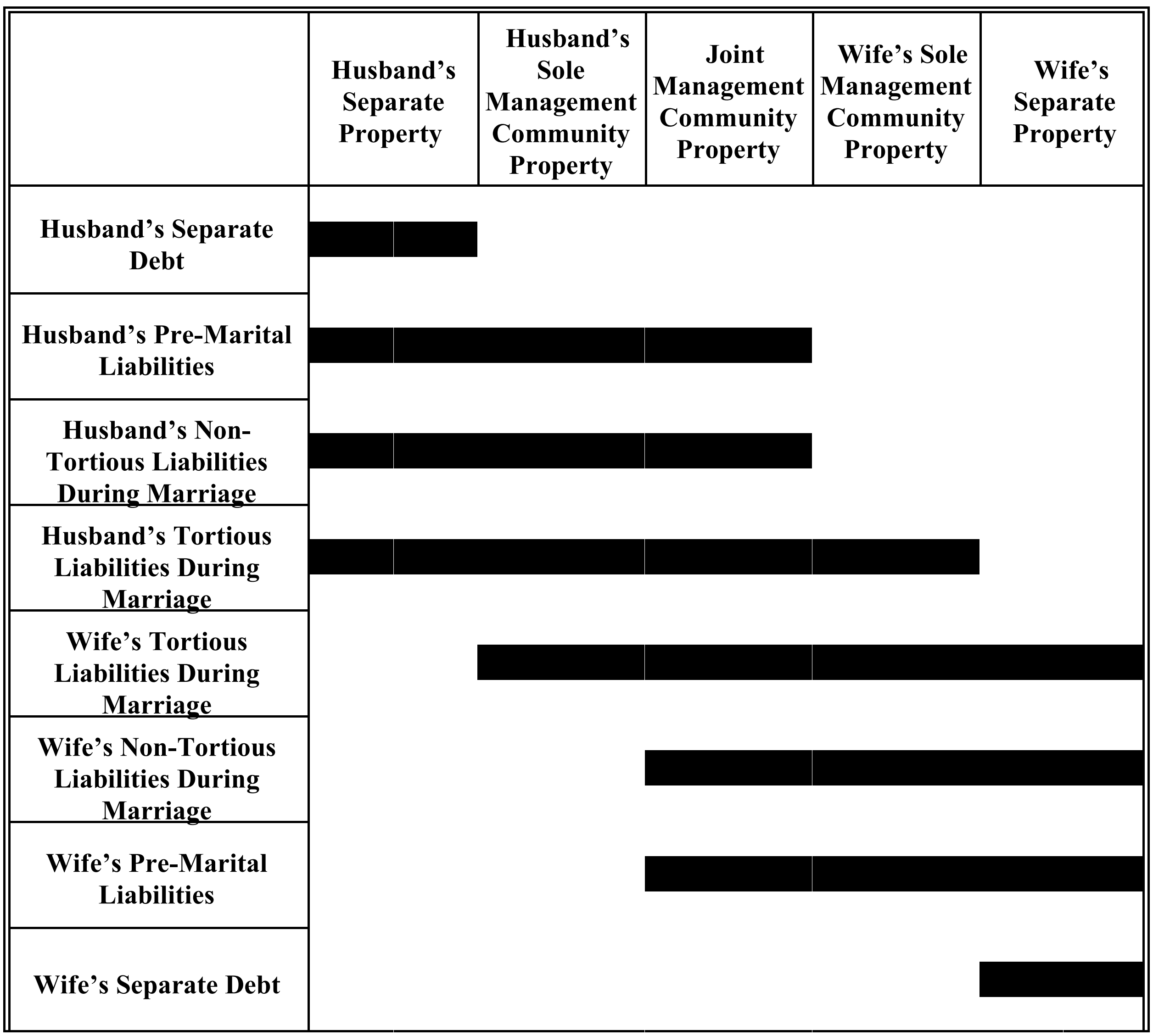
(c) The community property subject to a spouse's sole or joint management, control, and disposition is subject to the liabilities incurred by him or her before or during marriage.

(d) All the community property is subject to tortious liability of either spouse incurred during marriage.

Tex. Fam. Code § 3.202.

B. Joint and Sole Management Community Property. Family Code Section 3.102 describes community property which is subject to the sole management, control, and disposition of a spouse, and that which is subject to joint management. A spouse's sole management community property consists of community property which would belong to one spouse alone were there no marriage. Community property changes from sole management to joint management when the other spouse comes to share control of the property. If husband's sole and wife's sole management community property are mixed, the mixture is joint management community property. The general rules can be altered by agreement of the spouses.

C. Visualizing the Rule of Marital Property Liability. The rules of marital property liability can most easily be demonstrated by a diagram. The diagram on the next page shows which categories of the property owned by married persons are subject to which kinds of claims. The husband's pre-marital liabilities can be collected from his separate property, and his sole management community and joint management community property, but not from the wife's sole management community property and not from the wife's separate property. The husband's non-tortious liabilities incurred during marriage can be collected from his separate property, his sole management community property, and the joint management community property, but not the wife's sole management community property and not the wife's separate property. Tortious liabilities of the husband incurred during marriage can be collected from the husband's separate property, his sole management community property, his joint management community property, and the wife's sole management community property, but not the wife's separate property. The converse is true for the wife. A joint liability, being a personal liability of each spouse individually, can be collected from both spouses' non-exempt property, be it separate or community.



Join Liabilities of the Spouses

It should be noted that the ordinary rule set out in section 3.202(c)–that the community property subject to a spouse's sole or joint management, control, and disposition is subject to the liabilities incurred by that spouse before or during marriage–is not true in instances where a creditor has contracted away the right to seek recovery from community property. For example, a "no recourse" note can be collected only out of the collateral and not out of the borrowing spouse's sole or joint management community property. A "separate property debt" (i.e., where the creditor has agreed to look solely to the borrowing spouse's separate estate for repayment) cannot be collected out of community property.

D. Case Law. *Nelson v. Citizens Bank and Trust Co. of Baytown, Tex.,881* S.W.2d 128 (Tex. App.--Houston [1 Dist.] 1994, no writ), addressed the issue of whether one spouse could be personally liable for a debt personally guaranteed by the other spouse. Husband personally guaranteed a note executed by his separate corporation with Citizens Bank, and both Husband and Wife executed a note with that same bank at the same time. *Nelson,* 881 S.W.2d 128-29. Both notes were secured by deeds of trust on corporate realty and a ranch owner by the spouses. *Id.* The corporation defaulted on its note, and Husband and Wife defaulted on their note. *Id.* at 129. During subsequent litigation, the trial court held that Wife was personally liable on the corporate note personally guaranteed by Husband, and Wife appealed. *Id.*

Relying on the predecessor to Family Code Section 3.202, the court wrote "either spouse can incur contractual liability that will bind the share of the non- contracting spouse's community property subject to the sole or joint control of the contracting spouse, but the non-contracting spouse is not 'personally liable' for the obligation." *Id.* at 131 *(citing* Joseph W. McKnight, *Family Law: Husband and Wife,* 45 Sw.L.J. 415, 424 (1991)). The court distinguished *Cockerham* by pointing out that, unlike the spouse in that case, Wife had no actual involvement in Husband's business. *Id.* Thus, the court held that a spouse cannot be held personally liable for a corporate debt guaranteed only by the other spouse based solely on the marriage relationship and community property laws, but a non-signing spouse's interest in joint management and control community property is subject to execution to satisfy the debt. *Id.* at 128.

The case of *Latimer v. City Nat. Bank of Colorado City,* 715 S.W.2d 825 (Tex. App.--Eastland 1986, no writ), also demonstrates marital property liability. There, Husband, but not Wife, signed a promissory note. The creditor sued both spouses. The Court of Appeals held that Wife was not personally liable on the note, but that nonexempt community property was subject to execution to pay the note. The Court of Appeals was right in holding that Wife was not personally liable on the note, but wrong in failing to protect Wife's sole management community property.

The cases of *LeBlanc v. Waller,* 603 S.W.2d 265, 268 (Tex. Civ. App.--Houston [14th Dist.] 1980, no writ), and *Humphrey v. Taylor,* 673 S.W.2d 954, 956 (Tex. Civ. App.--Tyler 1984, no writ), relate to the question of whether an admittedly community liability is a personal obligation of both the contracting spouse and the non-contracting spouse, or whether it is a personal liability of only the contracting spouse. Again, the issue in those cases was not the question of whether the debt was separate or community.

The determination of the character and management rights of property can be made by the intervention in the divorce by a judgment creditor seeking a turnover order and declaratory judgment. *Owens v. Porter,* 796 S.W.2d 265 (Tex. App.--San Antonio 1990, no writ); *see also Brooks v. Sherry Lane National Bank,* 788 S.W.2d 874 (Tex. App.--Dallas 1990, no writ) (intent of spouses that property be one spouse's separate property is not determinative for the purposes of characterizing bank accounts to be garnished if other facts make the character community).

E. Recap. To recapitulate: under Texas marital property law, Spouse #2 does not automatically become *personally* liable for debts contracted during marriage by Spouse #1. Debts contracted for during marriage by Spouse #1 can be collected from Spouse #1's separate property, and from his sole management community property, and from the joint management community property. Such debts cannot, however, be collected from Spouse #2's sole management community property, or from Spouse #2's separate property, unless Spouse #2 is personally liable for the debt. *LeBlanc* and *Humphrey* deal with the question of whether the non-contracting spouse's sole management community property or separate property was liable for contractual debts incurred during marriage by the other spouse. Both cases said "no." The courts in both of those two cases recognized that the liability was a community liability, since there was no agreement from the lender to look solely to the borrowing spouse's separate estate for repayment. But since the other spouse was not personally liable on the debt, it could not be collected out of the other spouse's separate property or sole management community property. Tort claims arising before marriage can be collected from the tortious spouse's separate property and sole management community property and from joint management community property. Tort claims arising during marriage can be collected from the tortious spouse's separate property and all non-exempt community property.

F. Presumption Regarding Management Powers. Section 3.104 of the Family Code provides certain presumptions regarding management powers over marital property which can effect what property is liable for a creditor's claim. Property is presumed to be subject to a spouse's sole management and control if it is held in the spouse's name (for titled assets) or in the spouse's possession (for non-titled assets). Tex. Fam. Code § 3.104(a). A third person dealing with a spouse is entitled to rely on that spouse's authority to deal with property which is presumptively in that spouse's sole management and control, and the third person is not a party to a fraud on the other spouse, and does not have actual or constructive notice of the spouse's lack of authority to deal with the property. Tex. Fam. Code § 3.104(b).

G. Agreement Affecting Management Powers. Texas Family Code Section 3.102(c) authorizes spouses to enter into agreements regarding management rights over their property. In *LeBlanc v. Waller,* 603 S.W.2d 265, 267 (Tex. Civ. App.--Houston [14th Dist.] 1980, no writ), The Court found and enforced an oral agreement between spouses that all community property in Wife's control since marital separation was subject to her sole management and control. In *Brooks. v. Sherry Lane Nat. Bank,* 788 S.W.2d 874, 877 (Tex. App.--Dallas 1990, no writ), such a claimed oral agreement was deemed superceded when the spouses opened an account where the spouses had joint right of control.

H. Joinder of the Spouse. The Texas Supreme Court has ruled that a judgment from joint management community property. A judgment against one spouse can be collected out of joint management community property even where the other spouse was not joined as a party. In *Carlton v. Estate of Estes,* 664 S.W.2d 322 (Tex. 1983). The Supreme Court did not say that the creditor could dispense with joinder of the non-liable spouse where the creditor is a tort claimant seeking to collect from non- liable spouse's sole management community property. However, the San Antonio Court of Appeals has held that a non-liable spouse's interest in *all* community property can be reached by a tort creditor of the other spouse, even without joinder of the non-liable spouse in the lawsuit. *Lawrence v. Hardy,* 583 S.W.2d 795, 799 (Tex. Civ. App.--San Antonio 1979, writ red n.r.e.).

VII. SEPARATE VERSUS COMMUNITY CREDIT. Apart from the rules governing liability of marital property are the rules governing the *characterization* of debt as separate or community. The determination of the character of a debt does ***not*** control whether one or both spouses are personally liable for the debt. Rather, it controls whether the proceeds from the loan, or an asset purchased on credit, are separate or community property. Under Texas law, property acquired by community credit, or with funds borrowed on community credit, is itself community property. *Gleich v. Bongio,* 99 S.W.2d 881 (Tex. 1937).

A. General Principles. The Texas Family Code does not specify when a debt is a separate debt and when it is a community debt. Under the case law, "debts contracted during marriage are presumed to be on the credit of the community and thus are joint community obligations,[1] unless it is shown the creditor agreed to look solely to the separate estate of the contracting spouse for satisfaction." *Cockerham v. Cockerham,* 527 S.W.2d 162, 171 (Tex. 1975). The mere intent of the spouses does not control whether the credit is community or separate. *Gleich v. Bongio,* 128 Tex. 606, 99 S.W.2d 881 (1937). Some courts of appeals have taken a liberal view of what constitutes proof of an agreement by the creditor to look solely to the borrowing spouse's separate estate for repayment. For example, in *Brazosport Bank of Texas v. Robertson,* 616 S.W.2d 363, 366 (Tex. Civ. App.--Houston [14th Dist.] 1981, no writ), the court held that the bank's loan of money to the wife over the husband's objection, where the note was signed by the wife alone and the title to the automobile taken in the wife's name alone, constituted an agreement by the lender to look to the wife alone for satisfaction of the debt. *See also Holloway v. Holloway,* 671 S.W.2d 51, 57 (Tex. App.--Dallas 1983, writ dism'd), where an implied agreement on the part of a creditor to look solely to Husband's separate estate was construed from the fact that the loan proceeds were deposited into an account designated as Husband's separate property account, and the fact that Husband alone signed the loan papers "Pat S. Holloway, Separate Property," and the fact that only Husband's separate property was used a collateral. *Compare with Broussard v. Tian,* 295 S.W.2d 405 (Tex. 1956), where evidence that the down payment for land was made with Husband's separate property, that all payments on the note secured by the land were also made with Husband's separate property, that the deed ran to Husband alone, that Husband alone signed the note and deed of trust, that the spouses were separated at the time of the transaction, and that the banker and Husband discussed payment of the note with Husband's separate property royalty income, was held legally insufficient (i.e., no evidence) to support a jury finding of an agreement that the note would be paid out of the husband's separate estate.

B. Significance of Separate Versus Community Debt. A separate debt is, by definition, collectible only out of the borrowing spouse's separate estate. A community debt is collectible in accordance with the ordinary rules of marital property liability. *See* Tex. Fam. Code § 3.202.

VIII. CREDITORS AND DEBTORS.

A. Effect of Divorce on Creditors' Rights. A divorce decree does not diminish or limit the

[1] The Opinion's statement that community debts are "joint obligations" was regrettable and has needlessly confused the law in this area.

rights of creditors to go against what was previously marital property to satisfy debts. *Stewart Title Co. v. Huddleston,* 598 S.W.2d 321, 323 (Tex. Civ. App.--San Antonio 1980), *aff'd,* 608 S.W.2d 611 (Tex. 1980) (per curiam); *Rush v. Montgomery Ward,* 757 S.W.2d 521, 523 (Tex. App.--Houston [14th Dist.] 1988, writ denied); *Anderson v. Royce,* 624 S.W.2d 621, 623 (Tex. App.--Houston [14th Dist.] 1981, writ ref d n.r.e.); *Inwood National Bank of Dallas v. Hoppe,* 596 S.W.2d 183, 185 (Tex. Civ. App.--Texarkana 1980, writ ref d n.r.e.); *Dorfman* v. *Dorfman,* 457 S.W.2d 417, 423 (Tex. Civ. App.--Texarkana 1970, no writ). This issue was discussed in *Wileman v. Wade,* 665 S.W.2d 519 (Tex. App.--Dallas 1983, no writ), where the panel majority appears to have misunderstood the distinction between community property liability and personal liability.

B. No Imprisonment for Debt in Texas. The Texas Constitution provides that a person cannot be incarcerated for failing to pay a debt. Tex. Const. art. I § 18. The judiciary has respected this stricture. *See e.g., Ex parte Yates,* 387 S.W.2d 377 (Tex. 1965). Child support and court-ordered maintenance are not deemed to be a "debt" within the scope of this constitutional bar.

C. Property Exempt from Creditors' Claims. Both state law and federal law protect some properties from seizure to pay debts.

1. Protection Under Texas Law. Texas law protects the following categories of property from the claims of unsecured creditors:

1. Homestead.
2. Particular types of personalty totaling no more than $30,000 for an individual or $60,000 for a family. Tex. Prop. Code §§ 42.001(a), 42.002.
3. Current wages and unpaid commissions up to 25% of the $30,000/$60,000 limits. Tex. Prop. Code §§ 42.001(b)(1), (d).
4. Health aids. Tex. Prop. Code § 42.001(b)(2).
5. Alimony and child support. Tex. Prop. Code §42.001(b)(3).
6. Worker's comp. Tex. Rev. Civ. State. Ann. art. 8306, §§ 3(b), 8a.
7. Cemetery lots. Tex. Prop. Code § 42.001.
8. Property held in a spendthrift trust for the benefit of the judgment debtor. *Hines v. Sands,* 312 S.W.2d 275 (Tex. Civ. App.--Fort Worth 1958, no writ).
9. Insurance benefits.
10. Retirement benefits and HSA's.
11. College Savings Plans. Tex. Prop. Code §42.0022.
12. Artwork on Consignment.

For a more exhaustive list of exemptions and the authority underlying them, see Petrocchi, Mark J., <u>Exempt Property: Or, No Property is Safe While the Legislature is in Session,</u> Collections Practice Course (2003) at 9, 11-18.

a. Homestead Protection. Chapter 41 of the Property Code governs the homestead's exemption from seizure. *See* Tex. Prop. Code § 41.001, et seq. Texas has long been known for its laws relating to the homestead. Historians have observed that many of the politicians of the nation, and later the state, of Texas were men who had fled civilized areas of the United States to escape problems with creditors. When these fugitives from commerce fashioned a set of laws to govern Texas, they built into the constitution a number of restrictions upon creditors' ability to recover their debts. The homestead protection was one such restriction.

However, the laws relating to homestead go beyond debtor-creditor relations. Texas law places a number of restrictions on a spouse's or parent's ability to deal with the homestead. A spouse's homestead interest is also protected against the claims of heirs. Furthermore, Texas recognizes a homestead right as an asset, quite apart from ownership rights in the underlying property, which is subject to division in a divorce.

i. Definition of Homestead. A "homestead" is an estate in land, not just a privilege of exemption or possession. *Andrews v. Security Nat. Bank of Wichita Falls,* 121 Tex. 409, 50 S.W.2d 253, 256 (1932); *Villarreal v. Laredo Nat. Bank,* 677 S.W.2d 600, 607 (Tex. App.--San Antonio 1984, no writ). The homestead right does not depend upon unqualified fee ownership of the land. *Villarreal,* 677 S.W.2d at 606; *Gann v. Montgomery,* 210 S.W.2d 255, 258 (Tex. Civ. App.--Fort Worth 1948, writ ref d n.r.e.). The homestead right is akin to a life estate. *Sparks v. Robertson,* 203 S.W.2d 622 (Tex. Civ. App.--Austin 1947, writ ref d), except that a homestead interest can be abandoned.

The Texas Constitution differentiates between rural and urban homesteads based on whether or not the land is in a town or city. Tex. Const. art. XVI, § 51. The former may comprise no more than 200 acres of land for a family or 100 for an individual, while the latter may comprise no more than 10 acres. *Id.;* Tex. Prop. Code § 41.002(a), (b). A person may not claim both a rural and urban homestead. *Ran v. City National Bank,* 272 S.W. 510, 515 (Tex. Civ. App.--Fort Wroth 1925, writ dism'd). Urban homesteads may be used as a home, or for the claimant's business. Property Code section 41.002(c) provides the means for determining whether property is rural or urban:

(c) A homestead is considered to be urban if, at the time the designation is made, the property is:

(1) located within the limits of a municipality or its extraterritorial jurisdiction or a platted subdivision; and

(2) served by police protection, paid or volunteer fire protection, and at least three of the following services provided by a municipality or under contract to a municipality:

(a) electric;
(b) natural gas;
(c) sewer;
(d) storm sewer; and
(e) water.

Some courts interpret this statute to raise a presumption that property that fulfills these criteria is urban, but that other factors may still render the property rural, while other courts consider Section 41.002(c) the sole means for determining the nature of a homestead. *Compare In re Perry,* 267 B.R. 759 (W.D. Tex. 2001), *with In re Bouchie,* 324 F.3d 780 (5th Cir. 2003).

ii. Acquisition of Homestead. The following rules apply to the acquisition of a homestead interest in land under Texas law.

(A) Homestead Requires Some Interest in Land. Homestead can adhere only to some title or interest in land. *Villarreal v. Laredo Nat. Bank,* 677 S.W.2d 600, 606 n. 3 (Tex. App.--San Antonio 1984, no writ). However, fee simple ownership in the land is not required. *Id* at 606. Sufficient interests include tenancyin-common, tenancy-at-will, and a right of present possession. *Id* at 606 n. 3. In *Villarreal,* the provision in the decree of divorce allowing Wife "use and occupancy" of the house until the youngest child turned 18 was a sufficient interest to support a homestead claim for the wife, as against a creditor, even though ownership of the house was awarded by the decree of divorce to Husband.

(B) When Homestead Right Arises. A homestead right arises upon the intention of a person to use the premises for homestead purposes, coupled with occupancy or some overt act of preparing to occupy the premises for that purpose. *Kostelnik v. Roberts,* 680 S.W.2d 532, 536 (Tex. App.--Corpus Christi 1984, writ ref d n.r.e.); *Davis v. McClarken,* 378 S.W.2d 358, 360 (Tex. Civ. App.--Eastland 1954, no writ).

(C) Designation of Homestead. The owner's having designated or not designated the property as homestead for property tax purposes is not controlling. *Dodd v.Harper,* 670 S.W.2d 646 (Tex. App.--Houston [1st Dist.] 1983, no writ). Such designation, or the lack thereof, is merely one evidentiary factor to consider on the ultimate question, which is whether the claimant intended to make the property his homestead.

(1) Forcing Designation. The Property Code provides a way for a creditor to require a person to declare a homestead. Where execution is issued against someone who holds land which might be homestead, the judgment creditor can give the judgment debtor notice to designate homestead. The notice must state that upon failure of the debtor to designate a homestead, the court will appoint a commissioner to make such a designation, at the debtor's expense. Tex. Prop. Code § 41.021. The debtor has until 10:00 a.m. on the Monday following the twentieth day after service of notice to designate his homestead, by filing a written designation with the court issuing writ of execution. The designation must include a plat. Tex. Prop. Code § 41.022. If the debtor fails to do so, then on motion of the judgment creditor filed within 90 days of issuance of execution, the court issuing execution must appoint a commissioner, together with a surveyor and others whose assistance is needed. Tex. Prop. Code §41.023(a). The commissioner is to file his designation, and plat, on behalf of the judgment debtor, within 60 days of appointment, or within such time as the court may allow. *Id.* Either the judgment creditor or the judgment debtor may, within 10 days thereafter, request a hearing from the court on the designation, and by filing exceptions to the designation prior to hearing be entitled to present evidence for or against the designation. Tex. Prop. Code § 41.023(b). After the hearing, the court designates the homestead, and orders sale of any excess property. *Id.* The fees and expenses of the commissioner, appraiser and others appointed, are taxed against the debtor as costs of execution. Tex. Prop. Code § 41.023(c).

iii. Loss of Homestead. A homestead interest can be lost by death, abandonment or alienation. *Posey v. Commercial National Bank,* 55 S.W.2d 515 (Tex. Comm'n App.--1932, judgment adopted).

(A) Death. As stated above, the homestead status can terminate as a result of death. Upon the death of both spouses, the property ceases to be homestead. *Williamson v. Lewis,* 346 S.W.2d 957, 959 (Tex. Civ. App.--Fort Worth 1961, writ ref d). The fact that one spouse dies does not deprive the survivor of an existing homestead right. *Julian v. Andrews,* 491 S.W.2d 721, 727 (Tex. Civ. App.--Fort Worth 1973, writ ref d n.r.e.); *accord, Cox v. Messer,* 469 S.W.2d 611 (Tex. Civ. App.--Tyler 1971, no writ).

(B) Abandonment. The homestead status of land can be lost by abandonment. *Paddock v. Siemoneit,* 147 Tex. 571, 218 S.W.2d 428 (1949). If the homestead claimant is married, however, the homestead cannot be abandoned without the consent of the claimant's spouse. Tex. Prop. Code Ann. § 41.004. *See In re Johnson,* 112 B.R. 15 (Bkrtcy. E.D. Tex. 1989).

(1) Temporary Absence Not Fatal. It has been held that a temporary absence from a homestead, and even temporary removal to another state, does not alone constitute abandonment of the homestead. *McFarland v. Rousseau,* 667 S.W.2d 929, 931 (Tex. Civ. App.--Corpus Christi 1984, no writ).

(2) Temporary Renting Not Fatal. The temporary renting of the homestead does not destroy its homestead character provided the claimant has not acquired another homestead. Tex. Prop. Code § 41.003.

(3) Homestead Rights During and After Divorce. Several Texas courts have faced the question of whether a spouse's leaving the home upon marital separation constitutes abandonment of that spouse's homestead interest.

(a) The *Posey* Case. In *Posey v. Commercial Nat. Bank,* 55 S.W.2d 515 (Tex. Comm'n App. 1932, judgm't adopted), Husband conveyed his one-half community property interest in the parties' home to Wife for life in anticipation of divorce. Creditors of Husband claimed the conveyance constituted an abandonment of his homestead protection, and that his one-half interest was received by Wife subject to Husband's debts. The court rejected the argument, holding that Husband's homestead interest inured to the benefit of Wife because the conveyance was coerced by the impending court action, and was thus not a voluntary abandonment of the homestead.

(b) The *Sakowitz* Case. In *Sakowitz Bros. v. McCord,* 162 S.W.2d 437 (Tex. Civ. App.--Galveston 1942, no writ), the court rejected an argument that the filing of a divorce and issuance of a temporary injunction denying Husband access to the parties' home constituted abandonment by Husband of the homestead protection of his one-half interest in the property. The court held that once the homestead character of property is established, it continues through a divorce for so long as some members of the family continue to occupy the property.

(c) The *Rimmer* Case. In *Rimmer v. KcKinney,* 649 S.W.2d 365 (Tex. App.--Fort Worth 1983, no writ), Creditors argued that Husband had abandoned the homestead character of his one-half community property interest in the parties' home when he moved from the home after the divorce was filed and later conveyed his one-half interest to Wife pursuant to the decree of divorce. Because Wife and their children continued to live in the house, the court held that its homestead character continued. The appellate court observed certain differences from the facts in the *Sakowitz* case. Husband moved out voluntarily, rather than in obeisance to an injunction, and the conveyance in *Rimmer* was from Husband to Wife, rather than from both spouses to a third party, as in *Sakowitz.* These differences were not deemed significant.

(d) *Laster* and *Lawrence.* In *Laster v. First Huntsville Properties Co.,* 826 S.W.2d 125 (Tex. 1991), the parties' divorce decree granted both Husband and Wife undivided interests in the community property residence, which was their homestead. *Id.* at 127-29. Husband retained an interest unclassified by the Court (under these facts, probably a reversion). *Id.* Wife retained a present possessory interest subject to certain conditions, at least one of which was guaranteed to be fulfilled. *Id.* After the happening of one of those stated events, Wife's sole right to the use and possession of the residence would cease, and Husband and Wife would own the residence "in accordance with their interests as set out in the judgment." *Id. at* 128. Rejecting the lower court's classification of these interests as creating a cotenancy with Husband and Wife as tenants in common, the Court analogized Wife's interest to that of a life tenant (as in *Posey)* and the Husband's interest to that of the future interest held by a vested remainderman (also as in *Posey). Id.* at 128-29. Husband subsequently mortgaged his interest in the property and defaulted on the note. *Id* at 128. Bank sued to force the partition of Wife's homestead.

The issue on appeal was whether Husband's interest was protected from seizure by his debtors under the homestead designation (as Husband's reversion interest in Wife's life estate in *Posey* was exempt from his creditors). The Court explicitly stated that "homestead protection, however, can arise only in the person or family who has *a present possessory interest* in the subject property. Accordingly, one who holds only a future interest in property with no present right to possession is not entitled to homestead protection in that property." *Id.* at 130 (internal citations omitted) (emphasis added). Thus, the Husband's mortgage "created a lien against his non-possessory interest in the property which was not impressed with any homestead interest." *Id.* at 131. Thus, Bank was permitted to force the partition of what had been Wife's homestead because that designation had terminated upon the occurrence of a stated event *(viz.,* the youngest child of the parties' marriage attaining the age of majority). *Id.* at 131. Apparently, for the *Laster* Court, the conveying of a "life estate" was an alienation that terminated the homestead designation as to the conveyor.

This complex decision was addressed in *Lawrence v. Lawrence,* 911 S.W.2d 450 (Tex. App.--Texarkana 1995, writ denied), where the Texarkana Court of Appeals seemed to call into doubt *Posey, Sakowitz,* and *Rimmer,* writing that "we can only assume that the Supreme Court intended to change the law by its decision in *Laster." Id.* at 453. However, the *Lawrence* court also observed that "the *Laster* opinions, both majority and dissenting, do not even cite any of the earlier cases, either to overrule them or to attempt to distinguish them" *Id.* Even though the *Lawrence* court did not see any facts which distinguished *Laster* from *Posey,* it followed *Laster* and concluded that "one who holds only a future interest in property with no present right of possession cannot claim a homestead right in the property, regardless of how he was dispossessed." *Id.*

While *Posey* presents a set of facts so similar to *Laster* that the latter opinion can be reconciled in no way other than my concluding that it overruled the former, *Sakowitz* presents a materially distinct situation. In *Sakowitz,* Husband and Wife conveyed the property during the pendency of their divorce, while Husband was enjoined by *a temporary order* from present possession of the property. In *Laster,* on the other hand, Husband's present possessory interest was suspended by the final judgment of the court. The exact scope of *Laster* remains uncertain.

(e) Other Authorities. *See also Villarreal v. Laredo Nat. Bank,* 677 S.W.2d 600, 606 (Tex. App.--San Antonio 1984, no writ) ("[a]s a general rule, the complete breaking up of the family for any cause does not operate to forfeit the homestead right of one who has acquired it and continues to use the property as his home"); *Wierzchula v. Wierzchula,* 623 S.W.2d 730, 732 (Tex. Civ. App.--Houston [1st Dist.] 1981, no writ) ("[t]he homestead character of the property is not destroyed by a divorce if one of the parties to the divorce continues to maintain it as homestead").

(C) Alienation. In *Boyd v. United Bank, NA.,* 794 S.W.2d 839 (Tex. App.--El Paso 1990, no writ), the ex-wife was held to have alienated her homestead interest by a letter agreement and assignment to her ex-husband, which were relied upon by a bank in lending money to the ex-husband under a lien in the house.

iv. Homestead in Other Spouse's Separate Property. A spouse can have a homestead interest in land which is the separate property of the other spouse. *Villarreal v. Laredo Nat. Bank,* 677 S.W.2d 600, 606 (Tex. App.--San Antonio 1984, no writ). This interest, or the right to use the property as a residence, can be awarded to the custodial spouse for the duration of the minority of the parties' children. *Hedtke v. Hedtke,* 248 S.W.2d 21, 12 (Tex. 1923); *see Eggemeyer v. Eggemeyer,* 554 S.W.2d 137, 138 (Tex. 1977); *Villarreal,* 677 S.W.2d at 606. Presumably such a use can be continued for as long as the child support obligation continues, including beyond the age of majority. *See* Tex. Fam. Code Ann.§ 154.001. A homestead interest in the other spouse's separate property also constitutes a property right which can be awarded, or compensated for, on divorce. *See Wierzchula v. Wierzchula,* 623 S.W.2d 730 (Tex. Civ. App.--Houston [1st Dist.] 1981, no writ).

v. Liens. Under the Texas constitution,[2] certain types of liens can be foreclosed against a homestead, including purchase money liens, tax liens, builder's and mechanic's liens, and owelty of partition liens.[3] Tex. Const. art. XVI, § 50. The refinancing of a valid lien against a homestead can also encumber the property. *Id.* A judgment lien in favor of one spouse, created in a decree of divorce, cannot be foreclosed against a homestead interest, except to the extent that the lien fits one of the recognized exceptions: to secure an obligation to pay money in exchange for the home, or to secure a claim for reimbursement for payment of purchase money principle or interest, or for payment of property taxes on the property, or for payment of indebtednesses secured by vendor's liens or builder's and mechanic's liens in the property. *Eggemeyer v. Eggemeyer,* 623 S.W.2d 462, 466 (Tex. App.--Austin 1981, writ dism'd).

(A) Vendor's Lien. A vendor's lien is a lien which secures the unpaid portion of the purchase price of the property.

(1) Express Vendor's Lien. Ordinarily, the vendor's lien is retained in the deed conveying title to the purchaser. The vendor's lien can further be secured by a deed of trust, providing for non-judicial foreclosure if default is made in the payment of the purchase money indebtedness. A warranty deed reserving a vendor's lien to secure payment of part of the purchase price is valid and enforceable under the Texas Constitution. *See Benchmark Bankv. Crowder,* 919 S.W.2d 657, 660 (Tex. 1996); *Reed v. Skelly Oil Co.,* 227 S.W.2d 360, 362 (Tex. Civ. App.--Texarkana 1950, writ red n.r.e.).

(2) Implied Vendor's Lien. The Texas Supreme Court has ruled that where one party sells realty on credit to another, an implied vendor's lien arises to secure the debt. *McGoodwin v. McGoodwin,* 671 S.W.2d 880 (Tex. 1984). In *McGoodwin,* Wife conveyed her interest in the parties' homestead to Husband pursuant to an agreement incident to divorce. No vendor's lien was retained in the deed. The Supreme Court held that an implied vendor's lien arose from the property settlement agreement, securing the wife's one-half community property interest conveyed. The Court specifically noted that the lien reached only the undivided one-half community property interest conveyed by Wife to Husband, and not the one- half interest already owned by Husband. *Id* at 883.

A similar result was reached by the Austin Court of Appeals in *Colquette v. Forbes,* 680 S.W.2d 536 (Tex. App.--Austin 1984, no writ), where an implied vendor's lien was held to have arisen from the agreement incident to divorce even though no vendor's lien was retained in the deed conveying Husband's one-half community property interest in the property to Wife. *See* McKnight, *Family Law: Husband and Wife,* 39 Sw. L.J. 1, 19, 26-27 (1985).

In *Stapler v. Stapler,* 720 S.W.2d 271 (Tex. App.--Fort Worth 1986, no writ), an ex-husband was allowed to judicially foreclose on an implied vendor's lien in real estate awarded to his ex-wife in their agreement incident to divorce, where the ex-wife failed to pay an obligation owed to the IRS as required by the agreement. This was so, even though there was no language in the agreement to suggest that the realty was awarded

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[2] Federal law preempts state homestead protection in certain instances. *See United States v. Rodgers,* 103 U.S. 2132 (1983); *see also* discussion beginning at section VII.A.1.a.viii *infra.*

[3] The Property Code states that "[e]ncumbrances may be properly fixed on homestead property for: (1) purchase money; (2) taxes on the property; or (3) work and material used in constructing improvements on the property if contracted for in writing as provided by Sections 53.254(a), (b), and (c)." Tex. Prop. Code Ann. § 41.001.

to the ex-wife in consideration for her paying the IRS debt.

(B) Mechanic's, Contractor's or Materialman's Lien. The mechanic's, contractor's or materialman's lien is covered by Chapter 53 of the Texas Property Code. This chapter lists persons entitled to the lien and the property which is subject thereto, describes the procedure for perfecting the lien, and provides for the withholding of funds by the owner on behalf of subcontractors, among other provisions. Ordinarily, however, the family home will be homestead, and will be protected by Section 41.001 of the Texas Property Code. Section 41.001 provides that an encumbrance may be properly fixed on homestead property for work and material used in constructing improvements on the property only if contracted for in writing before the material is furnished or the labor is performed and in a manner required for the conveyance of a homestead, with joinder of both spouses if the homestead claimant is married. Tex. Prop. Code §§ 41.001, 53.254.

(C) Tax Lien. On January 1 of each year a tax lien attaches to property to secure all taxes, penalties and interest ultimately imposed for the year on that property. Tex. Tax Code Ann. § 32.01. This lien takes priority over a homestead interest in the property. *Id §* 32.05(a). The lien also has priority over other debts of the owner, even if they are secured by a prior lien on the property. *Id. §*32.05(b). Priority as to a federal tax lien is controlled by Texas law, subject, however, to any contrary provision of federal law on the subject. *Id. §* 32.04. The tax lien may be foreclosed.

(D) Home Equity Loan Lien. Prior to 1997, Texas was the only state in the United States that did not allow the proceeds from a voluntary lien against a homestead to be used for a purpose other than purchase money or improvements. 15 Tex. Prac., Texas Foreclosure Law & Prac. § 2.176 (2009). However, that year, the Texas Constitution was amended to include provisions allowing home equity loans less than or equal to 80% of the equity of the home. Tex. Const. art. XVI, § 50(a)(6). In *Stringer v. Cendant Mortgage Corp.,* 23 S.W.3d 353 (Tex. 2000), the Texas Supreme Court interpreted these provisions:

> The amendment's purpose was to expand the types of liens for loans that a lender, with the homeowner's consent, could place against a homestead. The amendment allows homeowners who have either entirely repaid their home loans or who have accumulated equity in their homestead over and above existing liens to apply for a loan against that equity. The first part of the amendment details the terms and conditions of a loan and the rights and obligations of both a borrower and the home-equity lender. *See* Tex. Const. art. XVI, §50(a)(6)(A)-(Q). It includes Section 50(a)(6)(Q)(i), which provides that a home-equity lender cannot require a borrower to apply the loan proceeds "to repay another debt except debts secured by the homestead or debt to another lender."

Id. at 354. Section 50(a)(6) allows a home-equity lender to require the borrower to use loan proceeds to pay: (1) debts secured by the homestead; and (2) non-homestead debts to third-party creditors. *Id.* at 356 (citing Tex. Const. art. XVI, § 50(a)(6)(Q)(i)). This provision establishes the substantive rights and obligations of lenders and borrowers and the terms and conditions a home-equity lender must satisfy to make a valid loan. *Id.*

The notice provision of this same subsection was amended following *Stringer* to mirror the language of Section 50(a)(6)(Q)(i), mandating that the home equity lender must notify the borrower that the former may not require the latter to apply the proceeds of the home equity loan to any other debt ***except*** a debt secured by the home or owed to a different lender. Tex. Const. art. XVI, § 50(g).

(E) Reverse Mortgage Lien. In 1999, the Texas Constitution was amended to include provisions permitting reverse mortgage liens on homesteads. Tex. Const. art. XVI, § 50(k). A reverse mortgage is an extension of credit to a homeowner based on the equity in their homestead in exchange for a voluntary lien on the property. *Id.* In order to qualify for a reverse mortgage, the borrower must be 62 years old, and the loan must be made without recourse for personal liability against the borrower. *Id.* No payment of principal or interest on the loan may be required until either the borrower dies or sells the property, abandons the homestead designation, defaults on an obligation to maintain the property, or commits actual fraud with regards to the loan. *Id.* The lender may not foreclose on the lien until the borrower is given the same notice required for the foreclosure of all liens on homesteads. *Id.*

(F) Equitable Lien. Upon divorce, where the court awards the house to one party and a money judgment to the other for his or her interest in the home, the money judgment can be secured by an equitable lien, created in the decree of divorce, which is enforceable against a claim of homestead. *Lettieri v. Lettieri,* 654 S.W.2d 554 (Tex. App.--Fort Worth 1983, writ dism'd). In *Wierzchula v. Wierzchula,* 623 S.W.2d 730, 732 (Tex. Civ. App.--Houston [1st Dist.] 1981, no writ), the court said that in a divorce action a lien could be placed on a spouse's separate property homestead "to secure the payment of the amount awarded to the other spouse for the spouse's homestead interest." *Accord, Wren v. Wren,* 702 S.W.2d 250, 252 (Tex. App.--Houston [1st Dist.] 1985, no writ). An equitable lien can also be awarded to secure a judgment for reimbursement for payments made on purchase money loans, home improvement loans, or property taxes on the home. *Eggemeyer v. Eggemeyer,* 623 S.W.2d 462, 466 (Tex. App.--Austin 1981, writ dism'd); *see Buchan v. Buchan,* 592 S.W.2d 367 (Tex. Civ. App.--Tyler 1979, writ dism'd) (husband awarded judgment to offset leasehold interest in wife's separate property residence taken from him in divorce). Professor McKnight wrote:

> Texas courts have generally acknowledged that in a suit for divorce a lien may be placed upon a spouse's homestead in order to secure the payment of a money judgment awarded to the other spouse for his or her homestead interest.

McKnight, *Family Law: Husband and Wife,* 38 Sw. L.J. 131, 154 (1984).

In *In re Miller,* 58 B.R. 192 (Bankr.S.D.Tex. 1985), the bankruptcy judge ruled that an equitable lien created by a divorce decree was an implied vendor's lien, enforceable against a homestead. The lien arose at the time of rendition of the decree of divorce, and did not have to be abstracted in order to be perfected. However, a number of courts have held that such a lien can be avoided in bankruptcy.

(1) Economic Contribution & Reimbursement. In 2009, economic contribution was repealed; the term "economic contribution" was replaced with "reimbursement" in the Family Code, and the economic contribution formula established by Family Code Section 3.403 was removed. Act of June 1, 2009, 81st Leg., R.S. (unpublished, available at: http://www.capitol.state.tx.us/BillLookup/History.aspx?LegSess=81R&Bill=SB866).

However, these changes only affect suits filed after September 1, 2009, and suits pending as of this date are still governed by the old economic contribution statute.

Under the repeated law, on dissolution of a marriage, the court was required to impose an equitable lien on property of a marital estate to secure a claim for economic contribution in that property by another marital estate. Tex. Fam.

Code § 3.406(a). This lien may be imposed upon the entirety of the spouse's property, *subject to homestead restrictions.* Tex. Fam. Code § 3.406(c). Under the new law, the mandatory language of subsection (a) is changed to permissive language and "economic contribution" is replaced with "reimbursement," while subsection (c) is repealed.

It is well-settled that a court can impose an equitable lien on a separate property homestead if the other spouse's reimbursement claim satisfies these strictures:

> [T]he homestead of a family or a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for the purchase money thereof, or a part of such purchase money, the taxes due thereon, or for work and material used in constructing improvements thereon, and in this last case only when the work and material are contracted for in writing, with the consent of both spouses.

Heggen v. Pemelton, 836 S.W.2d 145, 147-48 (Tex. 1992) (quoting Tex. Const. art. XVI, § 50).

In other words, if the award represents reimbursement for the payment of a debt that would be permitted under the Constitution to be secured by a lien on the homestead, then the reimbursement award may also be secured by a lien on the homestead. *See also Falor v. Falor,* 840 S.W.2d 683 686-87 (Tex. App.--San Antonio 1992, no writ).

Some commentators also aver that it is well-settled that a court can impose an equitable lien on a separate property homestead if the other spouse's *economic contribution* claim satisfies those constitutional strictures. *See, e.g., O'Connor 's Texas Family Law Handbook* (2009) at 775 (citing *Heggen* and *Falor).* The Eastland Court of Appeals cited these same sources, but remained noncommittal on the issue:

> The issue of whether a Section 3.406 lien can be foreclosed on a spouse's separate property which is homesteaded is not before us. Section 3.406(c); *also generally see Heggen v. Pemelton,* 836 S.W.2d 145 (Tex. 1992); *Falor v. Falor,* 840 S.W.2d 683 (Tex. App.--San Antonio 1992, no writ).

Langston v. Langston, 82 S.W.3d 686, 689 n. 1 (Tex. App.--Eastland 2002, no pet.). Both *Heggen* and *Falor* were decided before the enactment of the economic contribution statute in 1999.

(2) Equitable Lien For Interest in Homestead. In 1984, Professor McKnight suggested that the homestead is not subject to the imposition of an equitable lien for any claims "except liens for improvements and taxes attributable to the premises and interest in the property made the basis of the homestead and for improvements and taxes." McKnight, *supra* at 154-55, citing *Eggemeyer v. Eggemeyer,* 623 S.W.2d 462, 466 (Tex. Civ. App.--Waco 1981, writ dism'd); *Day v. Day,* 610 S.W.2d 195, 199 (Tex. Civ. App.--Tyler 1980, writ ref d n.r.e.). An equitable lien can also be fixed in the homestead for a reimbursement claim for payment of a vendor's lien indebtedness, as well. *See Heggen,* 836 S.W.2d at 147-48.

An interesting question exists regarding a separate property home. Where the home is the separate property of one spouse, can the other spouse be given a judgment secured by lien in the homestead for his or her "homestead interest" in the other spouse's separate property? The court in *Wierzchula v. Wierzchula,* 623 S.W.2d 730 (Tex. Civ. App.--Houston [1st Dist.] 1981, no writ), held that it could. Thus, although *Eggemeyer* would prohibit the divesting of title to separate realty and awarding it to the other spouse, perhaps a money judgment can be awarded to the other spouse who relinquishes his or her "homestead interest" in the other spouse's separate property home.

(G) Equitable Subrogation to Lien. Under certain circumstances, where a party pays an indebtedness secured by lien, that party is equitably subrogated to the lienholder's secured position. In *Citizens Say. Bank & Trust Co. v. Spencer,* 105 S.W.2d 671, 677 (Tex. Civ. App.--Amarillo), *writ dism'd,* 110 S.W.2d 1151 (Tex. 1937), it was said:

> A third person who has paid or has loaned money to pay a debt secured by a vendor's lien, is entitled to be subrogated to the rights of the vendor where the money was advanced at the debtor's request and for his benefit.

See also Henke v. First Southern Properties, 586 S.W.2d 617, 621 (Tex. Civ. App.--Waco 1979, writ ref d n.r.e.) (one who discharges a vendor's lien upon land, even homestead, either by paying as surety, or at the request of the debtor, or at a judicial sale, which for some reason fails to convey the title, is subrogated to the lien of the creditor to the extent of the payment made). It can be argued that a spouse, or even an unmarried "partner," should equitably subrogate to a vendor's, mechanic's, or tax lien in the other spouse's or partner's property, where funds of the former have been used to pay indebtednesses secured by such liens.

vi. Sale of the Homestead and Title Insurance. The proceeds from sale of the homestead are immune from garnishment for six months after the date of sale, during which time they can be reinvested in another homestead. Tex. Prop. Code § 41.001(c). Nevertheless, outstanding judgment liens can affect the ability to sell the homestead, since many are reluctant to buy a house without title insurance, and title companies often refuse to insure the title of a homestead as long as judgment liens appear to exist against the property. The situation was described in Tandy & Black, <u>Fundamentals of Title Insurance,</u> State Bar of Texas Advanced Real Estate Law Course D-25 (1985):

> In the ordinary course of business, when examination of title discloses abstracted and recorded judgment liens against the seller of putative homestead property, the almost universal response of Texas title insurers is a requirement that such judgment liens be released of record. Such releases are usually forthcoming only as the result of partial or complete satisfaction paid to the judgment-creditor from the seller's proceeds of sale. Certainly, on its face, this practice would seem to be in derogation of the constitutional and statutory protection afforded to the homestead. Practically speaking, however, as a matter of title insurance underwriting standards, the purely factual nature of homestead status cannot be satisfactorily demonstrated for the purpose of disregarding prior recorded abstracts of judgment against the seller-owner. The only other acceptable alternative for the title company would require the seller to institute a district court proceeding, citing the judgment-creditors as parties-defendant, out of which would hopefully come a judicial determination that, by reason of proven uninterrupted homestead status, the creditors' liens have not attached to the property being sold.

As a practical matter, when the buyer of financier requires title insurance as a condition of purchase, a seller with outstanding judgment liens may have to use some of the proceeds from sale of his homestead to discharge such liens, even though the liens are not enforceable against such proceeds at the time of sale.

vii. Fraud Can Vitiate Homestead Protection. In *Kolstelnick v. Roberts,* 680 S.W.2d 532 (Tex. Civ. App.--Corpus Christi 1984, writ ref d n.r.e.), the court ruled that the homestead exemption cannot be used as a shield against imposition of a constructive trust where the homestead claimants knowingly misused property transferred to them for the benefit of another. The trial court imposed a constructive trust for the benefit of a third party, upon a mobile home and other property alleged to be homestead. However, in *Curtis Sharp Custom Homes, Inc. v. Glover,* 701 S.W.2d 24 (Tex. App.--Dallas 1985, no writ) (en banc), a divided Dallas Court of Appeals concluded that a constructive trust could not be imposed on a homestead interest established prior to the wrongdoing. Thus, in that case a judicially- created equitable lien in homestead was held *void* where it secured a judgment for the recovery of embezzled funds which were used to *improve a* homestead.

Compare these cases with *In re Lodeck,* 61 B.R. 66 (Bkrtcy. W.D. Tex 1986), in which the bankruptcy judge held that an equitable lien given to secure a constructive trust imposed on a homestead for funds traced into improvements made to the homestead was not a judicial lien avoidable under Bankruptcy Code Section 522(f)(1).

viii. Federal Preemption. In *United States v. Rodgers,* 461 U.S. 677 (1983), the United States Supreme Court decided that the Texas law of homestead has been preempted by the Internal Revenue Code insofar as the Code affords the United States government the right to collect taxes owed to the government out of property recognized under Texas law as homestead. In *Rodgers,* the Supreme Court held that Husband's tax liability could be paid out of proceeds derived from selling his share of homestead property, even if that property is also the homestead of his Wife, who had no liability to the United States government. The Supreme Court further held that the government was not constrained to sell only Husband's interest in the property, but rather that the entire homestead property could be sold, with the government collecting its due from Husband's share of the proceeds. Wife's share of the proceeds would be given to her after the sale of her home.

b. Personal Property Exemptions. Sections 42.001 and 42.002 of the Texas Property Code set out personal property which can be exempt from the claims of creditors. An individual can have up to $30,000, and a family up to $60,000, in specified types of personal property that are protected from creditors' claims. Tex. Prop. Code § 42.001. Of course, the exemption does not apply if the personalty is pledged as collateral for the indebtedness being collected. Landlords' claims also can penetrate the exemption. Tex. Prop. Code § 42.001(c).

i. The "Laundry List." The types of personalty eligible for exemption are listed in section 42.002, and include: home furnishings; comestibles; farming and ranching implements; tools, equipment, books, and apparatus used in a trade or profession; clothing; jewelry valued up to a certain amount; two firearms; athletic and sporting equipment; one motor vehicle for each driver in the household; and certain animals, including pets. Life insurance and annuity benefits are also fully exempt. Tex. Ins. Code § 1108.051.

ii. Designation of Personalty Exceeding Monetary Cap. Section 42.003 provides a procedure for the debtor to determine which items of personalty will be seized if the total personalty exceeds the $30,000/$60,000 limit. Failing that, the officer executing on the items can designate what will be levied upon. Tex. Prop. Code § 42.003.

iii. Special Fraudulent Conveyance Provision. Section 42.004 regulates fraudulent converting of non-exempt property into exempt property. If non-exempt property is used to acquire, make improvements to, or pay debts on exempt property, and is done so with the intent to defraud, delay, or hinder an interested person[4] from

[4] The term "interested person" is not defined in the statute. The next subsection of the same provision substitutes the term "creditor" one time and the term "person with a claim" another time. The old fraudulent conveyance statute, former Tex. Bus. & Comm. Code

obtaining what they may be entitled to, then the otherwise exempt property will lose its exempt status. If the transaction is structured so that a secured debt to a third party is paid on exempt property, the aggrieved party subrogates to the rights of the other lien- holder. A claim under this Section must be brought within 4 years. A creditor with a claim that is unliquidated or contingent at the time of the transaction must bring suit within one year of when the claim is reduced to judgment.

c. Garnishment. Generally, non-exempt property such as bank accounts, safety deposit boxes, stock, commercial paper, and non-spendthrift trust distributions are subject to garnishment by a creditor. However, in Texas, garnishment of current wages from a debtor's employer is constitutionally prohibited. Exemptions statutes have also protected current wages. However, aggressive creditors have in the past made incursions into this forbidden area using the "turnover statute." The law on the point is set out below.

i. Relevant Constitutional and Statutory Provisions. Texas Constitution article XVI, section 28, provides that "no current wages for personal service shall ever be subject to garnishment, except for the enforcement of court-ordered child support payments or spousal maintenance." The Supreme Court defined "garnishment" as "a statutory proceeding whereby the property, money, or credits of one person in the possession of, or owing by another are applied to the payment of the debt of a debtor by means of proper statutory process issued against the debtor and the garnishee." *Beggs v. Fite,* 130 Tex. 46, 106 S.W.2d 1039, 1042 (1937), quoted in *Raborn v. Davis,* 33 Tex. Sup. Ct. J. 249 (February 21, 1990), *vacated,* 795 S.W.2d 716 (Tex. 1990). Civil Practice and Remedies Code section 63.004 provides that "current wages for personal service are not subject to garnishment." CPRC section 31.002(f) provides that a court may not require the post-judgment turnover of exempt property, which, by virtue of the Constitution and section 63.004, would include current wages for personal services.

ii. The Turnover Statute. Section 31.002 of the Texas Civil Practice & Remedies Code provides for the right of creditors to seek the assistance of the court in collecting money judgments, as to property that cannot readily be attached or levied on by ordinary legal process and is non-exempt.

Among other available remedies listed in the statute, the court can order the judgment debtor to turn over nonexempt property in his possession or control, and all related documents, to the sheriff or constable for execution. Or, the court can appoint a receiver to take possession of the property, sell it, and apply the proceeds to satisfy the judgment.

Section 31.0025 provides:

> (a) Notwithstanding any other law, a court may not, at any time before a judgment debtor is paid wages for personal services performed by the debtor, enter or enforce an order that requires the debtor or any other person to turn over the wages for the satisfaction of the judgment.
>
> (b) This section applies to wages in any form, including paycheck, cash or property.
>
> (c) This section does not apply to the enforcement of a child support obligation or a judgment for past due child support.

Tex. Civ. Prac. & Rem. Code § 31.0025. Thus, turnover orders are not available for wages not yet

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Section 24.02, used the phrase "creditor, purchaser or other interested person." *See* discussion of interpretive case law in Orsinger, Intra and Inter Family Transactions, State Bar of Texas Advanced Family Law Course J-20 (1983).

received.

In light of Chapter 31 of the CPRC and article XVI, section 28 of the Texas Constitution, the question of what the term "current wages" does–and does not–include will determine whether property is subject to turnover. For a good discussion of property that may not be exempt, *see* Brown, Donna, Post Judgment Remedies. Judgment Liens. Garnishment, Execution, Turnover Proceedings. Receiverships under the DTPA, and "Other Stuff?' Collections and Creditors' Rights Course (2006) at 32-35. *See also* Toben & Toben, Using Turnover Relief to Reach the Nonexempt Paycheck, 40 Bay. L. Rev. 195 (1988) for further background.

The following cases address the vulnerability of various forms of income to turnover orders:

In *Sloan v. Douglass,* 713 S.W.2d 436 (Tex. App.--Fort Worth 1986, writ ref d n.r.e.), the Court of Appeals concluded that deferred payments due a professional baseball player were current wages despite the fact they were to be paid out over a ten year period beginning when his employment contract expired. The Court held that the deferred payments were exempt as "current wages," and therefore not subject to a turnover order. The Court also ruled that the exemption of current wages, deriving as it does from the Constitution itself, cannot be made subject to a $30,000/$60,000 limit, and that to the extent Property Code section 42.001 purported to do so it was unconstitutional. The laundry list no longer contains an exemption for current wages.

In *Cain v. Cain,* 746 S.W.2d 861 (Tex. App.--El Paso 1988, writ den'd), the El Paso Court of Appeals reviewed a turnover order entered to assist a former wife in collecting a judgment for payments due from the former husband under the agreement incident to divorce that were never paid. At issue were the former husband's Teacher Retirement System payments and military retired pay. The Court had no problems with the anti- assignment statutes relating to either type of benefits, because no garnishment of the paying agencies was involved. Also, retirement benefits have been held to be property and not current wages. Also, all exemptions the benefits may have enjoyed prior to their receipt was lost on receipt. The Court indicated that the later passage of Property Code section 42.0021, regarding "Additional Exemption for Retirement Plan," would not change its ruling. The turnover order was held valid, amid a ringing pronouncement that "Texas will move out of the Twentieth Century not as a debtor state but as a state where just debts can be collected under the turnover statute." *Id.* at 864.

In *Maumus v. Lyons,* 771 S.W.2d 191 (Tex. App.--Fort Worth 1989, no writ), the Fort Worth Court of Appeals distinguished the 1920's vintage cases ruled that Property Code Section 42.002, which exempts "current wages for personal services," prohibits a court from ordering a turnover "for services performed during the pay period immediately preceding payment to an employee." *Maumus, supra* at 195. This limitation to the immediately preceding pay period might leave periodic bonuses at risk.

It should be remembered that the trial court is not required to order turnover. On appeal, the standard of review is abuse of discretion. *See Commerce Savings Association v. Welch,* 783 S.W.2d 668 (Tex. App.--San Antonio 1990, no writ).

d. Proceeds of Insurance Policy. Section 1108.051 exempts ***all*** proceeds, without limit, payable under an insurance policy issued by a life, health or accident insurance company, or payable under annuity, from execution, attachment or garnishment. The only exception to this exemption is for premium payments made in fraud of creditors of for debt actually secured by the proceeds. Tex. Ins. Code § 1108.052. Although not explicitly listed, such proceeds presumably would include a disability policy. One case has held that this statute does not protect the receipt of the cash surrender value of a policy. *In re Brothers,* 94 B.R. 82 (Bankr. N.D. Tex. 1988). Another case has held that this statute did not protect proceeds from the settlement of a personal injury claim due from a *liability* insurance carrier. In the case of *In re Powers,* 112 B.R. 178 (Bankr. S.D. Tex. 1990), the bankruptcy judge ruled that the phrase "life, health or accident insurance company" does not include a casualty or liability insurance company, and that sums due a debtor from a liability insurance company are not exempt under this statute.

e. Retirement Benefits. Section 42.0021 establishes a state law exemption for retirement plans. This exemption is above and beyond the $30,000 or $60,000 limit established by Section 42.002. The plan must be a "qualified plan" under the Internal Revenue Code. IRA's and SEP's are included. However, the exemption does not apply to overfunded IRA's, where the sums deposited exceed the deductible contributions permitted by the Internal Revenue Code. Non-taxable rollovers are protected as well. Roth IRA's are also exempt, despite the fact that contributions to Roth IRA's are not tax-deductible. Finally, HSA's are explicitly exempted by the statute. *See generally Lozano v. Lozano,* 975 S.W.2d 63 (Tex. App.--Houston [14th Dist.] 1998, no pet.) (burden of proof to establish exemption on party claiming it).

Several savings clauses are included in the statute in the event that the statute is preempted by Federal law. Tex. Prop. Code § 42.0021. Preemption is an important issue, as explained below.

i. Preemption by ERISA. The United States Supreme Court has ruled that the federal statute governing "qualified" retirement plans of private employers, ERISA, preempted a Georgia statute which exempted ERISA plans from garnishment. *Mackey v. Lanier Collections Agency & Service, Inc.,* 486 U.S. 825, S.Ct. 2182, 100 L.Ed.2d 836 (1988). Under the *Mackey* case, a state statute is preempted if it relates to an employee benefit plan, or in other words has a connection with or makes reference to an ERISA plan. Section 42.0021 of the Texas Property Code dangerously relates to a number of different types of retirement programs, ERISA plans being only one of them. Because the statute is preempted as to ERISA, there has been some concern that the entire provision, with all of its other exemptions, may have been invalidated, even as to non-ERISA plans. The statute itself contains a severance clause, supporting the validity of whatever portion of the statute that is not preempted. Tex. Prop. Code § 42.0021(a).

The fact that Section 42.0021 is preempted insofar as ERISA plans are concerned is universally acknowledged. The question is how much of the remainder of the statute survives the preemption. The bankruptcy judge in *In re Dyke,* 99 B.R. 343 (Bkrtcy S.D.Tex. 1989), acknowledged preemption of Section 42.0021 insofar as ERISA is concerned, but said that the preemption did not knock out the entire statute. The bankruptcy judge in *In re Volpe,* 100 B.R. 840 (Bkrtcy.W.D.Tex. 1989), ruled that the preemption did not destroy the entire statute, and that a debtor's profit sharing plan and IRA were exempt. The bankruptcy judge in *In re Laxson,* 102 B.R. 85 (Bkrtcy.N.D.Tex. 1989), also ruled that IRA's are exempt. *See generally In re Chadwick,* 113 B.R. 540 (Bkrtcy.W.D.Mo. 1990) (holding that ERISA does not apply to IRA's so that no preemption of Kansas state exemptions for IRA's occurred).

ii. ERISA Protection in Bankruptcy. The Fifth Circuit Court of Appeals ruled that a Keough plan cannot be exempt property in a bankruptcy proceeding, because it is a self-settled plan that doesn't meet the traditional definition of a spendthrift trust. *See In re Goff,* 706 F.2d 574 (5th Cir. 1983). In that same case, the Fifth Circuit also stated that ERISA plans are not exempt property in bankruptcy.

This view of the Fifth Circuit has not been universally accepted. A bankruptcy judge in the Western District of Texas, in the case of *In re Komet,* 104 B.R. 799 (Bankr. Ct. W.D. Tex. 1989), severely attacked the Fifth Circuit's reasoning in *In re Goff,* concluding that an ERISA plan is exempt in bankruptcy. And in the case of *In re Felts,* 114 B.R. 131 (Bkrtcy.W.D.Tex. 1990), yet another Texas bankruptcy judge ruled that ERISA plans and IRA's are exempt in bankruptcy.

However, another Texas bankruptcy judge, in the case of *In re Dyke,* 99 B.R. 343 (Bkrtcy S.D.Tex. 1989), ruled that ERISA plans are not exempt in bankruptcy. To quote an Oklahoma bankruptcy judge who ruled that ERISA plans cannot be exempt property in bankruptcy:

> This issue has been considered by many courts and the overwhelming majority including all United States Courts of Appeals that have considered the question have held that debtor's interest in qualified ERISA plans are not exempt from the debtor's estate under federal law as nonbankruptcy code federal exemptions. *See In re Graham,* 726 F.2d 1268 (8th Cir. 1984); *In re Golf,* 706 F.2d 574 (5th Cir.1983); and *In re Lichstrahl,* 750 F.2d 1488 (11th Cir.1985); *In re Daniel,* 771 F.2d 1352 (9th Cir.1985).

In re Brown, 95 B.R. 216, 219 (Bkrtcy.N.D.Okl. 1989).

f. Rules of Marital Property Liability May Offer Protection. A debtor need fall back on the protections of the personal property exemption statute only if the property in question is subject to the debt. If the creditor has a judgment against only the husband for a contractual claim, then the wife's sole management community property and her separate property are not subject to seizure for the claim, and would not be included in the calculation of the $60,000.00 worth of family personalty that can be exempted.

D. Perfecting Liens & Abstracts of Judgment. An abstract of judgment is designed to create a lien against the judgment debtor's property and to provide notice to subsequent purchasers and encumbrancers of the existence of the judgment and the lien. *Citicorp Real Estate, Inc. v. Banque Arabe Internationale D ' Invest issement ,* 747 S.W.2d 926, 929 (Tex. App.--Dallas 1988, writ denied). Tex. Prop. Code § 52.003 requires an abstract of judgment to contain the following seven elements: (1) the names of the plaintiff and defendant; (2) the birth date and driver's license number of the defendant if available to the clerk or justice; (3) the number of the suit in which the judgment was rendered; (4) the defendant's address, or if the address is not shown in the suit, the nature of citation and the date and place of service of citation; (5) the date on which the judgment was rendered; (6) the amount for which the judgment was rendered and the balance due; and (7) the rate of interest specified in the judgment. It is the judgment creditor's responsibility to insure that the clerk abstracts the judgment properly. *Texas American Bank/ Fort Worth, N.A. v. Southern Union Exploration Co.,* 714 S.W.2d 105, 107 (Tex. App.--Eastland 1986, writ ref d n.r.e.). Substantial compliance with the statutory requirements is mandatory before a judgment creditor's lien will attach. *Reynolds v. Kessler,* 669 S.W.2d 801, 804-05 (Tex. App.--El Paso 1984, no writ).

Compliance with the statutory requirements is mandatory before a judgment creditor's lien attaches. *Caruso v. Shropshire,* 954 S.W.2d 115, 116 (Tex. App.--San Antonio 1997, no pet.). Section 52.002 provides for the clerk of the court to prepare the abstract upon request, and permits the attorney for the judgment creditor to prepare the abstract himself or herself, as long as it is verified.

E. Filing Judgment in Deed Records Office. Property Code Section 12.013 permits a certified copy of a judgment to be filed with the deed record office. The issuing court can be of this state, or another state subject to the full faith and credit clause of the U.S. Constitution, or of a foreign country subject to an act of Congress or a treaty. A judgment properly recorded in the proper county is "notice to all persons of the existence of the instrument." Tex. Prop. Code § 13.002.

IX. PRE- AND POST-DIVORCE TRANSFERS, TRO'S AND TEMPORARY INJUNCTIONS.

A. Actions to Take Prior to Filing. As explained *infra,* once divorce is filed, both parties become subject to a variety of restrictions on their disposition of marital property and establishment of credit.

Two preparations for a spouse to consider before filing for divorce are withdrawing funds and prepaying bills. The spouse can withdraw enough funds to pay the retainer fees of counsel and an expert, and to prepay important bills such as the mortgage on a separate property house.

B. Transfers and Debts During Divorce. Section 6.707(a) of the Texas Family Code provides that a transfer of property by a spouse, occurring after a petition for divorce or annulment is filed, is void with respect to the other spouse if *the transfer was made with the intent to injure the rights of the other spouse.* The same concept applies to debts incurred by a spouse during the pendency of a divorce or annulment. *Id. at* § 6.707(b). However, a transfer or debt occurring under such circumstances is not void if the person dealing with the spouse had no notice of the intent to injure the rights of the other spouse. *Id.* Section 6.707(c) provides that the spouse seeking to invalidate the transfer or debt has the burden to prove notice of intent to injure. *Id.* One wonders whether that burden of proof is reversed if the third party is in a fiduciary or confidential relationship with the complaining spouse.

C. Post-Filing Protection of Property from the Other Spouse. One matter of concern upon the filing of a divorce is the possible damaging effect of the other spouse incurring debts which will have to be awarded in the divorce. Practitioners who fear this in a particular case frequently secure a temporary restraining order to prohibit many deleterious activities, including the incurring of indebtedness. However, there are some self- help measures that can be taken as well.

1. Reducing or Cutting Off Credit. If your client is concerned about the other spouse's possible abuse of credit, consider advising the client to reduce the risk of excessive charging, by placing a telephone call or faxing a letter to the appropriate creditors, reducing the credit limits on all of the charge cards, and revoking the other spouse's charge privileges on cards like American Express that have no credit limit. Once a TRO is issued or standing orders go into effect, such an action will be prohibited.

2. The TRO. Courts routinely grant upon request an ex parte TRO prohibiting the other spouse from incurring debts other than for necessary living expenses and in the ordinary course of business. If the prohibition is violated, theoretically at least the court can punish the violation as a contemptuous act.

a. Family Code § 6.501. Section 6.501 of the Texas Family Code contains a list of the kinds of commands that can be contained in an ex parte temporary restraining order. Tex. Fam. Code §6.501. While the expending of funds is mentioned as behavior which can be precluded, no mention is made of prohibiting the incurring of debts, other than a prohibition against "encumbering" an asset. A bar against encumbering property would prohibit pledging an asset but not incurring an unsecured debt. However, the list is non-exclusive.

b. The Form Book TRO. The State Bar of Texas Family Law Practice Manual 2d. ed. (2008) Form 4-3 suggests a paragraph for inclusion on the TRO that prohibits "[i]ncurring any indebtedness, other than legal expenses in connection with this suit, except as specifically authorized by this order." The Manual also suggests another paragraph regarding the cutting off of credit, prohibiting a spouse from "Waking any action to terminate or limit credit or charge cards in the name of [a spouse]." *Id.*

c. Standing Orders. The "standing orders" of several venues around the state are designed to replace TROs as a way of preserving the spouses' property during the divorce. For example, Dallas County's standing order prohibits the spouses from, among other actions: destroying, removing, concealing, encumbering, transferring, or otherwise harming or reducing the value of the spouses' property; damaging or destroying tangible property or documents; selling, transferring, assigning, mortgaging, encumbering or alienating the spouses' property; incurring any indebtedness other than legal expenses; et al.

3. Temporary Injunctive Orders. The Texas Family Practice Manual contains suggested Temporary Orders which regulate the parties' use of credit during the pendency of the divorce. The sample temporary orders contain a bar against "[i]ncurring any indebtedness, other than legal expenses in connection with this suit, except as specifically authorized by this order." *Id.* A paragraph is suggested that prohibits a spouse from terminating or limiting credit or charge cards in the other spouse's name. *Id.* The form later permits each spouse to incur indebtedness for reasonable attorney's fees and expenses related to the divorce, and reasonable and necessary living expenses. *Id.* The form also permits the spouse operating a business to engage in acts reasonable and necessary to the conduct of the business. *Id.* The form temporary orders further provide language for allocating the responsibility of paying debts during the pendency of the divorce. *Id.*

4. Lis Pendens.

a. Filing and Cancelling Notice of Lis Pendens. Texas Property Code § 12.007 provides for lis pendens. At common law, the mere pendency of a law suit affecting title to land resulted in all transactions in the land being subject to the outcome of the suit. The Legislature supplanted that rule with the lis pendens statute. *Fannin Bank v. Blystone,* 417 S.W.2d 502, 503 (Tex. Civ. App.--Waco, 1967), *writ ref'd n.r.e.,* 424 S.W.2d 626 (Tex. 1968). Under section 12.007, a party seeking affirmative relief in an action involving title to real property can file with the county clerk a lis pendens notice, identifying the suit and the property in question. This notice gives constructive notice to all persons who thereafter acquire an interest in the land, making their interest subject to the outcome of the law suit. Prop. Code § 13.004; *Cherokee Water Co. v. Advance Oil & Gas Co.,* 843 S.W.2d 132, 135 (Tex. App.--Texarkana 1992, writ denied) ("The rule effectively prevents a grantee from being an innocent purchaser"); *Gene Hill Equip. Co. v. Merryman,* 771 S.W.2d 207, 209 (Tex. App.--Austin 1989, no writ) (the underlying purpose of a lis pendens is to put those interested in a particular tract of land on inquiry as to the facts and issues involved the suit or action concerned). Under Prop. Code § 12.008, the lis pendens can be cancelled by filing a motion in the court hearing the action. The cancellation may be predicated on depositing money in court, in the amount of the judgment sought, plus interest, plus costs. If a bond is given, it must be in twice the amount of the judgment sought, and have two acceptable sureties.

b. When to File. Most lawyers believe that the standard temporary injunctive orders, which prohibit either spouse from transferring assets except for necessary living expenses, litigation costs, and in the ordinary course of business, are adequate protection in a divorce. Consequently, few lawyers file lis pendens notices in divorce. Fortunately, few spouses make fraudulent conveyances of real property during divorce, especially when temporary orders prohibit such transfers. However, occasionally a spouse will make a fraudulent conveyance of land, and then the issue arises of whether the other spouse's right or claim to the property is superior or inferior to the third party now claiming title. If a lis pendens notice of the divorce had been filed, there can be no basis for bona fide purchaser (BFP) status. There is little cost to filing a lis pendens notice in a divorce, and little chance of harm. Maybe we should file them more often.

c. Management Rights and Presumptions. If no lis pendens is filed when a divorce is filed, and a spouse alienates community property, whether the alienation is subject to the divorce depends on management rights to the property. In general, community property is subject to the "joint management, control and disposition of the spouses unless the spouses provide otherwise by power of attorney in writing or other agreement." *Jean v. Tyson-Jean,* 118 S.W.3d 1, 9 (Tex. App.--Houston [14th Dist.] 2003, pet. denied).

According to *Jean v. Tyson-Jean,* "[t]o effectuate a valid conveyance, both spouses must necessarily be joined in a transaction." *Id.* at 5 (citing *Cooper v. Texas Gulf Indus., Inc.,* 513 S.W.2d 200, 202 (Tex.1974)). The Court of Appeals said:

> In general, community property is subject to the "joint management, control and disposition of the spouses unless the spouses provide otherwise by power of attorney in writing or other agreement." Tex. Fam.Code Ann. § 3.102(c) (Vernon 1998); *In re McCloy,* 296 F.3d at 373. To effectuate a valid conveyance, both spouses must necessarily be joined in a transaction. *Cooper,* 513 S.W.2d at 202.
>
> However, where community property is held in one spouse's name only, there is a presumption that the property is sole-management community property. Tex. Fam. Code § 3.104(a) (Vernon 1998). Section 3.104 therefore trumps section 3.102. Absent a showing of fraud or notice on the part of persons dealing with the named spouse, this sole-management presumption protects third parties who rely on the spouse's authority to deal with the property. Tex. Fam.Code Ann. § 3.104(b) (Vernon 1998); *In re McCloy,* 296 F.3d at 373.

Jean v. Tyson-Jean, 118 S.W.3d 1, 5 (Tex. App.--Houston [14th Dist.] 2003, pet. denied).

d. Personal Property. Notice of lis pendens operates only against real estate. What about the IRA's, the 401K' s, the brokerage accounts, and the children's trust accounts? Try sending the temporary orders to the depository institutions, and see if they will put a "freeze" on the accounts. If not, ask the Court to order that community property assets be placed under joint control, requiring both spouses to sign for a transfer. Alternatively, join the institutions as parties to the divorce, and ask for injunctions prohibiting the removal of funds and assets on deposit.

e. Is Divorce a Special Case? In *Fannin Bank v. Blystone,* 417 S.W.2d 502, 503 (Tex. Civ. App.--Waco, 1967), *writ ref'd n.r.e.,* 424 S.W.2d 626 (Tex. 1968), the court of appeals stated that, even in the absence of a notice of lis pendens under the lis pendens statute, the Family Code provision relating to fraudulent transfers during a divorce gave lis pendens effect to the mere pendency of a divorce, so that persons who purchased property at a foreclosure sale under a deed of trust given by the husband on community property, were on notice of the divorce and were not protected from the wife's claim of fraud that nullified the deed of trust. The Supreme Court denied review, with a per curiam opinion noting evidence sufficient to support a finding that the purchaser at the foreclosure sale had actual notice of the wife's interest in the real estate which was in litigation, and that "[i]t is therefore unnecessary in this *case* to determine whether the mere pendency of a divorce action renders compliance with article 6640 unnecessary." Thus, the court of appeals' language on that point is dictum. The court in *First Southern Prop., Inc. v. Gregory,* 538 S.W.2d 454, 458 (Tex. Civ. App.--Houston [1st Dist.] 1976, no writ), held that the mere pendency of a divorce action was not constructive notice of wife's rights.

X. DISCOVERY OF DEBTS IN A DIVORCE.

In a depressed economy, ferreting-out liabilities is an important responsibility of the divorce lawyer. Even families with high levels of income have been damaged by the collapse in the value of real estate, which typically have a continuing debt service requirement. In many instances, partners in the investments have gone broke, leaving an increased burden of debt service on the remaining partners. The possibility of a bank or other creditor taking a major portion of the family's assets is a real concern in many cases.

In the present environment, it is extremely important for the non "wheeling-dealing" spouse to identify all credit threats to the marital property. Obtain the paperwork from the transaction to see if the non- investing spouse signed notes or guarantees. Determine which investments or business transactions present a threat of tort liability as opposed to contractual liability. Contractual creditors of one spouse alone cannot reach the other spouse's sole management community property. Tort creditors of one spouse alone can reach all non-exempt community property.

A. Inventory and Appraisement. Counsel will typically want temporary orders requiring the other spouse to prepare and deliver an inventory and appraisement of all debts. The opposing party's inventory should be a starting point, not an ending point, for discovery regarding debts. The Texas Family Practice Manual's suggests the following temporary order language relating to the preparation of an inventory:

> IT IS ORDERED that Petitioner and Respondent shall each (furnish to/exchange with) opposing counsel (INCLUDE IF APPLICABLE: and file with the Clerk of this Court) a sworn inventory and appraisement, in the form and detail prescribed by the Texas Family Law Practice Manual, form 5-1, of all the separate and community property owned by the parties. IT IS ORDERED that the inventory be (furnished to/exchange with) opposing counsel (INCLUDE IF APPLICABLE: and filed with the Clerk of the Court) by ______, 20___.

The Author, preferring to use his own format for an inventory, uses the following language instead:

> It is ORDERED that each party shall prepare and exchange Sworn Inventories and Appraisements of all of the property owned by the parties, whether located within or without the State of Texas, including property owned jointly with, or held in trust by, third persons, and stating the names, addresses, telephone numbers, and exact nature of ownership belonging to any such third person, and stating the location of all such property, and stating a separate value of each item of property, together with a list of all debts and liabilities owed by either party, showing the identity of the creditor, any identifying numbers for said debt, and the amount and frequency of payments due on each. Each party shall deliver a sworn inventory to the other party on or before 2009.

B. Interrogatories and Requests for Production. The Texas Family Practice Manual contains proposed interrogatories relating to debts. *Id.* at Form 543. Sample debt-related language to include in a request for production is set out in the Manual at Form 5-22.

C. Credit Report. The Author will sometimes obtain a credit report on the client or opposing party. Federal law imposes sanctions for improper credit inquiries and the state law tort of invasion of privacy might be implicated, so that the prudent practice is to secure written consent or a court order before obtaining a credit report. The applicable provisions of the Fair Credit Reporting Act should be complied with. *See, e.g.,* 15 U.S.C.A. § 1681b (Permissible purposes of credit reports).

XI. ASSESSING AND PROTECTING AGAINST RISK IN A PROPERTY DIVISION.

A. Assessing Risk. To assess risk in a particular case, you must engage in a risk assessment process. There are several important factors operating here. First, risk is basically uncertain, so that you are estimating risk rather than calculating risk. Second, you have neither the time nor the money to eliminate all risk, so you allocate resources among different risks. If the likelihood of harm is less, or if the degree of harm is less, then you will want to spend less of your resources to reduce that risk, or mitigate that damage. The risk assessment process involves identifying risks, assessing the likelihood of each risk occurring, calculating the harm that may arise, putting safeguards in place, and maintaining these safeguards over time. In a divorce property division, there can be the risk of loss of value of an asset, or risk of loss of property to a creditor, or risk that the opposing party may fail to perform obligations created in the divorce settlement or award.

B. Responding to Risk. The typical responses to risk are: avoidance, transfer, mitigation, and acceptance.

1. Avoidance. You avoid risk primarily by structuring the property division in such a way as to eliminate the risk, or have the other party bear the risk.

2. Transfer. You can transfer risk to someone else, including the opposing spouse. This is the function of insurance. You can insure against default resulting from death of the defaulting party by purchasing life insurance on that party. You can also get a guarantor of the risk, which transfers the risk of non-performance to the guarantor. In a property division, you can try to arrange the division of assets and debts to put the risk as much as possible on the other party. If you are receiving a risky asset as part of the property division, you can try to share the risk as much as possible with the opposing party. An example would be unvested employee stock options. There is a risk that the employed spouse will leave employment before they vest, and lose all value. There is also the risk that the stock price will drop after divorce and the options will no longer be "in the money" before they expire, in which event they will end up having no value. If the employed spouse takes the options at the market value at the time of divorce, that spouse is taking all the risk (and all the reward). If the options are divided if, as, and when received, the parties are sharing the risk.

3. Mitigation. You can mitigate risk by putting safeguards in place so that if the event occurs, the damage is minimized. Taking collateral on an obligation is an example. Also, requiring your client's consent before the opposing party can undertake risky behaviors would be another way to mitigate risk.

4. Acceptance. You can also accept risk, or take some corrective action to reduce risk to a level you can accept. Sometimes risk is offset with a chance of reward, so that some risks may be attractive to assume because the chance of reward offsets the risk. If the transaction standing alone does not have enough potential reward to warrant the risk, then perhaps something can be done to enhance the reward. Reducing risk to an acceptable level might involve structuring the arrangement in a way that the opposing party takes a greater share of the risk.

C. Creditors' Claims. When handling divorces in a depressed economy, the allocation of responsibility to pay debts can be as important as dividing assets.

1. Collateralized Debt. Where a debt is secured by a marital asset, the better choice is usually to award the debt to the party receiving the collateral. That way the desire to continue to own the collateral provides an incentive for the party receiving the collateral to pay the debt. Awarding the collateral to one spouse and the debt to the other eliminates that incentive. Furthermore, separating the debt from the asset also creates a situation where post-divorce litigation may be required, with its attendant costs and delays. The separation of debt from collateral can also result in an ex post facto change in the property division. Take for example a car worth $25,000 that is subject to a $25,000 debt. If the car is awarded to the wife and the debt to the husband, the wife receives a plus $25,000 on her side of the ledger while the husband receives a negative $25,000 on his side of the ledger. As a result, the wife gets the car in lieu of $25,000 of other property and the husband gets $25,000 more property to offset the debt he is assuming. If the husband defaults on payments after the divorce, and the loan company repossesses the car in discharge of the debt, it ends up that the wife had no plus $25,000 and the husband had no minus $25,000 in the property division, which throws the property division out of balance *after it is too late to do anything about it*. If the ex-wife sues the ex-husband and gets a judgment which she can then collect on, then maybe she'll be made whole. But the cost of collection and the hassle of litigating may not be recovered, in which event the ex-wife would have been better off to let the default go unpunished. Instead of that arrangement, it would be better for the wife if at the time of the divorce, she took the car and the debt on the car, which would be on her ledger as a net zero, and would not reduce the amount of other property she received in the divorce.

2. Uncollateralized Debt. If the debt is not collateralized, then the creditor may choose to move against any non-exempt community property that is subject to that type of creditor's claim. See the discussion of "marital property liability" in Section VI. In a property division, the non-debtor spouse would want to receive assets that are exempt from creditors' claims, or assets that are not subject to marital property liability for that claim.

3. Personal Liability. As discussed in Section V above, it is very important to determine whether your client is personally liable on a debt. If not, then the maximum exposure for your client is the loss of joint management community property or the sole management community property and separate property of the liable spouse that is awarded to your client in the divorce. If your client is personally liable on the debt, then it can be collected out of all non-exempt property that your client may receive in the divorce or acquire after the divorce.

4. Contingent Liability. Contingent liabilities (such as personal guarantees) may not be due at the time of divorce. The opposing party may take the position that the liability, being contingent, is not to be considered. If the case is settled on that basis, and the contingent liability is later triggered, then the property division is ex post facto altered by the amount that the spouse must pay on the contingent claim. A good response to a claim that a contingent liability is not real is for the spouse claiming that to indemnify the liable spouse, just in case the contingent liability is triggered. If the other spouse won't share that risk, then the claim of "no risk" is a hollow one.

5. Indemnification. If debts are awarded to Spouse #1 in a divorce, Spouse #2 can attempt to get an indemnity from Spouse #1 in case the creditors come against Spouse #2. If the indemnity is uncollateralized, it is not worth much, as the indemnity will trigger only after the indemnifying spouse has defaulted on paying the debt, so that the indemnifying spouse would probably be trying to enforce the indemnity against a judgment-proof ex-spouse. If the indemnity is collateralized, it provides an incentive for the indemnifying spouse to pay the debts, to avoid repossession or foreclosure by the indemnified spouse.

D. Other Risks in a Property Division.

1. Performance Risk. Performance risk is the risk that the other party will not perform their obligations under the Agreement Incident to Divorce and Decree of Divorce. If the obligation is to pay interest or principal, pay alimony, or pay off a debt owed to a third party, the risk is called "credit risk" or "default risk." This type of risk is ameliorated by structuring the divorce settlement to add incentives to performance, such as rewards and/or penalties. The obligation can also by collateralized or guaranteed by third partes or entities. The possibility of bankruptcy can be protected against by (i) collateralizing the obligation; or (ii) expressing the obligations as a non-dischargeable claim (like child support or alimony).

2. Inflation Risk. "Inflation Risk" is the risk that general increases in prices of goods and services will reduce the value of money you are to be paid in the future. One way to avoid this inflation risk is to purchase is to include an inflation adjustment in the obligation, so that the principal and interest keep pace with inflation. For example, the amount of the principal balance of a note could be adjusted in keeping with changes in the Consumer Price Index, or Implicit Price Deflator. If the obligation is an alimony obligation, the alimony could change as the inflation index changes. See Part II of this Article, Section VI.A.13. If the rate used in a promissory note is taken from market rates, an inflation premium will already be built into the market interest rate. An "inflation premium" is the portion of the interest rate that is attributable solely to expected increases in the general price level of goods and services.

3. Liquidity Risk. In the context of the present discussion, "liquidity risk" is the risk of not being able to liquidate the obligation in question quickly for a price that reflects the true intrinsic value of the asset. An alimony stream is not transferrable, but a promissory note is. The liquidity risk in taking a long-term promissory note from the opposing party in a divorce is the risk that the obligee may develop a need to cash that requires him/her to sell the note at a discount for cash. Recognizing the liquidity risk leads to the idea of a "liquidity premium," which is an additional component added to the interest rate to compensate for that risk.

XII. HANDLING DEBTS IN A DIVORCE. The following thoughts are offered on the handling of debts in a divorce.

A. Marshalling Assets. Section 3.202 of the Texas Family Code provides a procedure for a court to determine the order in which community and separate property will be subject to execution to satisfy a judgment. Tex. Fam. Code § 3.202. The standard is "just and equitable." The court is directed to consider the "facts surrounding the transaction or occurrence" giving rise to the liability. One spouse could trigger this process of paying debts in a divorce.

B. Secure Interspousal Payments by Lien.

Every divorce attorney contemplating a situation where the client is to receive payments from the other spouse in the future should consider obtaining a lien to secure the promise.

1. If Case is Settled. In *McGoodwin v. McGoodwin,* 671 S.W.2d 880 (Tex. 1984), the Supreme Court held that where the husband agrees to pay money to the wife in consideration of her interest in a piece of property, and that promise is included in an agreement incident to divorce, an implied vendor's lien arises from the agreement, such that the wife can foreclose on a one-half interest in the property despite the husband's assertion of homestead protection. However, it would be better to retain a vendor's lien in the deed between spouses, and to secure signed deeds of trust on all real estate that is to be used as collateral.

2. If Case is Tried. A divorce court can secure such a money judgment by an equitable lien in property awarded to the obligor spouse. An equitable lien is different from the judgment lien which arises upon the filing of an abstract of judgment. An equitable lien is created by virtue of a declaration contained in the decree of divorce. In *Hanson v. Hanson,* 672 S.W.2d 274 (Tex. App.--Houston [14th Dist.] 1984, writ dism'd), the court of appeals said that a trial court should provide security for money judgments granted to achieve an equitable division of the community estate, so as to protect the receiving party "from uncertainties such as bankruptcy, concealment, and use of assets, which could work to deprive the party of his share of the community estate." *Id.* at 279. However, several courts have declined to reverse for the failure to impose an equitable lien in a divorce. *See Wren v. Wren,* 702 S.W.2d 250 (Tex. App.--Houston [1st Dist.] 1985, writ dism'd); *Wisdom v. Wisdom,* 575 S.W.2d 124 (Tex. Civ. App.--Forth Worth 1978, writ dism'd); *Goldberg v. Goldberg,* 392 S.W.2d 168 (Tex. Civ. App.--Fort Worth 1965, no writ).

A question arises as to whether the court can affix an equitable lien in homestead. Cases suggest that the court can affix a lien in the homestead to secure: reimbursement for community funds spent in payment of a purchase money lien against the property, *Day v. Day,* 610 S.W.2d 19 (Tex. Civ. App.--Tyler 1980, no writ); a money judgment to the husband for his leasehold interest in the wife's separate residence, *Buchan v. Buchan,* 592 S.W.2d 367 (Tex. Civ. App.--Tyler 1980, writ dism'd); an amount awarded the other spouse for his or her homestead interest in the property, *Wierzchula v. Wierzchula,* 623 S.W.2d 730, 732 (Tex. Civ. App.--Houston [1st Dist.] 1981, no writ). Some cases have said that a lien should not be affixed in homestead to secure a money judgment not specifically referable to the homestead. *See Wren v. Wren,* 702 S.W.2d 250 (Tex. App.--Houston [1st Dist.] 1985, writ dism'd); *Wierzchula,* supra at 732 (lien is permissible only to secure payment of a sum awarded for the other spouse's homestead interest).

There is some doubt whether a judgment given to achieve an equitable division of the community estate can be secured by an equitable lien in a spouse's separate property. *Duke v. Duke,* 605 S.W.2d 408 (Tex. Civ. App.--El Paso 1980, writ dism'd), held that ordering a spouse to execute a deed of trust in his separate property to secure a promissory note granted to the other spouse violated the proscription of *Eggemeyer* against divestiture of separate property. By extension the same reasoning would apply to a court-ordered equitable lien. The case of *Smith v. Smith,* 715 S.W.2d 154 (Tex. App.--Texarkana 1986, no writ), supports this proposition to the extent that the court of appeals would permit a lien in a spouse's separate property only to secure a claim for reimbursement relating to the property put under lien. However, several other courts of appeals have held that imposing such a lien on separate property does not violate *Eggemeyer. See Mullins v. Mullins,* 785 S.W.2d 5 (Tex. App.--Fort

Worth 1990, no writ); *Buchan v. Buchan,* 592 S.W.2d 367, 371 (Tex. Civ. App.--Tyler 1980, writ dism'd); *Wisdom v. Wisdom,* 575 S.W.2d 124, 125-26 (Tex. Civ. App.--Fort Worth 1979, writ dism'd).

3. Dischargeability In Bankruptcy. 11 U.S.C. §523(a)(5) of the federal Bankruptcy Code excepts from discharge debts owed "to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or such spouse and child, in connection with a separation agreement, divorce decree, or property settlement agreement . . . ." The Fifth Circuit Court of Appeals long ago established that payments to be made after the divorce by one spouse to another can be non- dischargeable alimony in bankruptcy. *In re Nunnally,* 506 F.2d 1024 (5th Cir. 1975).

When the dischargeability of such an obligation arises in bankruptcy, the bankruptcy court must "determine the true nature of the debt, regardless of the characterization placed on it by the parties' agreement or the state court proceeding." *In re Benich,* 811 F.2d 943, 945 (5th Cir. 1987). The bankruptcy court hears extrinsic evidence on the point. The burden is on the person asserting nondischargeability to prove it. In *Benich,* the husband's obligation in the agreement incident to divorce to pay the wife $ 725.00 per month for three months and then $ 400.00 per month for life or until remarriage was found by the bankruptcy judge to be nondischargeable, and this finding was affirmed by the Fifth Circuit. In the case of *In re Smith,* 97 B.R. 326 (Bkrtcy.N.D.Tex. 1989), a former husband's obligation under an Agreement Incident to Divorce to pay off a $ 130,000.00 promissory note to the former wife over twenty years was deemed to be nondischargeable alimony. In the case of *In re Pattie,* 112 B.R. 437 (Bkrtcy.M.D.Fla. 1990), a $ 250,000.00 lump sum payment ordered in the divorce "to effect equitable distribution and as a lump sum alimony payment" was held to be dischargeable. The Court in *Pattie* listed ten different factors to consider in determining whether an obligation is for support or property division.

C. Duty to Pay Debts Owed to Third Parties and to Indemnify the Other Spouse. The following considerations arise in connection with promises or obligations by one spouse to pay after the divorce, debts owed to third parties, and to hold the other spouse harmless from those debts.

1. Form Book: Indemnification for Listed Debts. The sample decree of divorce in the Texas Family Law Practice Manual, Form 17-1, awards debts to each party, and provides that the party made responsible for debts and obligations "shall indemnify and hold [the other] harmless from any failure to so discharge these debts and obligations." Similar indemnification in Form 17-6. It is important to remember that an indemnification obligation is performable in the future, just like a promissory note. The very same factors that might lead to the granting of collateral or security for a promissory note exist in connection with an indemnification obligation. In *Stapler v. Stapler,* 720 S.W.2d 271 (Tex. App.--Fort Worth 1986, no writ), the court of appeals found that in an agreed divorce the award of land to the former wife was dependent upon the former wife's paying certain unrelated debts, and that an implied vendor's lien in the land arose in favor of the former husband to secure the former wife's obligation to pay unrelated debts. The ex-husband was allowed to foreclose on the land to collect his judgment for damages caused by the ex-wife's failure to pay the debts.

2. Form Book: Indemnification for Unlisted Debts. The sample agreement incident to divorce in the Texas Family Practice Manual, Form 17-6, requires each party to indemnify the other for debts, obligations, or other liabilities incurred by such party not described in the agreement incident to divorce. The indemnification obligation includes the duty to pay any loss, cost, expense, penalty, or other damages, such as counsel fees and expenses of investigation, etc. This indemnification obligation applies only to debts and obligations not described in the agreement. If the obligation is specifically assigned to a spouse, then the indemnification language in the award of debts would apply. It should be noted that the form decree of divorce does not contain an equivalent indemnification clause for undisclosed debts.

3. Dischargeability in Bankruptcy of Duty to Pay Creditors and Hold Other Spouse Harmless. The same standards of determining the dischargeability of a payment between spouses applies to an obligation of a spouse to pay creditors of jointly-owed debts, and to hold the other spouse harmless therefrom. If the obligation is in the nature of support of the other spouse or children, it is not dischargeable in bankruptcy. If the promise is in the nature of property division, it is dischargeable. *See In re Calhoun,* 715 F.2d 1103 (6th Cir. 1983). The fact that the obligation is to pay third parties rather than the ex-spouse is of no consequence. *Id* at 1107. *Accord, In re Coil,* 680 F.2d 1170 (7th Cir. 1982); *In re Williams,* 703 F.2d 1055 (8th Cir. 1983); *Draper v. Draper,* 790 F.2d 52 (8th Cir. 1986); *Stout v. Prussel,* 691 F.2d 859 (9th Cir. 1982); *In re Goin,* 808 F.2d 1391 (10th Cir. 1987).

In the case of *In re Gianakas,* 112 B.R. 737 (W.D.Pa. 1990), the federal district judge affirmed a bankruptcy judge's ruling that a former husband's promise, in the agreement incident to divorce, to pay the second lien mortgage on the home awarded to the former wife in the divorce, was nondischargeable support. In the case of *In re Robinson,* 113 B.R. 687 (D.Colo. 1990), a bankruptcy judge ruled that the former husband's divorce-time promise to pay the second lien on the home awarded to the former wife was in the nature of support and would be non-dischargeable. However, the former wife had refinanced the debt, and the bankruptcy judge ruled that in doing so she extinguished the debt the former husband was obligated to pay. On appeal, the federal district judge affirmed the finding that the obligation was in the nature of support and therefore non-dischargeable, but reversed as to the extinguishment of the debt, holding that the former husband had a non- dischargeable obligation to pay the refinanced loan.

In *In re Woods,* 561 F.2d 27 (7th Cir. 1977), an indemnification obligation running from the ex-husband to the ex-wife as to debts owed to third parties was discharged in the ex-husband's later bankruptcy, as being part of the property settlement and not support for the ex-wife. In *Smith v. Smith,* 595 S.W.2d 631 (Tex. Civ. App.--Fort Worth 1980, no writ), the former husband failed to list his ex-wife as a creditor in his bankruptcy, so that after the bankruptcy was concluded she was able to recover a judgment against him for breaching his promise to pay debts owed to third parties.

An obligation to pay creditors was discharged in *In re Cline,* 114 B.R. 665 (Bkrtcy.D.Neb. 1990).

D. Tax Liability. Each spouse is liable for income and social security and medicare taxes on his or her income. In community property states, like Texas, an additional complication sets in. A spouse in a community property state owns only one-half of his/her community income, and also owns one-half of the other spouse's community income. If the spouses file separate returns, each spouse must report one-half of his income, and one-half of the other spouse's income. Each spouse will be personally liable for the tax liability on one-half of the community income, and on any of the spouse's separate property income. If the spouses file a joint return, then all income will be combined into one figure, and each spouse who signs the joint return will be personally liable for all taxes owed on all income reported on the tax return. A spouse, by signing a joint return, makes himself/herself personally liable for payment of the other spouse's tax liability.

E. Partition Agreement Versus Agreement Incident to Divorce. As discussed in Section VIII.A above, the rights of creditors to collect debts from available assets are not impaired by a divorce and property division. Thus, an agreement incident to divorce may be seen as being subject to the rights of creditors. On the other hand, Texas Constitution article XVI, section 15, provides that spouses can partition or exchange their community property into separate portions, if this is done without the intent to defraud preexisting creditors. *See also* Tex. Fam. Code § 4.106 (partitions or exchanges void as to creditors who are defrauded thereby). Can a divorce be settled with a partition agreement instead of an agreement incident to divorce, and have the better protection afforded partitions under the Texas Constitution?[9]

F. Use of Assets to Pay Debts. The parties may agree that assets will be liquidated and used to pay debts. The divorce court also can order this. However, the court cannot require spouses to liquidate property which is exempt from the claims of creditors and require them to use this money to pay unsecured creditors. *Delaney v. Delaney,* 562 S.W.2d 494 (Tex. Civ. App.--Houston [14th Dist.] 1978, writ dism'd); *Klein v. Klein,* 370 S.W.2d 769 (Tex. Civ. App.--Eastland 1963, no writ).

Where cash is going to be used to pay debts, or assets liquidated and the proceeds used to pay debts, cautious lawyers will want to assure that the money or assets targeted for this purpose are in fact used for this purpose. As to cash, require that it be paid at or before the decree of divorce is signed by the Court, or put it in a trust account or joint account requiring two signatures. As to assets to be liquidated, either put title in escrow or make the spouses joint payees, so that one spouse cannot misdirect the proceeds.

XIII. CREDITORS' REMEDIES.

A. Fraudulent Transfers. In 1987 the Texas Legislature enacted the Uniform Fraudulent Transfer Act, replacing an older Texas statute on the subject. The Uniform Fraudulent Transfer Act is contained in Chapter 24 of the Texas Business and Commerce Code. It is similar in concept to prior law, but different in various details.

1. Fraudulent Conveyance Can Be Set Aside. Under Section 24.008, a creditor can obtain "an avoidance" of a fraudulent transfer or obligation, to the extent necessary for the creditor to satisfy his claim. The creditor can secure an attachment or other provisional remedy against the asset transferred. And the creditor can obtain an injunction to stop further attempts to convey or encumber the property in question, or the appointment of a receiver to take charge of the asset in question or even other property of the *transferee*, or "other relief the circumstances require." Where the creditor has obtained a judgment against the debtor, the creditor levy execution on the transferred asset or its proceeds. Tex. Bus. & Com. Code § 24.008.

2. When Can This Be Done? Relief from a fraudulent transfer is afforded under Section 24.005 and also section 24.006 of the Texas Business and Commerce Code.

a. Section 24.005 Transfers. Under Section 24.005 of the Texas Business and Commerce Code, a transfer made, or obligation incurred, by a debtor is fraudulent as to a present or future creditor, if the debtor made the transfer or incurred the obligation:

(1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or

(2) without receiving a reasonably equivalent

value[5] in exchange for the transfer or obligation, and the debtor was: (i) engaged or about to engage in an undercapitalized business or transaction; or (ii) intended to incur, or believed that he would incur, debts beyond his ability to pay as they become due.

Tex. Bus. & Comm. Code § 24.005(a). Section 24.005(b) lists (non-exclusively) eleven factors that can be considered in determining the actual intent of the debtor. They include:

- whether the transaction was with an "insider"
- whether the debtor retained possession or control of the property transferred
- whether the transaction was concealed
- whether the transfer was of substantially all of the debtor's assets
- whether what was received was reasonably equivalent to what was given up
- whether the debtor was insolvent or became insolvent shortly after the transaction

b. Section 24.006 Transfers. Under Section 24.006 of the Business and Commerce Code, a transfer made, or obligation incurred, by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or obligation incurred, if:

(a) the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor was insolvent[6] at that time or the debtor became insolvent as a result of the transaction;

(b) the transfer was made to an insider[7] for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.

Tex. Bus. & Com. Code § 24.006.

3. Spouses and Children as Creditors. Cases interpreting prior law acknowledged spouses as creditors who could invoke the powers of the

[5] Various concepts of "value" and "reasonably equivalent value" are described in Section 24.004(b). For example, Section 24.004(a) concedes that value is received where property is transferred or a preexisting debt is secured or a pre-existing debt is satisfied in the transaction under attack. However, value does not include an unperformed promise made outside the ordinary course of the prommisor's's business to furnish support to the debtor or another person. Section 24.004(b) provides that a reasonably equivalent value is given if a third party acquires the debtor's interest in the asset pursuant to a regularly conducted, noncollusive foreclosure sale, based upon default under a mortgage, deed of trust, or security agreement. Section 24.004(d) provides that "reasonably equivalent value" includes a transfer or obligation that is "within the range of value for which the transferor would have wilfully sold the assets in an arms length transaction."

[6] Insolvency is discussed in Section 24.003. A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation. "Assets" does not include assets that were transferred in a fraudulent transfer. "Debts" does not include secured obligations to the extent they are secured by valid lien in property not included as an "asset." A debtor who is generally not able to pay his debts as they come due is presumed to be insolvent. Tex. Bus. & Comm. Code § 24.003.

[7] "Insider" is defined in Section 24.002(7). If the debtor is a person, "insiders" include relatives, or partnerships or corporations owned or managed by the debtor. If the debtor is a corporation, "insiders" include officers, directors, or persons in control. If the debtor is a partnership, "insiders" include a general partner, or relative of a general partner, or affiliated business.

previous fraudulent conveyance statute. *See* Orsinger, Intra and Inter Family Transactions, State Bar of Texas Advanced Family Law Course J-19 (1983). Chapter 24 of the Business & Commerce Code (the Uniform Fraudulent Transfer Act) now governs these transactions. This Act can be used by creditors to set aside transfers in fraud of the creditors' rights.

A spouse is considered to be a creditor. §24.002(4). A transfer (or obligation incurred) is fraudulent as to a creditor whose claim arose before the transfer, or within a reasonable time thereafter, where the transaction was done "with actual intent to hinder, delay, or defraud any creditor of the debtor." The statute prescribes a list of factors to consider in determining actual intent, including whether the recipient was an insider, whether the transferor retained control, whether the transfer included most of the debtor's assets, and the like. A transfer (or obligation incurred) is also fraudulent as to a creditor whose claim arose before the transfer or obligation arose if (a) the debtor was insolvent, at the time or as a result of the transaction, and the debtor did not receive a reasonably equivalent value in exchange for the transaction, or (b) the transfer was by an insolvent creditor to an insider in discharge of an antecedent debt, where the insider had reasonable cause to suspect involvency. *Id.* § 24.006. A creditor who succeeds in a fraudulent transfer suit can set aside the transfer, obtain an injunction, have a receiver appointed, and more. *Id.* **§** 24.008.

The present statute explicitly lists "a spouse, minor, or ward, who has a claim." Tex. Bus. & Com. Code Ann. § 24.002(4). Additionally, the term "claim" as used in the statute includes a right to property. Tex. Bus. & Comm. Code Ann. § 24.002(3). A spouse, minor, or ward has a special limitation period. An action under section 24.005 (intent to hinder, delay or defraud) or 24.006(a) (transfer by insolvent debtor) must be brought within two years after the cause of action accrues, or if later, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant. An action under Section 24.006(b) (transfer by insolvent debtor to insider for antecedent debt) must be brought within one year after the date the transfer was made. *Id. §* 24.010.

See Jackson Law Office v. Chappell, 37 S.W.3d 15 (Tex. App.--Tyler 2000, pet. denied) (transfers by debtor to mother and former lover were fraudulent); *Putman Pension Plan v. Stephenson,* 805 S.W.2d 16 (Tex. App.--Dallas 1991, no writ) (debtor's transfer of community property to his own pension plan was fraudulent).

B. Secured Property. Chapter 9 of the Texas Business and Commerce Code governs the use of personal property as security for indebtedness. Section 9.109 describes the scope of Chapter 9, and includes "a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract...." Perfection of a security interest in chattel paper, deposit accounts, documents, and goods covered by documents, instruments, investment property, letter-of-credit rights, and money; perfection by permissive filing; temporary perfection without filing or transfer of possession are governed by Section 9.312, and require control of the collateral. Under Section 9.104, a deposit account is under control of the secured party if, among other things, the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor.

C. Setoff. In some circumstance, banks have a right of "setoff," which is the common law right of a lender to seize a debtor's deposits with that lender for non-payment of an obligation. Thus, if a debtor with $1,000 in deposit at a bank defaults on a $500 note owed to that bank, the bank may seize $500 from the funds the debtor has on deposit to set off the obligation owed. One important limitation to the right of set-off is the Truth in Lending Act, which prohibits set-off in some consumer credit transactions.

If your client has an unsecured bank loan, as well as community *and* separate property on deposit at the bank, have them withdraw the separate funds from the bank, so the set-off can only be exercised against community property funds.

D. Turnover Proceedings. Civil Practice and Remedies Code Section 31.002 gives the court the power to assist collection of a judgment through court proceedings. This remedy is available where the property of the judgment debtor cannot readily be attached through ordinary legal process, and the property is not exempt. The exclusion of exempt property does not apply to enforcement of a child support obligation. *Id. §* 31.002(f). The court can issue a turnover order, appoint a receiver to sell the property, and enforce by contempt a refusal to obey. The creditor can also recover attorneys' fees. *Id.* §31.002(e).

Courts of appeals have disagreed whether a turnover order can be directed to third parties holding property for a judgment creditor. *Compare Parks v. Parker,* 957 S.W.2d 666, 668-69 (Tex. App.--Austin 1997, no pet.) (cannot issue order against third party); *Cross, Kiesch-nick & Co. v. Johnston,* 892 S.W.2d 435, 439 (Tex. App.--San Antonio 1994, no writ) (improper to issue turnover order against non judgment debtor); *with Lozano v. Lozano,* 975 S.W.2d 63, 68 (Tex. App.--Houston [14th Dist.] 1998, pet. denied) (turnover statute allows a court to reach assets owned by and subject to control of a judgment debtor, even in the hands of a third party); *Dale v. Finance Am. Corp.,* 929 S.W.2d 495, 498 (Tex. App.--Fort Worth 1996, no writ) (turnover order can be issued to third party holding property under the control of the judgment debtor); *Plaza Court, Ltd. v. West,* 879 S.W.2d 271, 277 (Tex. App.--Houston [14th Dist.] 1994, no writ) (court, in dicta, said that turnover statute can be brought against a non-judgment creditor if the property is subject to the possession or control of the judgment debtor).

E. Other Remedies. Creditors may also seek other remedies, such as foreclosing on real estate, hiring a debt collection agency, or filing an adverse claim with a credit reporting agency.

XIV. CREATION OF ENTITIES. Corporations and partnerships have certain features which affect what funds creditors can access.

A. Corporations. Since a corporation has a separate legal identity from the shareholders, all assets of a corporation belong to the corporation and not the shareholder. *Legrand-Brock v. Brock*, 246 S.W.3d 318, 322 (Tex. App.--Beaumont 2008, pet. denied) (*citing Bryan v. Sturgis Nat'l Bank*, 40 Tex. Civ. App. 307, 90 S.W. 704, 705 (Tex. Civ. App. 1905, writ ref'd) ("The accumulated earnings or surplus funds of a corporation constitute a part of its assets, and belong to the corporation, and not to the stockholders, until they have been declared and set apart as dividends."). TBCA art. 4.01B provides that a shareholder has no vested right resulting from the articles of incorporation.

One of the signature qualities of a corporation is that shareholders are not liable for corporate debts. However, shareholders can be held liable for corporate debts under the equitable doctrine of "piercing the corporate veil." *See Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986). The holding in *Castleberry*, that a complaining party may show either actual or constructive fraud in order to prove that a corporation had been used as a sham to perpetrate a fraud, has been limited by TBCA art. 2.21A(1) & (2) as to contract creditors, effective August 28, 1989. Piercing the corporate veil based on "failure of the corporation to observe any corporate formality" has been eliminated as to any "obligation of the corporation." Id. The statute has been held to be retroactive. *Farr v. Sun World Sav. Ass'n*, 810 S.W.2d 294, 296 (Tex. App.--El Paso 1991, no pet.). The effect, if any, of *Castleberry* and Article 2.21A on piercing the corporate veil in divorce proceedings is still being worked out.

B. Partnerships. Some of the Texas marital property cases involving partnerships were decided at a time when Texas followed the aggregate theory of partnership. On January 1, 1962, it is said that TUPA ushered the entity theory of partnership into Texas. TUPA was replaced effective January 1, 1994, by TRPA. The holdings and analysis in Texas cases involving partnerships and marital property law should be considered in the context of the common law or partnership statute that governed the case. For example, the significant Texas Supreme Court case of *Norris v. Vaughn*, 152 Tex. 491, 260 S.W.2d 676 (1953), was decided before TUPA.

The normal rules of marital property govern whether a partnership interest is separate or community property at the time it is acquired. *See In re Marriage of Higley*, 575 S.W.2d 432 (Tex. Civ. App.--Amarillo 1978, no writ) (partnership interest acquired prior to marriage was separate property); *Horlock v. Horlock*, 593 S.W. 2d 743 (Tex. Civ. App.--Houston [1st Dist.] 1980, writ ref'd n.r.e.) (limited partnership interest acquired by husband after divorce was his separate property); *York v. York*, 678 S.W.2d 110 (Tex. App.--El Paso 1984, writ ref'd n.r.e.) (partnership interest acquired during marriage deemed to be community property).

The Texas Revised Partnership Act establishes that specific partnership assets do not belong to a spouse. TRPA art. 5.01. They therefore are neither separate nor community property. A court in a divorce cannot award specific partnership property to either spouse. *McKnight v. McKnight*, 543 S.W.2d 863, 867-68 (Tex. 1976).

XV. HEALTH CARE COVERAGE.

A. Private Health Insurance. The major source of health insurance for clients not covered by Medicare is private employer-sponsored group health insurance. Private health insurance can be purchased on an individual basis, but typically it costs more and covers less. A good summary of health insurance for Texas residents is *A Consumer's Guide to Getting and Keeping Health Insurance in Texas* on the web at <http://www.healthinsuranceinfo.net/statecoverageguides/TexasHealthInsuranceGuide.pdf>.

B. COBRA. The Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA) amended ERISA to require private employee benefits plans (for 20 or more employees) to permit employees and their dependents, at their own expense, to continue group health care benefits if they leave the group due to a "qualifying event." "Qualifying events" include loss of benefits coverage due to (1) the death of the covered employee, (2) a reduction in hours that causes the worker to lose eligibility for coverage, (3) divorce, which normally terminates the ex-spouse's eligibility for benefits, or (4) a dependent child reaching the age at which coverage terminates. <http://www.dol.gov/dol/topic /health-plans/cobra.htm>. Where the qualifying event is divorce, coverage can be continued for up to 36 months. <http://www.dol.goviebsa/faqs/faq _consumer_cobra.ht ml>.

C. HIPAA. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) contains "portability rules" that allow workers to change jobs and group health plans more easily without being denied benefits under the new health plan because they had a pre-existing health condition.

D. Texas' High Risk Health Insurance Pool. Texas has a high risk pool health insurance program, called the Texas Health Insurance Risk Pool. This plan offers health coverage for persons who are HIPAA eligible and for people with expensive health conditions who are unable to buy individual coverage. You qualify for the Risk Pool if you are HIPAA eligible. More explanation is set out in *A Consumer's Guide to Getting and Keeping Health Insurance in Texas,* <http://www.healthinsuranceinfo.net/statecoverageguides/TexasHealthInsuranceGuide.pdf>.

XVI. UNDOING TRANSFERS IN BANKRUPTCY. There are a number of different situations where a court in bankruptcy can undo prior transfers, or invalidate liens. The matter is only touched on here, with a caveat to the reader that there is complexity and controversy in this area of the law. Cases barring bankruptcy discharge because of this kind of activity are included, for good measure.

A. Preferences. Section 547 of the federal Bankruptcy Code (11 U.S.C. § 547) relates to preferential transfers made by a debtor shortly before filing for bankruptcy. A transfer of a debtor's interest in an asset is a preference which can be set aside if the transfer is made within ninety days of the filing of the bankruptcy petition, and the transfer was for the benefit of a creditor on account of a debt owed by the debtor prior to when the transfer was made, and the transfer was made when the debtor was insolvent, and the creditor thereby received more than it would receive if the case were a Chapter 7 liquidation and the payment were made under the Bankruptcy Code.

B. Avoidance of Lien in Homestead. Family law practitioners who secure for their client a court-ordered lien in the homestead to secure a money judgment on a divorce take heed! Your lien may be subject to avoidance in bankruptcy.

11 U.S.C. § 522(f)(1) of the federal Bankruptcy Code permits a debtor to avoid a lien in the following circumstances:

1. The lien is fixed on an interest of the debtor in property;

2. The lien impairs an exemption to which the debtor would otherwise be entitled; and

3. The lien is a judicial lien.

In *In re Sanderfoot*, 899 F.2d 598 (7th Cir. 1990), the Seventh Circuit Court of Appeals invalidated a lien in the husband's home, where the lien had been given to the wife in a decree of divorce, to secure the husband's obligation to pay the wife money as part of the property division. In the divorce, the trial court awarded the wife property valued at $1,000, and awarded the husband property valued at $60,000. To achieve a fair division of the property, the court ordered the husband to pay the wife some $29,000, in two installments, one due four months and one due seven months after the divorce. The husband later filed Chapter 7 bankruptcy, and sought to avoid the lien securing the debt, which remained entirely unpaid. The Seventh Circuit characterized the problem as follows:

> The issue before the court is whether 11 U.S.C. §522(f) allows a bankruptcy creditor to avoid a lien against his homestead where the lien was granted to the debtor's former spouse under a divorce decree.

Id. at 600. The Seventh Circuit rejected that argument that the lien attached to an interest of the wife in the home, and not an interest of the husband, saying that any rights the wife had in the house were extinguished when the decree awarded the house to the husband. The lien was therefore "fixed on an interest of the debtor in property," meeting the first prong of the test. It was undisputed that the home was exempt under state law as homestead, so that the second prong of the test was met. And the lien was a judicial lien, having been created by the decree of divorce, so that the third prong of the test was met. The former wife's lien was therefore invalidated.

On appeal, the United States Supreme Court overruled *Sanderfoot*, holding that "[section] 522(f)(1) of the Bankruptcy Code requires a debtor to have possessed an interest to which a lien attached, before it attached, to avoid the fixing of the lien on that interest." *Farrey v. Sanderfoot*, 500 U.S. 291, 301, 111 S.Ct. 1825, 114 L.Ed.2d 337 (1991). The Court examined the legislative history and the reasons for the enactment of section 522(f), and reasoned that its primary purpose was to avoid a "race to the courthouse" between a debtor filing bankruptcy and their creditors seeking to get a judgment lien in place before the filing. *Id.* at 297. Reasoning that section 522(f) was intended to allow a debtor to avoid a lien on exempt property only if the lien attached *after* the debtor acquired their interest, the Court observed that Wife's lien and Husband's fee simple interest accrued simultaneously through the divorce decree. *Id*. at 296, 299-300. Thus, Husband "took the interest and the lien together, as if he had purchased an already encumbered estate from a third party." *Id*. at 300. As a result, Wisconsin's homestead exemption did not apply to this lien. *Id*. at 299-300.

Subsequently, Texas courts applied *Farrey*, with one concluding that Texas and Wisconsin marital property law are comparable, and that, because the community property interest of a spouse terminates on divorce, the division of property via divorce is the acquisition of a new interest. *See generally In re Finch*, 130 B.R. 753 (S.D.Tex. 1991). Another Texas court limited *Farrey*'s scope to situations where community property interests are *divided*, not to include situations where separate property interests are *confirmed*. *See In re Parrish*, 144 B.R. 349, 353 (Bankr.W.D. Tex.) *aff'd and remanded* 161 B.R. 785 (W.D.Tex. 1992).

C. Undoing Fraudulent Conveyances. Section 548 of the Bankruptcy Code allows a bankruptcy trustee to set aside certain conveyances which constitute fraudulent transfers, thus bringing the property recovered back into the estate. The controlling statute is 11 U.S.C. § 548, of the federal Bankruptcy Code. In general terms, there are two three-prong tests: (1) the debtor transfers an interest in property, within one year of filing bankruptcy, with the intent to hinder, delay, or defraud any entity to which the debtor is then indebted; (2) the debtor transfers an interest in property, within one year of filing bankruptcy, at a time when the debtor was insolvent, and the debtor received less than a reasonably equivalent value in exchange for the transfer.

1. Bona Fide Purchaser Status of Third Party. The case of *In re SLF News Distributors, Inc.,* 649 F.2d 613 (8th Cir. 1981), involved the old Bankruptcy Act provision relating to fraudulent transfers. In this case, the trustee filed suit to recover from a third party the sum of $ 10,000.00, allegedly made as a fraudulent transfer. The third party claimed to be a bona fide purchaser since it had waived its right to file a mechanic's lien on a debt owed to it by the debtor. The transfer met the Act's definition of a fraudulent conveyance: the bankrupt, while insolvent, made a transfer within the year prior to the bankruptcy without receiving "fair consideration." However, the transfer was made to pay the debt of another business. The court found that the third party did not know or receive notice of the fraudulent conveyance, and provided a valid consideration (albeit not to the debtor), and therefore had BFP status.

2. Enhanced Scrutiny of Intrafamily Transfers. In the case of *Orbach v. Pappa,* 482 F.Supp. 117 (S.D.N.Y. 1979), a trustee attempted to set aside as fraudulent a bankrupt's conveyance of his marital residence to his wife. The property had previously been held in tenancy-by-the-entirety. The trustee relied upon Section 70(e) of the Bankruptcy Act which provides that a transfer by a bankrupt which is a fraudulent transfer under any federal or state law is null and void against a trustee of the debtor. In this case, the conveyance rendered the bankrupt insolvent under state law. The Court stated that in an intrafamily transaction, a *heavier burden* is placed on the grantee to establish fair consideration for the transfer. The wife's purported release of an $ 8,000.00 debt owed by husband to wife was not sufficient to save the transaction, where the property transferred was worth $ 100,000.00. The conveyance was set aside. *See In re Porter,* 37 B.R. 56 (Bicrtcy.E.D.V a.1984) (where transfer is between related parties, it is subject to close scrutiny, and if without adequate consideration, it is presumptively fraudulent). *See also In re Stevens,* 112 B.R. 175, 177 (Bankrtcy. S.D. Tex. 1989) (execution of a disclaimer of right to inherit was a fraudulent transfer; fact that debtor's children received the inheritance instead was a "badge of fraud" from which the court can deduce fraudulent intent).

3. Consideration Received Not "Reasonably Equivalent Value." Under Code Section 548(b), a trustee may avoid a transfer of an interest in the debtor's property, made within the year prior to filing for bankruptcy, where the debtor received less than a reasonably equivalent value for the transfer, and the debtor was insolvent on the date of the transaction, or was thereby made insolvent. The term "value" does not include "an unperformed promise to furnish support to the debtor or to a relative of the debtor...." 11 U.S.C. § 548(d)(2)(A). *See In re Butcher,* 72 B.R. 447 (Bkrtcy.E.D.Tenn. 1987) (promise to provide future legal services to debtor's dependents not reasonably equivalent value).

a. Promissory Note With Unfavorable Terms. In the case of *In re Newman,* 11 B.R. 628 (S.D.N.Y. 1981), a Chapter 7 trustee sued to set aside the debtor's transfer of $40,000.00 cash to a corporation owned entirely by his children, in exchange for a $ 40,000.00 promissory note from the corporation, to be paid over 36 years and 11 months at an interest rate of 7% per annum. The Court held that the note was not "the reasonable equivalent" of $ 40,000.00 in cash on hand now. The Court cited old section 548(a)(2) (now section 548(b)) of the Bankruptcy Code as authority that the trustee may avoid any transfer of a debtor's interest in property made within one year of the filing of the petition, if the debtor received less than reasonably equivalent value in exchange for the transfer or obligation and was insolvent on the date of the transfer, or became so as a result of the transfer.

b. Are Family Obligations Enough? In the case of *Butz v. Wheeler,* 17 B.R. 85 (S.D.Ohio 1981), a trustee sought to negate the debtor's transfer of an undivided one-half interest in his tax refund to his wife. The bankruptcy judge held that the Federal law permitting the filing of a joint tax return did not affect the ownership of the refund. The fact that the husband possessed familial responsibilities to the wife was not considered sufficient consideration to cause the transfer to be an allowable preference of a creditor. The husband received nothing of value in exchange for the assignment, and he was insolvent on the date of the transfer. It was therefore a fraudulent conveyance. The court stated that the fact the transfer occurred just prior to the filing of the bankruptcy petition is prima facie evidence of actual intent to defraud. The conveyance was set aside.

4. Do These Rules Apply to Exempt Property? Under Texas law a creditor without a specific lien on an exempt asset cannot attack the transfer of that exempt asset. *Morriss v. Morriss,* 482 S.W.2d 400, 402 (Tex. Civ. App.--Waco 1972, writ ref d n.r.e.); *Collier v. Perry,* 149 S.W.2d 292, 295-96 (Tex. Civ. App.--El Paso 1941, writ dism'd judgmt. cor.). This same rule exists in many other jurisdictions. Some cases involving these issues are discussed below.

a. When Homestead Converted Into Cash Held by Third Party. In the case of *In re Vidana,* 19 B.R. 787 (D.S.Fla. 1982), a trustee sought to rescind a transfer of property pursuant to 11 U.S.C. §§ 544 & 548. Exactly one year before filing for bankruptcy, the debtor and his wife jointly conveyed the homestead they owned in tenancyby-the-entirety to their adult daughter, who gave no consideration. The debtor had outstanding judgments against him at the time. The daughter sold the property for $150,000 to a third party and, after paying the closing costs and mortgage, paid $5,000 to the debtor's wife and kept the rest. The debtor argued that the property was exempt homestead not subject to the claims of creditors, and that therefore the transfer could not have involved the intent to defraud creditors. However, the bankruptcy judge found that the daughter was a straw man used to convert an exempt homestead into cash to be held on behalf of the debtor. The trustee was given judgment against the daughter for the money she retained.

Note that Under Texas law, the proceeds from the sale of a homestead are exempt from the claims of general creditors for up to six months after sale. Tex. Prop. Code § 41.001. After six months, those proceeds lose their exempt status if not reinvested in a new home. A debtor who fraudulently conveys the proceeds from sale of a homestead runs the risk that the six month period will have run by the time the conveyance is set aside, making the funds subject to general creditors' claims.

b. When Homestead Abandoned Upon Marital Separation. The case of *Joe T. Dehmer Distributors, Inc. v. Temple,* 826 F.2d 1463 (5th Cir. 1987), involved a husband's conveyance of his interest in the homestead to his estranged wife, a year and five months prior to his filing a Chapter 7 bankruptcy. Dehmer, a creditor of the husband, sued under 11 U.S.C. § 544(b) to void the transfer as a fraudulent conveyance under Mississippi law. The bankruptcy judge, district judge, and Court of Appeals all agreed that the transaction was a fraudulent conveyance under Mississippi law. The wife cited a Mississippi case holding that the conveyance of a homestead cannot be fraudulent, since it involved an exempt asset which was not subject to the claims of creditors. The lower courts found, however, that the debtor had abandoned the property as homestead when he separated from his wife and moved to another town.

c. Conversion From Non-Exempt to Exempt. In the case of *In re Carey,* 112 B.R. 401 (W.D. Okl. 1989), the federal district judge affirmed the bankruptcy court's decision that the debtor's actions in liquidating all non-exempt property and using the proceeds to pay down the mortgage on the exempt homestead was not done with fraudulent intent. The court cited the following authority:

> With respect to conversions of non-exempt property to exempt property, the law defining the "per se" rule is old and well established. It is succinctly stated in *Crawford v. Sternberg,* 220 F. 73, 76 (8th Cir. 1915), as follows:
>
> It is well settled that it is not a fraudulent act by an individual who knows he is insolvent to convert a part of his property which is not exempt into property which is exempt for the purpose of claiming his exemptions therein, and of thereby placing it out of the reach of his creditors (citations omitted).

See also, Forsberg v. Security State Bank, 15 F.2d 499 (8th Cir. 1926); *In Re Ellingson,* 64 B.R. 271 (Bkrtcy.N.D.Iowa 1986).

Id. at 403. The bankruptcy judge's determination that there was not fraud such as should bar a discharge in bankruptcy was also affirmed.

In the case of *In re Chadwick,* 113 B.R. 540 (Bkrtcy.W.D.Mo. 1990), the debtors paid some $ 70,000.00 on their house mortgage 30 days before filing bankruptcy. The bankruptcy judge wrote:

This type of prefiling planning is universally permitted in respect to homesteads. *See In re Johnson,* 880 F.2d 78 (8th Cir. 1989) (setting forth the Eight Circuit's approval of such activity). Further, Kansas courts, including both federal bankruptcy and state courts, have approved the procedure of "maximizing" the homestead exemption by paying down the mortgage with otherwise non-exempt funds. *See e.g. Barash v. Public Finance Corp.,* 65 F.2d 504 (1981).

In the case of *In re Compton,* 70 B.R. 60 (Blcrtcy.W.D.Pa. 1987), the Court, evaluated the debtor's conversion of non-exempt property into exempt property via transfers to his wife shortly before filing for bankruptcy. Based on case law that a transfer of nonexempt to exempt property can be rescinded if done with the intent to defraud, hinder or delay creditors, the court invalidated the interspousal transfers. In this case, the wife was a co-debtor, and the transfer of property was made to allow the wife to apply Bankruptcy Code exemptions to the assets.

Note that Property Code Section 42.004 provides that a conversion of non-exempt property to exempt property will destroy the newly-argued exempt status, if the conversion is done with the intent to defraud, delay, or hinder interested persons. See discussion at p. 28 above.

d. Incidental Benefit Ignored. *In re Jamison,* 21 B.R. 380 (D.Conn. 1982), involved a preferential transfer of cash by a debtor to a credit union to which he owed money. The debtor had incurred the debt to buy a car which was taken in the son's name. The trustee argued that the debtor's payment to the credit union benefitted the son by increasing the equity in the son's vehicle for which the debtor received no consideration in return. The court noted that there was no depletion of the debtor's estate since the transfer was matched by an equivalent reduction in the debtor's debt. Despite the incidental benefit to the son, the transfer was not set aside.

5. Other Cases. *In re Stevens,* 112 B.R. 175 (Bankr. S.D. Texas 1990), the debtor's renunciation of an interest in his grandmother's probate estate was done for no consideration and while the debtor was insolvent, so the renunciation was canceled as a fraudulent conveyance and the property was brought into the bankruptcy estate. The debtor's children would have received the inheritance if the renunciation stood.

D. Bar to Bankruptcy Discharge for Fraud. Section 523(a)(2), (4) and (6) of the Bankruptcy Code permit the court to except particular debts from discharge. Section 727 of the Bankruptcy Code allows the court to refuse discharge altogether, if fraudulent conveyances occur prior to the filing of the bankruptcy.

1. Barring Discharge as to Certain Debts. Under the Bankruptcy Code, the court may except a particular debt from discharge. For example, in *In re Tressler,* 41 B.R. 779 (Bkrtcy.D.C. Del. 1984), an ex- husband sought to have a debt excepted from discharge in his ex-wife's bankruptcy, under section 523(a)(4), where she didn't pay a debt owed to a third party and awarded to her in the divorce. He argued that his ex-wife had defalcated while acting in a fiduciary capacity. The argument was rejected by the court.

2. Barring Discharge Altogether. The following cases involve efforts to bar a debtor's discharge as a consequence of fraud or fraudulent conveyances.

a. Gift to Grandson Resulting in Discharge Being Denied. *In re Riddle,* 8 B.R. 797 (S.D.Fla. 1980), involved an action by two creditors to deny a debtor's discharge under 11 U.S.C. §727(a)(2)(A). The court observed that under this Section, discharge may be denied if the debtor had actual intent to hinder, delay, or defraud his creditors. Such intent may be inferred and will be presumed if the debtor gratuitously transfers valuable property when pressed by creditors. In this case, the debtor conveyed homes to each of his two daughters, to his secretary, and to his grandson. The first three transfers were completed more than a year before the filing of the bankruptcy petition and could not, therefore, be a ground for denial of discharge under Section 727. The gift to the grandson, however, occurred within a year of filing. The bankruptcy judge found that the debtor did have actual intent to hinder, delay or defraud the creditor-plaintiffs, as well as other creditors. Discharge was denied.

b. Wrongful Intent Must be Clearly Shown. The case of *Matter of Vogel,* 16 B.R. 546 (S.D.Fla. 1981), involved a trustee's attempt to bar discharge on the grounds of a fraudulent conveyance and false oath made in connection with bankruptcy proceedings. The trustee's request was denied. The bankruptcy judge noted that, in the Fifth Circuit, "the rule of law requires a specific proof by the objector to clearly and concisely establish the intention the part of the debtor to conceal assets, to hinder and delay creditors, to make false oath, or to conceal property. This proof cannot be by inference, it must be positive." *Id.* at 549.

c. Shifting Burden. *In re Bateman,* 646 F.2d 1220 (8th Cir. 1981), was an attempt to bar discharge under the old Bankruptcy Act. Here the husband conveyed his one-half interest in a profitable family business to his wife, after which he remained a director of the corporate business. The court stated that "the fact...that valuable property has been gratuitously transferred raises a presumption that such transfer was accompanied by the actual fraudulent intent necessary to bar a discharge . . .. [U]pon a showing that the act alleged was in fact committed, the burden of rebutting the presumption shifts to the bankrupt." *Id See In re Johnson,* 68 B.R. 193 (Bkrtcy.D.Or. 1986) (agreeing that burden shifts upon prima facie showing by creditor).

d. Default in Divorce was Fraudulent Conveyance. In the case of *In re Clausen,* 44 B.R. 41 (Bankr. D. Minn. 1984), discharge was denied under Section 727(a)(2) where the debtor allowed his wife to take a default judgment in a divorce proceeding, thereby acquiring the husband's interest in the parties' homestead. The court found that permitting the default judgment to be taken was done with the intent to hinder or delay the debtor's creditors.

e. Converting Non-Exempt to Exempt. In the case of *In re Ford,* 773 F.2d 52 (4th Cir. 1985), the Court of Appeals affirmed a lower court determination that a debtor husband had fraudulently transferred a piece of real estate from himself to himself and his wife, in tenancy-by-entireties, in an effort to make the property exempt. According to the Court of Appeals, mere conversion of property from non-exempt to exempt is not enough to show the kind of fraud that would bar discharge of the debtor under Section 727. However, if the transfer of property occurs within one year of the filing of bankruptcy, and there is evidence other than the conversion itself to show fraudulent purpose, then the claimed exemption is subject to the provisions of Section 727.

In the case of *In re Reed, 11* B.R. 683 Bankr. N.D. Tex. 1981), *aff'd sub nom First Texas Saving Assoc. v. Reed,* 700 F.2d 986 (5th Dir. 1983), a debtor used nonexempt assets to pay down the mortgage on his homestead. The bankruptcy judge could not invalidate the homestead protection, but he could and did deny the debtor a discharge.

f. Malicious Injury to Property, as an Alternative. The case of *Matter of Ries,* 22 B.R. 343 (W.D.Wis. 1982), was a proceeding brought by a creditor to deny discharge under 11 U.S.C. §727(a)(2)(A). To warrant this, the creditor must show three things: (1) that the debtor transferred, removed, destroyed, mutilated or concealed his property; (2) that he did so within one year of the filing of the petition; and (3) that it was done with the requisite intent. In this case, the creditor did not prove that the transfer occurred within a year of filing, so discharge was not barred. However, the bankruptcy judge was persuaded that the debtor had engaged in a wilful and malicious injury to property under 11 U.S.C. § 523(a)(6). The creditor's debt was therefore not discharged to the extent of the value of collateral wrongfully sold by the debtor.

g. Sustained Course of Transfers Without Consideration. In the case of *In re Powers,* 112 B.R. 184 (Bankr. S.D. Tex. 1990), a Houston area builder's discharge was denied by Judge Letitia Clark, for a series of conveyances to friends, a girlfriend, and employees, all detailed in the Opinion.