

Update on Mortgage-Related Litigation in Texas

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Larry recently served on the Committee established by the Texas Consumer Credit Commissioner to draft plain language consumer contracts. He currently serves on the Manufactured Housing Institute Finance Lawyers Committee, the American Bar Association (ABA) Business Law Section Task Force on Insolvency and the Federal Court Structure and the ABA Business Law Section Planning Committee. Larry is a past Chairman of the ABA Consumer Bankruptcy Committee, the ABA Consumer Financial Services Debt Collection Practices and Bankruptcy Subcommittee and the ABA Commercial Financial Services Interest and Usury Subcommittee.

Larry has defended numerous consumer class actions and has designed Texas home equity lending programs, national debt collection programs, and bankruptcy reaffirmation and post-discharge secured creditor programs. He originated several Bankruptcy Code provisions and wrote part of the Bankruptcy Code's legislative history. He initiated cases that held the bankruptcy court unconstitutional and was in-house bankruptcy counsel to the amicus curiae in *Northern Pipeline Company v. Marathon Pipeline Company*, the United States Supreme Court case that ultimately held the bankruptcy court unconstitutional. As in-house counsel, he further initiated *United States v. Security Industrial Bank*, the United States Supreme Court case that found retroactive lien avoidance under the Bankruptcy Code to be in violation of the Fifth Amendment Taking Clause of the United States Constitution.

Larry attended the University of Michigan Law School and is a former Marine officer.

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Lindsay L. Lambert is a 1991 graduate of South Texas College of Law, where he was a member of the South Texas Law Review and Order of the Lytae. He also interned for Justice Jack Hightower at the Texas Supreme Court.

Prior to law school, Mr. Lambert worked as a mortgage banker, where he focused primarily on residential and consumer lending and compliance issues. In his years since becoming an attorney, Mr. Lambert has defended numerous class action lawsuits involving alleged violations of state and federal consumer lending, debt collection and mortgage banking laws. He has also defended countless actions involving Texas home equity loans and other lending/debt collection lawsuits filed by individuals and class representatives. Mr. Lambert has extensive experience in analyzing procedures and advising clients with regard to avoiding credit/debt related litigation by identifying potential problems and solutions. His primary focus today is defense of consumer financial services litigation, with emphasis on mortgage-related issues.

Mr. Lambert is a partner in the law firm of Hughes, Watters & Askanase, L.L.P. He is an AV rated attorney, and is a member of the American, Texas and Houston Bar Associations. He is admitted in all state courts in Texas, Nebraska and Oklahoma, as well as all federal courts in Texas, and the Fifth and Ninth Circuit Courts of Appeal, as well as the United States Supreme Court.

Mr. Lambert is active in his Church in Bellaire, Texas. He is also a lieutenant in the Bellaire Volunteer Fire Department in the City of Bellaire, Texas. Mr. Lambert was selected as the Volunteer Firefighter of the Year in 2006. In addition, Mr. Lambert is an adult leader in the Boy Scouts of America.

Lindsay L. Lambert – representative cases of note:

LaSalle Bank, N.A. v. White, 246 S.W.3d 616 (Tex. 2007). Established, for the first time, a lender's right to equitable subrogation in those cases in which a home equity lien is declared invalid.

McMillen v. Drive Financial Serv., L.P., 172 Fed. Appx. 896 (10th Cir. 2006). Held that a creditor's reinstatement of a retail installment contract after buyer paid outstanding balance was not a "sale" under consumer protection laws.

Acceptance Ins. Co. v. Lifecare Corp., 89 S.W.3d 773 (Tex. App. – Corpus Christi 2002). Established that allegations of negligence for providing inaccurate information about a former employee is an "occurrence" within the comprehensive general liability insurance policy and such occurrence is not precluded by the "employment-related" exclusion in the policy.

Wilting v. Progressive County Mutual Insurance Company, - 227 F.3d 474 (5th Cir. 2000). Determined that evaluating a request for a premium quote for insurance is "underwriting" within the meaning of federal Fair Credit Reporting Act.

PAUL KELLOGG

My practice focuses on formation of business entities, including non-profits, with an emphasis on partnerships and LLC's, and fundamental issues facing small to medium-size businesses: contracts, non-competition and non-disclosure, protection of intellectual property, employees and consultants, and the purchase and disposition of assets and stock. I also have considerable experience in the areas of multi-state private placements of securities, going-private transactions, debt financing and equity investment. Over the past two years, I have expanded my practice to include commercial and consumer financial services, regulatory compliance and home mortgage/home equity lending and compliance. Before becoming a lawyer, I managed several small businesses and worked several years as a community liaison and issue analyst for two mayors of Houston, Kathy Whitmire and Bob Lanier.

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Memberships

- Houston Bar Association
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Papers and Presentations

"Microsoft v. Vizcaino,"
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I. HOME EQUITY LITIGATION

Mortgage related issues continue to find their way into the courts. Recent pronouncements by the Texas Supreme Court and the Texas Courts of Appeals help clarify important concerns. These decisions are briefly noted immediately below and then discussed in more detail beginning at Part II.

Case Law Summary of Holdings

- The Texas Supreme Court ruled that Section 50(e) does not abrogate the common law doctrine of equitable subrogation, which remains broadly available to lenders who pay off constitutionally permissible pre-existing liens.¹
- Following the Texas Supreme Court ruling on equitable subrogation, a district court held that a lender was entitled to equitable subrogation even where cure provisions under section 50(a)(6)(Q)(x)(b) provided an alternative remedy.²
- A Texas Court of Appeals and a bankruptcy court agreed that a timely and sufficient offer to cure is enough to cure loan defects, and a borrower may not refuse to cooperate.³
- Another Texas Court of Appeals granted summary judgment for the lender on the grounds that the statute of limitations barred an action based on constitutional violations four years after the date of the closing of the loan.⁴
- Several district courts addressing variable-rate loans granted summary judgment in favor of lenders based on 7 TEX. ADMIN. CODE § 153 *et seq.*
- A federal district court in Texas found that Texas law does not impose on lenders a duty of care to parties unrelated to the transaction.⁵

These recent cases are discussed further below.

A. Class Action cases in the Eastern District of Texas

Trahan and *Morehouse* are being discussed together because they involve similar issues.⁶ The plaintiffs argued that variable rate home equity loans (generally called an “adjustable rate mortgage” or ARM) are prohibited under the Texas Constitution. Among other things, the

¹ *LaSalle Bank N.A. v. White*, 246 S.W.3d 616 (Tex. 2008).

² *Cochran v. Ameriquest Mortgage Company*, No. 96-215111-05 (96th Dist. Ct., Tarrant County, Tex. May 20, 2008).

³ *Adams v. Ameriquest Mortgage Co.*, 307 B.R. 549 (Bankr. N.D. Tex. 2004); *Fix v. Flagstar Bank, FSB*, 242 S.W.3d 147 (Tex. App.—Fort Worth 2007, pet. denied).

⁴ *Rivera v. Countrywide Home Loans, Inc.*, 262 S.W.3d 834 (Tex. App.—Dallas 2008, no pet. hist.).

⁵ *Ray v. Carmax Auto Superstores, Inc.*, No. SA-06-CA-366-OG (W.D. Tex. Sep. 27, 2007).

⁶ *Trahan v. Long Beach Mortgage Co. and Washington Mutual Bank*, C.A. No. 9:05CV29 (E.D. Tex.); *Morehouse v. Ameriquest Mortgage Co.*, C.A. No. 05-00075-civ-TH (E.D. Tex.).

plaintiffs sought loan forfeiture under section 50(a)(6)(Q)(x), declaratory and injunctive relief, and recovery of attorney fees. The defendants, contending that the plaintiffs had no valid claims, relied on the text, construction, and reasonable interpretation of the Texas Constitution specifically authorizing variable rate equity loans.

Specifically, the plaintiffs asserted that: (1) the Texas Constitution mandates that equity loans are required to be repaid in substantially equal successive periodic installments; (2) ARM promissory notes allow for payments that are not substantially equal; (3) the Texas Constitution mandates, but that the notes do not provide for, the repayment of the extension of credit in substantially equal successive monthly installments; and (4) ARM notes allow the lenders to improperly modify the payments contrary to the Texas Constitution.

Accordingly, the summary judgment issues included: (1) whether the home equity amendment to the Texas Constitution authorizes variable rate equity loans; (2) whether the home equity amendment requires that payments for equity loans must all be equal or substantially so; and (3) whether the home equity amendment authorizes new schedules of payments for variable rate loans after interest rate adjustments. In their summary judgment motions, the defendants answered these issues by citing sections 50(a)(6)(L) (the repayment section) and 50(a)(6)(O) (the variable rate section) in Article XVI of the Texas Constitution and section 303.015 of the Texas Finance Code as unambiguously authorizing variable rate home equity loans, not requiring that all payments must be equal, and as not being in conflict with the terms of the promissory notes. The defendants' position recognized that, constitutionally, an equity loan is to provide an initial schedule of installments that are substantially equal and sufficient to pay accrued interest, but that the initial schedule is not set in stone. The defendants' arguments are consistent with the Constitutional provision that negative amortization is impermissible because each installment must be at least sufficient to discharge the interest accruing during the month preceding the payment.⁷

The *Morehouse* litigation was transferred pursuant to a MDL Conditional Transfer Order, but vacated and returned to the District Court. The court has yet to enter a new Docket Control Order. The *Morehouse* litigation remains pending while the courts await the resolution of the *Trahan* case. *Trahan* continues to wind its way through the courts. Class certification was granted; however, that issue is currently on appeal to the Fifth Circuit.⁸

B. Related Cases⁹

In a series of similar cases, plaintiffs sought forfeiture of the principal and interest on their home equity loans. The plaintiffs alleged several theories, including fraud, misrepresentation, inflated appraisal, and deceptive trade practices;¹⁰ however, the primary allegation was that the challenged loans violated the Texas Constitution because they were variable-rate home equity loans.

⁷ TEX. CONST. ART. XVI, §50(a)(6)(L).

⁸ Case No. 08-40874 (5th Cir.).

⁹ These cases are representative of variable-rate home equity litigation claims across Texas.

¹⁰ The plaintiffs DTPA failed because the extension of credit is not a "good or service." See, e.g., *Fix v. Flagstar Bank, supra*.

Plaintiffs argue that variable-rate loans are unconstitutional based on a reading of section 50(a)(6)(L)(i). That section requires that home equity loans be

scheduled to be repaid in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment.¹¹

Codification of regulatory interpretations now expressly permits variable-rate home equity loans. The Texas Administrative Code states

A lender may contract for and receive any fixed or variable rate of interest authorized under statute . . . the lender may contract to vary the scheduled installment amount when the interest rate adjusts on a variable rate equity loan. . . . The scheduled installment amounts of a variable rate equity loan must be: (A) substantially equal between each interest rate adjustment; and (B) sufficient to cover at least the amount of interest scheduled to accrue between each payment date and a portion of the principal.¹²

Therefore, as long as a loan is scheduled to be repaid in substantially equal installments over the remaining loan term after each interest adjustment, it is in compliance with the constitutional provisions, statutes, and regulatory interpretations. Section 153 of the Texas Administrative Code became effective Jan. 8, 2004, so variable-rate loans made prior to the effective date of section 153 are not equally insulated. However, the logic behind the interpretation codified by section 153 can be argued to apply with equal force for any variable-rate loan.

C. Marketic v. U.S. Bank Nat'l Ass'n¹³

Under the Texas Constitution, property designated for agricultural use is protected from foreclosure when the foreclosure is to satisfy outstanding debt on a home equity loan.¹⁴ Lenders therefore obviously proceed with caution when a property owner whose property is designated for agricultural use wishes to obtain a home equity loan. However, after *Marketic v. U.S. Bank Nat'l Ass'n*, lenders will need to proceed with even more caution. According to *Marketic*, lenders may not foreclose on property even if that property was not designated for agricultural use at the time of the closing as long as the property is designated for agricultural use prior to foreclosure.¹⁵

In *Marketic*, the property owner agreed to change the property tax designation to “non-agricultural use” in order to obtain the home equity loan. At the time of closing, the property

¹¹ TEX. CONST. art. XVI, § 50(a)(6)(L)(i).

¹² 7 TEX. ADMIN. CODE § 153.1 *et seq.* (effective Jan. 8, 2004).

¹³ 436 F. Supp.2d 842 (N.D. Tex. 2006).

¹⁴ Tex. Const. art. XVI, § 50(a)(6)(I).

¹⁵ *Marketic*, 436 F. Supp.2d at 849-51.

was not designated for agricultural use. After the property owner defaulted on the loan, the owner brought suit for injunctive relief to prevent the lender from foreclosing on the property. The basis for the injunction was that the property was now designated for agricultural use, thereby giving it protection from foreclosure under the Constitution.

The court agreed with the property owner and refused to accept the lender's argument that "the only relevant designation ... is the designation in effect at closing, when the lien is created."¹⁶ The court's interpretation theoretically allows a property owner to obtain a loan on property not designated for agricultural use, and then subsequently designate the property for agricultural use in order to prevent foreclosure. However, one cannot ignore the fact that an agricultural property designation was removed to close a home equity loan, then changed back to agricultural after the closing.

The court based its conclusion on interpretations of the tax code. Other courts have interpreted the phrase "designated for agricultural use" when analyzing statutes governing property tax. Under these statutes, "a property's designation may vary from year-to-year."¹⁷ Therefore, the court reasoned, the designation for purposes of foreclosure should be able to vary from year to year as well. This interpretation places even greater "risk on the lender to ensure that any ... property that may be securitized as collateral for a loan will not be designated for agricultural use in the event of foreclosure."¹⁸ The lender may be required to "show that ... it did not have the means of knowing that [the] land was being used for agricultural purposes and was so designated or would be so designated at the time of possible foreclosure."¹⁹ One cannot imagine, however, that property never designated as agricultural could be deemed "lien free" by changing its designation to agricultural after closing a home equity loan. If so, Constitutional "taking" issues in violation of the Fifth Amendment of the United States Constitution are raised. This case must be confined to its facts: agriculture designation changed for the purpose of closing a home equity loan, then changed back.

As a final matter, the court indicated that it would have preferred to certify this constitutional question to the Texas Supreme Court; however, certification from a federal district court to the Texas Supreme Court is not permitted.²⁰ Because the issue was not certified, the court was quick to point out that "its interpretation of [the Texas Constitution] on this narrow issue of law is not binding precedent in the Texas state courts."²¹

D. LaSalle v. White²²

Lenders who find themselves in the position of the lender in *Marketic* may not be completely without remedy, however. *LaSalle v. White* reaffirmed the doctrine of equitable subrogation, holding that the doctrine continued to be applicable to homestead property, even in the face of TEX. CONST. art. XVI, § 50(e). In *White*, Lorae White took out a home-equity loan to

¹⁶ *Id.* at 848.

¹⁷ *Id.* at 850.

¹⁸ *Id.* at 852.

¹⁹ *Id.* at 853.

²⁰ *Id.* at 852 n.7.

²¹ *Id.* at 852.

²² *LaSalle Bank N.A. v. White*, 246 S.W.3d 616 (Tex. 2008).

refinance and cash out a portion of the equity in her homestead. At the time of the refinance, her homestead was designated for agricultural use. The Texas Constitution prohibits agricultural homesteads from being used to secure a home-equity loan.²³ The homestead was burdened by constitutionally permissible purchase-money liens, as well as state property tax liens. When White refinanced her loan, LaSalle Bank paid off the \$185,011 purchase-money lien and \$9,411 property tax lien. White received \$57,519 in cash.

White failed to timely make payments on her loan, and LaSalle filed an application for home-equity foreclosure. White filed suit seeking a declaratory judgment on the basis that LaSalle had forfeited all principal and interest, and that its lien was invalid, because the loan violated the “agricultural homestead” provision of the Texas Constitution. The trial court and the court of appeals agreed with White, but the Texas Supreme Court reversed in part.

The Court found itself balancing the strong homestead protections in the Texas Constitution²⁴, and a lienholder’s long-standing common law right to equitable subrogation.²⁵ In the final analysis, the Court recognized that the two concepts were not entirely at odds, saying, “[w]ithout equitable subrogation, lenders would be hesitant to refinance homestead property due to increased risk that they might be forced to forfeit their liens. The ability to refinance provides homeowners the flexibility to rearrange debt and avoid foreclosure.”²⁶ Accordingly, the only question the Court faced was whether TEX. CONST. art. XVI, § 50(e), abrogated common law equitable subrogation.

TEX. CONST. art. XVI, § 50(e) states:

(e) A refinance of debt secured by a homestead and described by any subsection under Subsections (a)(1)-(a)(5) that includes the advance of additional funds may not be secured by a valid lien against the homestead unless:

(1) the refinance of the debt is an extension of credit described by Subsection (a)(6) of this section; or

(2) the advance of all the additional funds is for reasonable costs necessary to refinance such debt or for a purpose described by Subsection (a)(2), (a)(3), or (a)(5) of this section.²⁷

Looking at the plain language of § 50(e), the Court could not find any indication that there was any intent to displace equitable common law remedies. “[T]he legal forfeiture that article 50(e) imposes does not destroy the well-established principle of equitable subrogation.”²⁸ Thus, section 50(e) only invalidated LaSalle’s lien related to the cash-out portion of the loan, and

²³ TEX. CONST. art. XVI, § 50(a)(6)(I).

²⁴ *White*, 246 S.W.3d at 618.

²⁵ *Id.*

²⁶ *Id.* at 620.

²⁷ TEX. CONST. art. XVI, § 50(e).

²⁸ *White*, 246 S.W.3d at 619.

to the extent that LaSalle's refinance paid off constitutionally permissible liens, LaSalle was equitably subrogated to the prior lienholder's position.²⁹

E. Cochran v. Ameriquest Mortgage Co.³⁰

In *Cochran*, the Plaintiff alleged that Defendant Ameriquest's Home Equity Loan violated TEX. CONST. art. XVI, § 50(a)(6)(B) by exceeding 80% of the fair market value of her homestead. Cochran's homestead was encumbered by a \$14,900 subordinate lien by the City of Forth Worth, which was a disappearing lien – completely forgiven in the event of compliance, and only payable upon sale, transfer, or abandonment of the homestead. In addition to the subordinate lien, the homestead was also encumbered by tax liens totaling \$2,575 in favor of the City, Tarrant County, Fort Worth I.S.D., and a \$60,483 purchase money mortgage.

Ameriquest argued that since the City's subordinate loan could not subject Cochran's home to a forced sale, it should not be included in the calculation under TEX. CONST. art. XVI, § 50(a).³¹ Alternatively, Ameriquest argued that it was entitled to equitable subrogation for paying off the prior permissible liens.

Cochran argued that *LaSalle* and the doctrine of equitable subrogation were inapplicable because they applied only where there was no adequate remedy at law.³² Under that argument, Cochran stressed, *LaSalle* was correct because there was no way for LaSalle to "undesignate" the borrower's homestead as agricultural property. Therefore, LaSalle lacked any remedy at law, and equitable subrogation was appropriate. Continuing that logic, Cochran argued that Ameriquest should be denied equitable subrogation because Ameriquest had an adequate remedy in the cure provisions under TEX. CONST. art. XVI, § 50(a)(6)(Q)(x)(b).³³

Ameriquest pointed out that *LaSalle* subrogation arises not from the credit transaction in section 50(a)(6), but from payment of constitutionally valid pre-existing liens.³⁴ Furthermore, Ameriquest argued, the Court in *LaSalle* intended for equitable subrogation to be broadly available, as evidenced by their holding that "Article XVI, section 50(e) does not abrogate this longstanding common law principle."³⁵

The court agreed with Ameriquest. Judge Walker found that the subordinate lien did not subject the property to a "forced sale" under TEX. CONST. art. XVI, § 50(a). Therefore, the Home Equity Lien as created was constitutionally valid. Alternatively, Ameriquest's lien paid off prior constitutionally valid liens, and under the doctrine of equitable subrogation, affirmed in *LaSalle v. White*, Ameriquest would stand in the shoes of the prior lienholders.

²⁹ *Id.* at 620.

³⁰ *Cochran v. Ameriquest Mortgage Company*, No. 96-215111-05 (96th Dist. Ct., Tarrant County, Tex. May 20, 2008).

³¹ TEX. CONST. art. XVI, § 50(a) begins, "The homestead of a family, or of a single adult person, shall be, and is hereby *protected from forced sale*, for the payment of all debts . . ." (emphasis added).

³² PL.'S RESP. TO DEF.'S MOT. FOR INTERLOCUTORY SUMM. J. AND SUMM. J. ON BREACH OF CONTRACT CLAIM, § II(F).

³³ *Id.* at § II(J).

³⁴ DEF.'S REPLY TO PL.'S RESP. TO DEF.'S MOT. FOR SUMM. J. at 2.

³⁵ *Id.* at 3 (citing *LaSalle v. White*, 246 S.W.3d 616, 620 (Tex. 2008)).

F. Adams v. Ameriquest and Fix v. Flagstar Bank, FSB³⁶

Fix helps clarify for creditors the time and manner of curing loans in violation of the Texas Constitution. The Fixes had a \$288,000 home equity loan, executed in March 2002. In January 2003, the Fixes refinanced the loan. The refinancing violated two constitutional provisions: (1) it was executed within less than one year after the first loan was executed, in violation of TEX. CONST. art. XVI, § 50(a)(6)(M)(iii); and (2) it was in the form of a conventional loan which allowed for personal liability and nonjudicial foreclosure, in violation of TEX. CONST. art. XVI, § 50(a)(6)(C), and (D).³⁷

The Fixes called the bank to discuss the loan, and also exchanged letters with the bank's vice-president regarding the potential constitutional illegalities. Twenty-one days after receiving the letter, Flagstar offered to cure the constitutional violations by reclosing a new home equity loan, at no cost to the Fixes, with an equal or better rate, and to pay the Fixes \$1,000. The Fixes refused the offer to cure, and brought suit alleging violations of the Texas Constitution and Texas Deceptive Trade Practices Act (DTPA). The trial court granted summary judgment to Flagstar on all claims, and the Fixes appealed.³⁸

The first issue the appeals court considered was whether the September 2003 amendments to the Texas Constitution cure provisions applied retroactively. The court noted that statutes and constitutional amendments generally are only forward-looking; however, they may operate retroactively "when it is apparent that the makers and adopters intended retroactive application of the amendment, provided retroactive application does not impair vested rights."³⁹ Citing *Stringer v. Cendant Mortgage Corp.*, the court used a plain language reading of the text of the amendment, giving effect to the intent of the drafters.⁴⁰ The court stated,

The face of the amendment nowhere indicates that the makers and adopters intended retroactive application. Furthermore . . . the legislative history of the constitutional amendment in this case indicates that the makers meant it as nothing more than a clarification of the cure process.⁴¹

Therefore, the court applied the version of the constitution that existed at the time the loan was created.⁴² That version provided

The lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit

³⁶ *Adams v. Ameriquest Mortgage Co.*, 307 B.R. 549 (Bankr. N.D. Tex. 2004); *Fix v. Flagstar Bank, FSB*, 242 S.W.3d 147 (Tex. App.—Fort Worth 2007, pet. denied).

³⁷ *Fix*, 242 S.W.3d at 152.

³⁸ *Id.* at 152–53.

³⁹ *Id.* at 155.

⁴⁰ *Id.*

⁴¹ *Id.* at 156.

⁴² *Id.* at 157.

within a reasonable time after the lender or holder is notified by the borrower of the lender's failure to comply.⁴³

The court followed the Texas Supreme Court decision in *Doody v. Ameriquest Mortgage Co.*,⁴⁴ which also analyzed the pre-2003 amendment version of section 50(a)(6)(Q)(x), to decide that both the loan and the lien could be validated if there had been a sufficient offer to cure within a reasonable time.⁴⁵ Because Flagstar made the offer to cure within three months of the initial telephone conference giving them notice of the defects, the court held that this three month period, like in *Doody*, was within a reasonable time.⁴⁶ Furthermore, the offer to reclose the loan at the same or better interest rate, at no cost to the Fixes, and to pay them an additional \$1,000, constituted a sufficient offer to cure the defects.⁴⁷

The court did not address the permissibility or effect of the Fixes refusal to accept the offer, because that issue was not presented to the trial court or on appeal.⁴⁸ Therefore, the bank's timely and sufficient offer to cure was satisfactory to validate both the loan and lien.⁴⁹

Finally, the court addressed the Fixes' DTPA claims. The court observed that pure loans did not fall under the DTPA, as money is neither a good nor service. "Because the Fixes had already purchased their house, the Flagstar refinance merely extended credit to the Fixes. As such, the refinance cannot qualify as a good or a service under the DTPA."⁵⁰ Additionally, the Fixes had asserted DTPA claims against the title company involved in the transaction. As to those claims, because the basis of the Fixes' claims was the early refinancing and personal recourse, those claims did not implicate the title company's services.⁵¹

G. Rivera v. Countrywide Home Loans, Inc.⁵²

Wilfredo and Ines Rivera applied for a loan from Countrywide in 2001, secured by their homestead. An appraisal valued the property at \$350,000, and Countrywide agreed to lend \$280,000, eighty percent of the fair market value based on the appraisal. A review appraisal, however, indicated that the fair market value of the property was between \$261,040 and \$293,580. Regardless, the loan was made based on the \$350,000 appraisal. By 2006, the Riveras were unable to keep up with the payments, and the property was scheduled for foreclosure. The Riveras sued, asserting various common law claims, as well as violations of the Texas Constitution, particularly section 50(a)(6)(B) which prohibits lending more than eighty percent of the fair market value of homestead property.⁵³

⁴³ Act of May 24, 2003, 78th Leg., R.S., S.J.R. 42, 2003 Tex. Gen. Laws 6219 (amended 2003) (current version at TEX. CONST. art. XVI, § 50(a)(6)(Q)(x)).

⁴⁴ *Doody v. Ameriquest Mortgage Co.*, 49 S.W.3d 342 (Tex. 2001).

⁴⁵ *Fix*, 242 S.W.3d at 157.

⁴⁶ *Id.* at 158.

⁴⁷ *Id.*

⁴⁸ *Id.* at 158 n.6.

⁴⁹ *Id.* at 158.

⁵⁰ *Id.* at 160.

⁵¹ *Id.*

⁵² *Rivera v. Countrywide Home Loans, Inc.*, 262 S.W.3d 834 (Tex. App.—Dallas 2008, no pet. hist.).

⁵³ *Id.* at 838–39.

The trial court granted summary judgment to Countrywide on its statute of limitations defense and the Riveras appealed. On appeal, Countrywide argued that the action should be barred by the four year statute of limitations, since the cause of action accrued on the date of the loan closing.⁵⁴ The Riveras agreed that the four year statute of limitations applied, but argued that the date of accrual was the date the last installment payment was made. Furthermore, the Riveras argued that the discovery rule and fraudulent concealment doctrine precluded summary judgment based on limitations.⁵⁵

The court observed that the accrual date for a cause of action arising from a violation of a constitutional provision is not defined. The general rule, however, is “the ‘legal injury rule,’ which states that a claim accrues when a wrongful act causes some legal injury, even if the fact of injury is not discovered until later, and even if all resulting damages have not yet occurred.”⁵⁶ Based on this definition, the court concluded that the cause of action accrued on the date of the loan closing.⁵⁷

The Riveras argued that “it would be manifestly unjust to permit a lender to force the sale of a property up to four years after the due date of the last payment . . . while limiting a borrower’s defense against such action to four years after the making of the note.”⁵⁸ The court disagreed; pointing out that a lender’s cause of action arises from a breach of the underlying note when the borrower fails to make a payment, while the borrower’s cause of action arises immediately from the closing of an unlawful loan.⁵⁹

Therefore, since the date of the loan closing was September 28, 2001, the cause of action became barred by September 28, 2005. Since the Riveras did not bring their claim until March 31, 2006, the trial court’s grant of summary judgment to Countrywide was correct.⁶⁰

The *Rivera* opinion stands for the proposition that a cause of action for a constitutional violation arising from a home equity loan accrues on the date of the loan closing. Although the *Rivera* decision was based on the pre-2003 amendment version of the Texas Constitution, the same logic should continue to apply to loans made after the amendments, effectively insulating lenders from stale claims arising from loans made more than four years ago.

It is important to note, however, that the court did not address the Riveras’ arguments that the discovery rule and fraudulent concealment doctrine precluded summary judgment. The discovery rule and the doctrine of fraudulent concealment must be properly pleaded and proved to negate a defense of limitations. Because the Riveras did not properly plead either one, the court concluded that those arguments were waived.⁶¹

⁵⁴ *Id.* at 839.

⁵⁵ *Id.* at 840.

⁵⁶ *Id.* (citing *Murphy v. Campbell*, 964 S.W.2d 265, 270 (Tex. 1997)).

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at 840–41.

⁶⁰ *Id.* at 840.

⁶¹ *Id.* at 841.

H. Rosie Ray v. CarMax Auto Superstores, Inc.⁶²

In a case concerning general consumer credit issues, the court discussed whether a creditor has a duty to protect a third-party from identity theft. Rosie Ray's identity was stolen by one of her employees, Maria Briones. Briones and an imposter used Ray's identity as co-signer on a note to purchase a vehicle from CarMax. Ray subsequently brought suit against CarMax alleging various causes of action, including negligence in failing to verify the identity of the imposter. Ray argued that CarMax had a duty to verify the identity of the person making the signature on the loan documents and failed to do so. CarMax countered that they did not owe a duty to a third-party stranger to the transaction.

The court granted summary judgment in favor of CarMax, finding that Texas law imposed no duty to prevent harm to others absent a special relationship. The court cited various cases for the proposition that a lender owes no duty to parties unrelated to the transaction.⁶³ Therefore, because the plaintiff did not establish that there was a special relationship, the general rule that a person has no legal duty to protect another from the criminal acts of a third person supported the grant of summary judgment for CarMax.

II. OTHER MORTGAGE-RELATED LITIGATION

A. Perez v. Saxon Mortgage Servs., Inc.

In a suit for unlawful debt collection under the Fair Debt Collection Practices Act ("FDCPA"), the *Perez* court upheld a jury trial waiver provision in a mortgage.⁶⁴

Generally, "a party asserting a claim for a violation of the FDCPA has a right to a trial by jury."⁶⁵ However, a knowing and voluntary waiver of the right to a jury will be upheld. The plaintiff in *Perez* argued that the alleged waiver was not knowing and voluntary because "the jury trial waiver provision was inconspicuous."⁶⁶ The court rejected this argument, and found that the waiver provision in the mortgage is conspicuous, since:

- (1) it is in its own separate paragraph, (2) it is in the same size font as the rest of the document, (3) it is located in the last numbered paragraph of a relatively short document, and as such, it cannot be considered to be hidden within the document,

⁶² *Ray v. Carmax Auto Superstores, Inc.*, No. SA-06-CA-366-OG (W.D. Tex. Sep. 27, 2007).

⁶³ See, e.g., *Smith v. Citibank, N.A.*, No. 00-0587-CV-W-1-ECF, 2001 WL 34079057, at *2-3 (W.D. Mo. Oct. 3, 2001) (credit card issuer owed no duty to non-customer who was victim of imposter fraud); *Huggins v. Citibank, N.A.*, 585 S.E.2d 275, 277 (S.C. 2003) (credit card issuers have no duty of care to protect potential victims of identity theft because there is no special relationship); *Polzer v. TRW, Inc.*, 256 A.D.2d 248, 248 (N.Y. App. Div. 1998) (plaintiffs failed to state a cause of action for negligence because credit card issuer had no special relationship with the plaintiffs or with the imposter who stole plaintiffs' personal information and fraudulently obtained the credit cards).

⁶⁴ *Perez v. Saxon Mortgage Servs., Inc.*, No. 8:06-cv-1239-T-24 TBM, slip op. 2006 WL 2868938, at *3 (M.D. Fla. Oct. 6, 2006) order vacated in part by *Perez v. Saxon Mortgage Servs., Inc.*, 2007 WL 430723 (M.D. Fla. Feb. 5, 2007) (vacating portion of order striking request for punitive damages).

⁶⁵ *Id.* at *2 (citing *Sibley v. Fulton Dekalb Collection Serv.*, 677 F.2d 830, 834 (11th Cir. 1982)).

⁶⁶ *Id.* at *3.

and (4) it states in clear and unambiguous language that Plaintiffs are waiving their right to a jury trial.⁶⁷

The court also rejected plaintiffs' argument that the waiver was not voluntary because there was "no parity of bargaining power between the parties and the terms of the mortgage were not negotiable."⁶⁸ In reaching this conclusion, the court held that lack of bargaining power and non-negotiability of terms were not sufficient, standing alone, to prove knowing or voluntary waiver of the right to a jury trial.

B. Sterten v. Option One Mortgage Corp.

A borrower in a Chapter 13 bankruptcy who rescinds a mortgage under the Truth-in-Lending Act ("TILA")⁶⁹ may be allowed to repay in monthly installments that exceed the five year period imposed by 11 U.S.C. § 1322(d).⁷⁰ In *Sterten*, the debtor had successfully rescinded their mortgage under TILA, and the court was left to decide under what terms to implement the rescission.⁷¹

The court noted that there has been considerable "judicial debate concerning ... the degree to which courts have equitable discretion to control the precise manner in which the rescission remedy is implemented."⁷² The court discussed two lines of cases. One line of cases held that the voiding of a mortgage may be conditioned on the debtor tendering the amount owed.⁷³ The other line of cases held that "the voiding of a creditor's security interest occurs before the obligor must tender what is owed."⁷⁴ Because the parties in *Sterten* agreed that termination of the mortgage may be conditioned upon tender of the repayment amount, the court did not need to decide which line of cases to follow.⁷⁵

The court did, however, decide under what terms the repayment was to take place. The court found that the debtor should have "a reasonable time frame to repay the creditor", especially when "the creditor retains the security interest" until final repayment.⁷⁶ The debtor asked the court for a repayment period of 360 months, and although the mortgagor found this period to be "excessive", the court approved the 30 year repayment period. The court thereby approved a repayment period which exceeded the 5 year period under 11 U.S.C. § 1322(d) by 25 years.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ 15 U.S.C. § 1601, *et seq.*

⁷⁰ See *Sterten v. Option One Mortgage Corp. (In re Sterten)*, No. 03-14014-ELF, 2006 WL 2918792, at *7 (Bankr. E.D. Pa. 2006) (agreeing to a 360 month repayment period by the debtor).

⁷¹ *Id.* at *2.

⁷² *Id.* at *3.

⁷³ See *id.* (quoting *In re Apaydin*, 201 B.R. 716, 718 (Bankr. E.D. Pa. 1996).

⁷⁴ See *id.* (quoting *In re Williams*, 291 B.R. 636 (Bankr. E.D. Pa. 2003).

⁷⁵ *Id.* at *5 ("This concession by the Debtor makes it unnecessary for me to delve further into the Apaydin-Williams-Bell caselaw thicket.")

⁷⁶ *Id.* at 6.

The court cited the “consumer protective purposes of TILA” in support of its conclusion.⁷⁷ In the court’s view, it “restructure[d] the mortgage repayment terms in a fashion as to maximize the likelihood that the debtor will be able to afford the monthly instalment [sic] amount.”⁷⁸

III. GUIDANCE ON NON-TRADITIONAL MORTGAGE PRODUCT RISKS

Several financial agencies⁷⁹ have issued a “guidance” on non-traditional mortgage products (“Guidance”).⁸⁰ Non-traditional mortgage products include: (1) interest-only mortgages (borrower does not pay any principal during the first few years), and (2) payment option adjustable-rate mortgages (“borrower has flexible payment options with the potential for negative amortization”).⁸¹ The Guidance was issued to address the risks associated with these non-traditional mortgage products because “the market for these products ... has expanded rapidly.”⁸² In addition, these “products are now offered by more lenders to a wider spectrum of borrowers who may not otherwise qualify for more traditional mortgage loans and may not fully understand the associated risks.”⁸³

The Guidance addressed three primary areas of concern: (1) Loan Terms and Underwriting Standards; (2) Portfolio and Risk Management Practices; and (3) Consumer Protection Issues.

A. Loan Terms and Underwriting Standards

According to the Guidance, nontraditional mortgage products are of special concern because they typically provide for substantial payment increases after a few years of the initial loan date. Because these payment increases may severely impact the borrower’s ability to repay the loan, underwriting standards for nontraditional mortgage products deserve special attention.

To address the additional risk of nontraditional mortgage products, the Guidance proposes that the analysis of a borrower’s repayment capacity should be more stringent. The “repayment capacity should include an evaluation of their ability to repay the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. In addition, for products that permit negative amortization, the repayment analysis should be based upon the initial loan amount plus any balance that may accrue from the negative amortization provision.”⁸⁴

⁷⁷ *Id.* at *7.

⁷⁸ *Id.*

⁷⁹ The agencies included: The Office of the Comptroller of the Currency, Treasury; The Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; and National Credit Union Administration.

⁸⁰ Interagency Guidance on Nontraditional Mortgage Product Risks, available at [http://www.occ.gov/ftp/release/2006-107a\(Guidance\).pdf](http://www.occ.gov/ftp/release/2006-107a(Guidance).pdf)

⁸¹ *Id.* at 16.

⁸² *Id.* at 17.

⁸³ *Id.*

⁸⁴ *Id.* at 20.

Another recommendation in the Guidance is that institutions should avoid the trend of relying on reduced documentation when making loans. According to the Guidance, “institution[s] [should] more diligently verify and document a borrower’s income and debt reduction capacity.... For example, stated income should be accepted only if there are mitigating factors that clearly minimize the need for direct verification of repayment capacity.”⁸⁵

B. Portfolio and Risk Management Practices

The Guidance provides that institutions that originate or invest in nontraditional mortgage loans “should adopt more robust risk management practices.”⁸⁶ According to the Guidance, institutions should institute policies that “specify acceptable product attributes, production and portfolio limits, sale and securitization practices, and risk management expectations.”⁸⁷ Other practices that should be implemented to comply with the Guidance’s expectations are for institutions to: (1) “[d]esign enhanced performance measures and management reporting that provide early warning for increasing risk”, and (2) [m]aintain capital at levels that reflect portfolio characteristics and the effect of stressed economic conditions on collectibility.”⁸⁸

C. Consumer Protection Issues

With regard to consumer protection issues, the Guidance makes clear that institutions should make sure that consumers are alerted to the risks of nontraditional mortgage products. Nontraditional mortgage products are especially attractive to consumers with high-credit risk because the products are advertised “based on their affordability in the near term.”⁸⁹ Because of this, the Guidance provides that “institutions should take appropriate steps to alert consumers to the risks of these products, including the likelihood of increased future payment obligations.”⁹⁰ Institutions should also provide this information in a “timely manner,” even “before disclosures may be required under the Truth in Lending Act or other laws.”⁹¹ The Guidance also lays out several specific “Recommended Practices” that can address the risks associated with nontraditional mortgage products.⁹²

The response to the Guidance has been mixed. Many have suggested that “institutions should have more flexibility in determining appropriate risk management practices.”⁹³ Some contend that under the Guidance, qualified borrowers will not be approved for loans. Others “questioned whether the guidance is an appropriate mechanism for addressing ... consumer

⁸⁵ *Id.* at 21-22.

⁸⁶ *Id.* at 24.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.* at 30.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *See id.* at 33-37.

⁹³ *Id.* at 4.

protection concerns.”⁹⁴ Finally, some have “argued that the guidance does not go far enough in regulating or restricting nontraditional mortgage products.”⁹⁵

IV. POSSIBLE LENDER DEFENSIVE MEASURES

A. Notice of Default Provision

Section 50(a)(6)(Q)(x) of Article XVI of the Texas Constitution provides that for an extension of credit to be valid, it must be made on condition that the lender forfeits all principal and interest if the lender fails to comply with its obligations under the extension of credit “within a reasonable time after the lender or holder is notified by the borrower of the lender’s failure to comply.” Thus, the borrower must provide notice to the lender of its failure to comply with its obligations and allow the lender a “reasonable time” to take corrective action.

As alluded to in the discussion of *Vincent* above, the individual nature of this notice and the cure that may be required, along with differences in what is a “reasonable time” to cure in individual circumstances, may preclude class certification. Individual issues, rather than common ones, may predominate. If so, a class action is inappropriate.

In addition, the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) require the following “Notice of Grievance” to be placed on their uniform mortgage instrument forms:

Neither Borrower nor Lender may commence, join or be joined to any judicial action (as either an individual litigant or the member of a class) that arises from the other party’s actions pursuant to this Security Instrument or that alleges that the other party has breached any provision of, or any duty owed by reason of, this Security Instrument, until such Borrower or Lender has notified the other party (with such notice given in compliance with the requirements of Section 15) of such alleged breach and afforded the other party hereto a reasonable period after the giving of such notice to take corrective action.

Thus, all Fannie Mae and Freddie Mac mortgage instruments include a clear requirement that the borrower must notify the lender of any violation and allow the lender time to take corrective action before commencing any legal action (including a class action) in conjunction with the provisions cited above. Whether this will create individual issues related to notice and cure that will preclude a class action remains to be seen.

B. The Loan Agreement Statute and the Common Law Parol Evidence Rule

Both the common law parol evidence rule and the Texas Business and Commerce Code Statute of Frauds can operate to block the introduction of parol evidence regarding a Texas home equity loan agreement and any prior contemporaneous or, perhaps, superceding oral agreements.

⁹⁴ *Id.*

⁹⁵ *Id.*

Under the parol evidence rule, extrinsic evidence is inadmissible to contradict or vary the meaning of explicit language or a written agreement if the written agreement is not susceptible to more than one legal meaning or construction.⁹⁶

Moreover, section 26.02(c) of the Texas Business and Commerce Code creates a statute of frauds that is specifically applicable to a loan agreement exceeding \$50,000 in value made by a statutorily defined “financial institution” which includes both HUD-approved home mortgage lenders and depository institutions and their affiliates. Under section 26.02 any oral agreement prior to or contemporaneous with the home equity loan agreement is inadmissible if the statutory notice and the borrower’s signature acknowledging the notice is contained or incorporated in the loan documents. The statutory notice also bars admission of subsequent oral agreements, and is arguably a contractual bar since it is separately signed and included in the loan agreement. A home equity lender can use these rules to defend against any claims by the borrower that contradict the terms of the home equity loan agreement.

C. Arbitration Provisions

Many home equity cases have been dismissed after being sent to arbitration as a result of an arbitration clause in the loan documents. Therefore, lenders should consider including a carefully drafted arbitration clause in their loan documents that, among other things, will preclude participation in a class action. Care must be taken, however, to carve out remedies prescribed by the Texas Constitution, such as foreclosure, which rely on a court order. Care must also be taken to not further invoke federal preemption of any provision of section 50(a)(6), Article XVI, of the Texas Constitution. Section 50(a)(6) provides that if any one of its provisions is federally preempted, Section 50(a)(6) is inseverable and home equity lending in Texas comes to an end.

In a plurality opinion, the U.S. Supreme Court case in *Green Tree Fin. Corp. v. Bazzle*⁹⁷ upheld a class-wide arbitration under an arbitration clause that did not expressly exclude it. This case puts a premium on drafting the arbitration provision to expressly allow only individual arbitration and to expressly preclude participation in a class action.

V. CONCLUSION

Lenders continue to be successful in the Texas Supreme Court, appellate courts, and in most trial courts in taking the home equity high ground in Texas. Many fears have subsided due to favorable interpretations of several key home equity provisions, including a broad interpretation of the ability to cure. The availability of equitable subrogation also soothes concerns over the harshness of the forfeiture provisions. Finally, while litigation still continues in variable-rate home equity loans, it appears that those issues are headed towards resolution in favor of lenders. However, lenders remain in the spotlight; and especially in the current economy, home equity litigation is as vigorous as ever.

⁹⁶ *Nat'l Union Fire Ins. Co. v. CBI Indus. Inc.*, 907 S.W.2d 517, 520 (Tex. 1995).

⁹⁷ *Green Tree Fin. Corp. v. Bazzle*, 123 S.Ct. 2402 (2003).