

Texas Supreme Court Opens Door to Home-Equity Lien Challenges

On May 20, 2016, the Supreme Court of Texas decided two cases that arise from the requirements of Article XVI, Section 50 of the Texas Constitution regarding provisions related to home-equity loans. The opinions have great significance for mortgage servicers, originators, and title insurers that deal with Texas home-equity loans. **Claims related to origination defects, once believed barred on limitations grounds, are now fair game for the life of the loan and will undoubtedly create a new incentive for borrowers to challenge the validity of lien securing their home-equity loan.**

The Texas Constitution was amended in 1998 to allow home-equity loans, essentially a non-recourse extension of credit or cash-out refinance secured by a homestead. Tex. Const. art. XVI, § 50(a)(6)(A)-(Q). Forced sale of the homestead for repayment purposes is prohibited unless a valid mortgage, deed of trust, or other lien exists that meets certain requirements and deadlines. If a lien is made in contravention of these requirements, a borrower may give notice of an alleged defect, and the lender has sixty days to cure. Until recently, lenders operated under the belief that the Texas Civil Practice and Remedies Code residual four year limitations period applied to such claims, running from the date the loan closes. The Supreme Court of Texas's recent opinion in *Wood v. HSBC Bank USA, N.A.*, No. 14-0714, entirely changed the landscape with regard to home-equity lien claims.

In *Wood*, eight years after obtaining a home-equity loan, the Woods notified the current owner and holder of the note that the loan did not comply with the constitutional provisions governing home-equity loans. After the alleged defects were not cured, the Woods brought suit to quiet title, seeking a declaration that the loan was void and that all principal and interest should be forfeited. In a 6-3 decision, the Supreme Court held that although defects in home-equity loans can be cured, the loans are invalid until the defects are cured. Therefore, the Court held that **a suit to quiet title based upon alleged constitutional defects is not subject to any limitations period.**

The opinion runs contrary to the Fifth Circuit's recent holding in *Priester v. JPMorgan Chase Bank*, 708 F.3d 667, 674 (5th Cir. 2013), as well as opinions by Texas Courts of Appeals for the Third, Fifth, Sixth, Thirteenth, and Fourteenth Districts. While the Court's holding is troubling in and of itself, equally concerning is the Court's suggestion, in dicta, that "lenders are permitted, and indeed should be encouraged, to cure constitutional noncompliance on their own, without notice

from the borrower.” As pointed out by the dissenters, the *Wood* opinion is problematic in that **there are no limits on when a borrower may challenge validity of a home-equity lien, which could be long after witnesses, proof, or other evidence of compliance is “difficult or impossible” to obtain.**

While this decision is concerning for those involved in home-equity transactions, the Court did offer some relief for the lender. Based upon the reasoning in *Garafolo v. Ocwen Loan Servicing, LLC*, No. 15-0437, decided the same day, the Court held the Woods could not seek a declaratory judgment to obtain forfeiture of principal and interest paid on the loan, which is generally believed to be a remedy for failure to meet constitutional requirements.

In *Garafolo*, the Court addressed a certified question from the Fifth Circuit. After paying off her home-equity loan, the borrower brought a claim for forfeiture of all principal and interest paid because she was not provided a recordable release of lien after the loan was paid off. The borrower’s claim was based on a constitutional provision and a provision in her loan agreement, both of which required the lender to provide the borrower a release of lien in recordable form after the loan was paid off.

In a 7-2 opinion, the Court held that the borrower did not have either a constitutional or contractual right to seek forfeiture. Rather, the borrower must prove actual damages or seek other relief, such as specific performance, because forfeiture is an available remedy only if one of the six corrective measures provided under the constitution can actually correct the underlying problem and the lender fails to timely cure the defect. Thus, as applied in *Wood*, *Garafolo* clarifies a declaratory-judgment action based on a constitutional right to forfeiture is not available to access the forfeiture remedy.

Both *Wood* and *Garafolo* will have an important and immediate impact on mortgage lenders, servicers, and title insurers operating in Texas. A sudden increase in cure letters from borrowers and their attorneys is likely and may lead to at least a temporary slowdown—or even halt—to home equity lending and foreclosures. The notion that servicers should preemptively cure any violations (even on a non-defaulted loan with a borrower exhibiting no signs of complaint or dissatisfaction) also gives rise to the specter of extensive loan review, similar to the “lookbacks” that followed the foreclosure crisis.