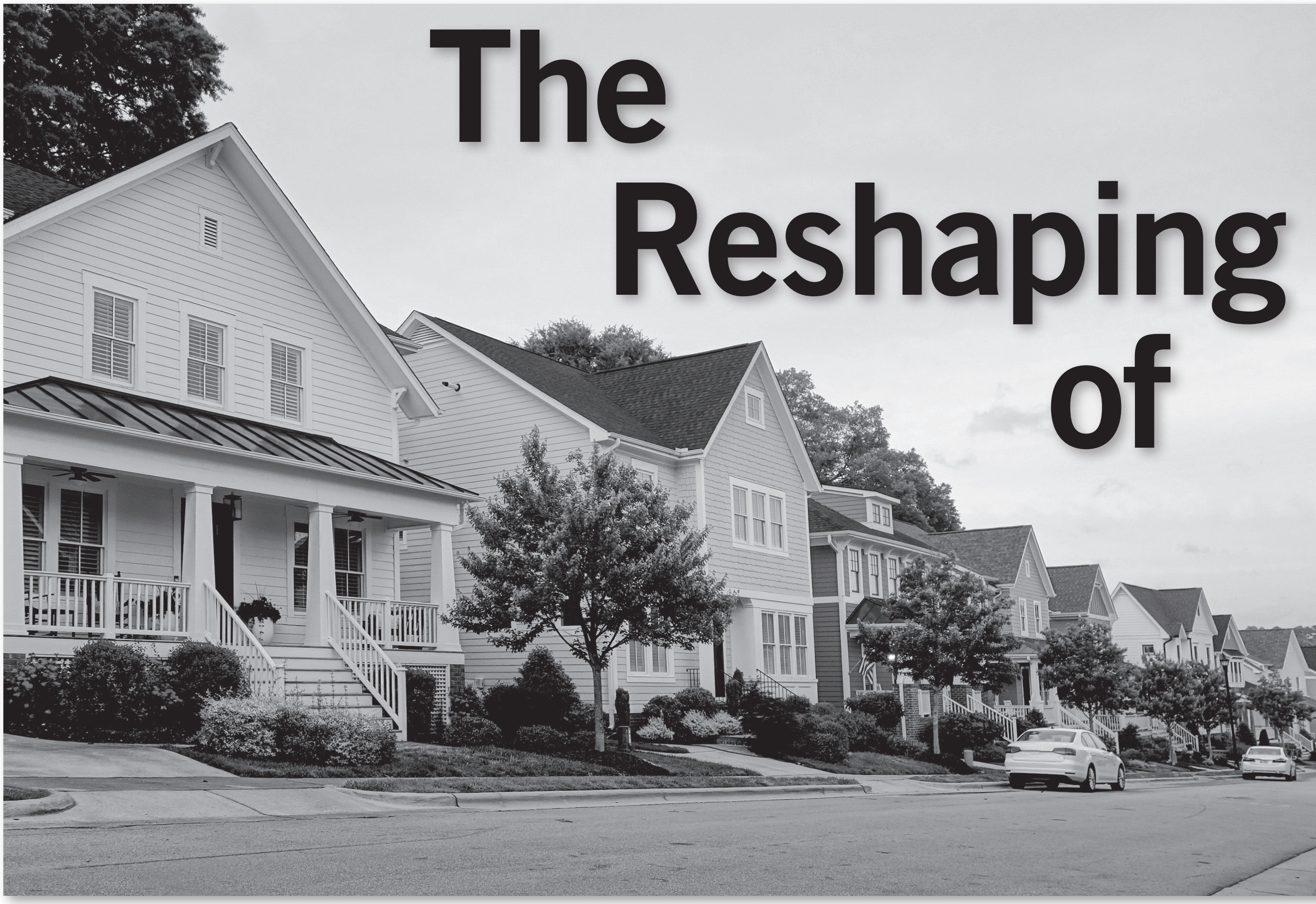

The Reshaping of Texas Home Equity Laws and Remedies*

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There are few areas of state law anywhere in the United States that are as arcane and complicated as the laws governing home equity loans and lines of credit in Texas.[1] It does not help that the text of the law—actually an amendment to the Texas Constitution[2]—is at points inconsistent, imprecise, and perhaps contradictory. This has led to long-standing issues of interpretation. Faced with a lack of regulatory guidance or court cases, lawyers and lenders have been forced to make difficult and uncertain choices—sometimes, as it turns out, the wrong choices.

Fortunately for lenders, borrowers, and their attorneys, the Texas Supreme Court has provided more clarity—and a few surprises—in several recent decisions. These decisions upended some long-existing practices while making the life of the lender somewhat easier. This Article will focus on those decisions and the implications for modifying and extending existing loans. This topic is particularly timely in light of the need to modify and extend loans for borrowers who suffered as a result of the Covid-19 epidemic or our periodic natural disasters.

I. The Sacrosanct Texas Homestead

Texas has always had strong protections for the family homestead.[3] These protections are enshrined in the Texas Constitution: "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 except for: . . . (6) an extension of credit" that meets twenty-seven distinct conditions.[4]

(b) "An owner . . . may not sell or abandon the homestead without the consent of each owner and the spouse of each owner . . . ."[5]

(c) "No mortgage, trust deed, or other lien on the homestead shall ever be valid unless it secures a debt described by this [Section 50]. . . . All pretended sales of the homestead involving any condition of defeasance shall be void."[6]

(d) "A purchaser or lender for value without actual knowledge may conclusively rely on an affidavit that designates other property as the homestead of the affiant and that states that the property to be conveyed or encumbered is not the homestead of the affiant."

(e) A refinance of debt described by (a)(1)-(a)(5) above that includes additional funds will "not be secured by a valid lien" unless:
(1) the refinance of the debt is a home equity loan; or
(2) "the advance of all the additional funds is for reasonable costs necessary to refinance such debt or for [payment of taxes on the homestead, an owelty of partition, or home improvements]."

(f) "A refinance of debt secured by the homestead, any portion of which is [a home equity loan], may not be secured by a valid lien" unless the refinance is a home equity loan.

Subsection (t) provides additional rules for HELOCs.[7]

There are a host of issues embedded in these provisions and many a trap for the unwary lender and its legal counsel. Two of the most lasting and important issues have been (1) whether a defective home equity loan is void or voidable, and (2) what statute of limitations (SOL) applies to claims by borrowers. In the following sections of this article, we will explore how the Texas Supreme Court has recently brought some of these provisions into harmony with each other while upending several accepted lending practices.

II. Modifications Are Not (Completely) Covered by 50(a)(6)

Given the Draconian remedies for Constitutional violations, it can be no surprise that the treatment of a nonperforming home equity loan is a veritable minefield for lenders. The traditional solution has been to offer refinancing. But what happens if a refinance is not feasible? For example, what if it would fail the underwriting standards of the lender or does not comply with the federal ability-to-repay rules? The alternative to refinancing is to modify the loan's terms to make the payments more affordable for the borrower. A long-standing gray area of Texas home equity lending has been whether, and on what terms, a lender may modify a home equity loan. Can a lender ever alter the terms of a Texas home equity loan without endangering its lien? We now turn to the perennial question of how a lender can best assist defaulting borrowers to bring their Texas home equity loans into performance, and whether such loss mitigation assistance exposes a lender to liability, including lien cancellation and forfeiture of principal and interest.

In *Sims v. Carrington Mortgage Services, L.L.C.*,[8] the Texas Supreme Court articulated a three-part test to determine if the restructuring of a home equity loan was an extension of new credit required to comply with constitutional requirements for new home equity loans.

The borrowers obtained a thirty-year home equity loan in 2003.[9] The borrowers fell behind on payments and, in 2009, entered into a loan modification agreement, "capitalizing past-due interest and other charges, including fees and unpaid taxes and insurance premiums, and reducing the interest rate and monthly payments."[10] The borrowers fell behind again, and the mortgage servicer sought foreclosure. In response, the borrowers asserted that the 2009 loan modification violated the Texas Constitution.[11] However, the borrowers entered into a second loan modification in 2011, further reducing the interest rate and payments.[12] Both the 2009 and 2011 loan modification agreements provided that the borrowers' obligations and all the loan documents remained unchanged.[13]

Two months after entering into the 2011 loan modification, the borrowers brought a class action suit in federal district court against the mortgage servicer alleging that the loan modifications violated Article XVI, Section 50 of the Texas Constitution.[14] On appeal, the Fifth Circuit certified four questions to the Texas Supreme Court, the first of which was:

> After an initial extension of credit, if a home equity lender enters into a new agreement with the borrower that capitalizes past-due interest, fees, property taxes, or insurance premiums into the principal of the loan . . . , is the transaction a modification or a refinance for purposes of Section 50 of Article XVI of the Texas Constitution?[15]

The Texas Supreme Court began its response by noting the certified question's distinction between *modification* and *refinance*, and whether the Texas Constitution draws a distinction, which is a question of how each of these terms is used in the Texas Constitution and by the Texas Finance Commission and Texas Credit Union Commission in Chapter 153 of the Texas Administrative Code.[16] In its analysis, the court noted that the commissions have prohibited a "refinancing" like a "new equity loan" but not a "modification," which does not involve the satisfaction or replacement of the original note.[17] The court's analysis of the distinction between *refinance* and *modification* found that the threshold question is whether there has been a new extension of credit.[18] In light of this conclusion, the court reframed the certified question as follows: "[if the new agreement] . . . neither satisfies nor replaces the original note, is the transaction a new extension of credit for purposes of Section 50 of Article XVI of the Texas Constitution?"[19]

The extension of credit consists not merely of the "the creation of a principal debt but includes all the terms of the loan transaction" including "requiring the borrower to pay taxes, insurance premiums, and other such expenses." [20] The court found these obligations to be as integral to the extension of credit as terms requiring timely payment of principal and interest.[21] Although the borrowers argued that the capitalization of past-due interest, taxes, and insurance premiums represent an advance of additional funds, the court noted that these amounts do not represent a new extension of credit but rather are terms of the original extension of credit.[22]

The servicer argued that the test for whether restructuring a loan involves a new extension of credit is whether (1) "the borrower's note is satisfied or replaced" and (2) "new money is extended."[23] The court agreed but opined that these two factors alone are insufficient and that the test should include a third factor—whether "the secured obligations are those incurred under the terms of the original loan."[24]

> In answer to the Fifth Circuit's certified question, the Texas Supreme Court responded that:
>
> [T]he restructuring of a home equity loan that, as in the context from which the question arises, involves capitalization of past-due amounts owed under the terms of the initial loan and a lowering of the interest rate and the amount of installment payments, but does not involve the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note, is not a new extension of credit that must meet the requirements of Section 50.[25]

Ultimately, the court concluded that modifications to home equity loans permit lenders to lower monthly payments for struggling borrowers, which gives lenders a meaningful alternative to foreclosure and further serves the public policy underlying Section 50—to protect homesteads in Texas.

Lenders should be aware, however, that *Sims* does not hold that any and all modifications would be compliant with the law. During the Covid-19 epidemic, the quartet of state agencies that issue official interpretations of the constitutional provisions[26] issued formal guidance on the modification of existing home equity loans in light of *Sims*:

> An existing home equity loan may be modified at the request of the homeowner without violating the Texas Constitution if the modification is consistent with the opinion of the Texas Supreme Court in *Sims v. Carrington Mortg. Services, L.L.C.* 440 S.W.3d 10 (2014). In the context of an existing home equity loan in default, the court held that a new agreement with the borrower that capitalizes past-due interest, fees (late charges), property taxes, and insurance premiums into the principal of the loan (all past-due amounts owed under the terms of the initial loan) and lowers the interest rate and amount of installment payments, but does not involve the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note, is not a new extension of credit for purposes of Section 50(a)(6). Further, the court held that the capitalization of past-due interest, taxes, insurance premiums, and fees was not an "advance of additional funds" within the meaning of Section 50(a)(6) if those amounts were among the obligations assumed by the borrower under the terms of the original loan.

In response to the *Sims* case, the commissions adopted amended 7 Tex. Admin. Code §153.11(1), explaining that Section 50(a)(6)(L)(i) does not prohibit a modification that does not satisfy and replace the original home equity loan and does not create a new extension of credit. The amendment also explains that the modification may include a deferment of the borrower's original obligation and may include amounts that are past due under the home equity loan (e.g., accrued but unpaid interest, taxes[,] and insurance).

> As noted in 7 Texas Admin. Code §153.14(2), a home equity loan and a subsequent modification are considered a single transaction for purposes of the home equity lending requirements of Section 50(a)(6), including the percentage cap on loan fees.[27]

Later in the Covid-19 epidemic, the same quartet of state agencies further noted:

> Although the *Sims* case did not explicitly involve traditional payment deferrals or an extension of the term of the original note, we believe these to be permissible under the Court's holding that "[t]he Constitution does not prohibit the restructuring of a home equity loan that already meets its requirements in order to avoid foreclosure while maintaining the terms of the original extension of credit."[28]

Lenders should note that Rule §153.11 and Rule §153.14(2) were amended effective November 26, 2020.[29] Rule §153.11 was amended to add language adopting the result in *Sims*. Perhaps more important is what was not changed: the (renumbered) paragraph 4 that says a balloon payment is prohibited. The same is true of Rule §153.14 which states that "a modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit."[30]

During the Covid-19 epidemic, a substantial number of borrowers sought a forbearance of their mortgage payments pursuant to the CARES Act.[31] The Consumer Financial Protection Bureau and the Federal Housing Finance Administration announced that "[t]he missed payments can be added to the normal monthly payments, paid back all at once, tacked on to the end of the loan, or the borrower can have the term of the loan extended."[32] Note that two of these options involve a lump-sum payment—at the end of the forbearance period or at the end of the loan term. But that is not consistent with Texas law. A balloon payment would not have been permitted as of the date the existing loan closed, and nothing in *Sims* should be interpreted to authorize such a payment. The modification at issue in *Sims* involved monthly payments that were restructured in "tiers"; the modification called for a set of reduced equal successive periodic installments for a set number of months, followed by substantially equal payments for the remainder of the loan term that would fully amortize the debt. *Sims* and the amended regulations are limited to the specific actions that were taken by the defendant lender; subsequent court decisions have validated that view. [33] In that sense, Section 50(a)(6) does continue to apply to modifications. The forborne amounts should be recapitalized at the end of the forbearance period so that the balance is paid off in a manner that is consistent with the constitutional requirement that the loan must be "scheduled to be repaid in substantially equal successive periodic installments, . . . each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment [if the loan is a close-end home equity loan]"; or "regular periodic installments," each of which "equals or exceeds the amount of accrued interest" during the draw period, and is "substantially equal" during the repayment period.[34] The "tiers" of rates in the *Sims* case are consistent with that requirement, in that they were substantially equal in between each adjustment; a lump-sum repayment is not.

III. Neither Void or Voidable; the Lien Is Invalid Until Cured

Historically, trial courts and appellate courts in Texas, as well as the Fifth Circuit, concluded that a defective home equity loan was voidable and that a claim seeking to void the lien was subject to a four-year statute of limitations.[35] The cure provisions seemed to suggest as much.[36] In that light, if the lender found a defect in the loan documentation or process (e.g., in an audit of the loan file), it made sense not to cure a defect until the borrower gave notice of the defect. It was better to "let sleeping dogs lie" while the statute of limitations ticked away.

Wood v. HSBC Bank USA, N.A proved the error of that strategy.[37] The Woods obtained a home equity loan in 2004. Eight years later, they notified the note holder and the servicer

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that the loan provisions did not comply with the home equity laws. Neither the holder nor the servicer attempted to cure the alleged defects. In 2012, the Woods sued both parties "seeking to quiet title and asserting claims for constitutional violations, breach of contract, fraud, and a declaratory judgment that the lien securing the home-equity loan is void, that all principal and interest paid must be forfeited, and that the Woods have no further obligation to pay."[38] The holder and servicer moved for summary judgment on the grounds that the lien was voidable and that the statute of limitations barred the Woods' claims. The trial court granted summary judgment for the holder and servicer. The only issue the Woods raised on appeal was whether their claims were subject to a statute of limitations. The court of appeals affirmed holding that home equity liens are voidable and that the residual four-year statute of limitations applied to the Woods' claims, accruing from the date of closing.

The Woods had argued that a home-equity lien securing a noncompliant loan is invalid until the defect is cured, citing Section 50(c).[39] If a lender chooses not to cure after notice (i.e., as provided in Section 50(a)(6)(Q)), the defect is no longer curable, and the lien becomes absolutely void. The Woods asserted that no statute of limitations applies to actions seeking to declare the status of an already-invalid lien. The holder and servicer responded that a lien securing an uncured home-equity loan is voidable, because only voidable liens can be validated, and thus the four-year residual statute of limitations should apply.[40]

The Texas Supreme Court agreed with the Woods that "a lien securing a constitutionally noncompliant home-equity loan is not valid before the defect is cured," and that "no statute of limitations applies to an action to quiet title on an invalid home-equity lien."[41] The court clarified that its holding in *Doody* was meant to reconcile strict invalidity under Section 50(c) with the lender's right to cure under Section 50(a)(6)(Q).[42] In so doing, the court abandoned the common-law notion of void versus voidable. As the court stated:

> [C]ourts faced with this issue have typically confined their analysis to the common-law concept of void-versus-voidable liens. As the dissent notes, these courts have generally concluded that because *Doody* held that an invalid lien could later be made valid, the lien could never have been absolutely void and thus must be voidable. . . . A voidable lien is presumed valid unless later invalidated . . . while [S]ection 50 and *Doody* contemplate precisely the opposite: that noncompliant liens are invalid until made valid.[43]

The court later explained that:

> Constitutional mandates need not be shoehorned into common-law concepts when those concepts conflict with the Constitution's plain text. . . . Section 50(c) starts with the premise that a lien securing a noncompliant loan is never valid. Implementing a [S]ection 50(a)(6)(Q)(x) cure provision brings the loan into constitutional compliance, thereby validating the accompanying lien. . . . A lien that was invalid from origination remains invalid until it is cured. In so holding, we do not create a new common-law category of liens that are "void until cured." We are merely interpreting the plain language of the Constitution, which defies common-law categorization.[44]

The court held that treating a noncompliant lien as "valid unless later invalidated" would contravene Section 50(c), and neither the cure provisions in Section 50(a)(6)(Q) or the disclosure given to borrowers before closing[45] evince an intent to do that. "Further, lenders are permitted, and indeed should be encouraged, to cure constitutional noncompliance on their own, without notice from the borrower, as the lender did in *Doody.*"[46] In other words, don't let sleeping dogs lie.

The court then turned to the question of whether a statute of limitations should apply to the borrower's right to challenge the validity of the lien. The court noted that the cure provisions in Section 50(a)(6)(Q) give the lender sixty days in which to respond to notice from the borrower, but there is no corresponding time limit on the borrower's notice.[47] The court concluded that, in light of the fact that the lien remains invalid until cured, no statute of limitations applies to cut off a homeowner's right to quiet title to real property encumbered by an invalid lien under Section 50(c).

> We have held that as long as an injury clouding the title remains, so too does an equitable action to remove the cloud; therefore, a suit to remove the cloud is not time-barred." . . . Indeed, it would make little sense to cut off a homeowner's claim merely because of the passage of time when the constitutional protections do not contemplate such a limitation. The Constitution's plain text compels [the conclusion] that homeowners' right to seek a declaration of an invalid lien not be bound by a statute of limitations. As such, no statute of limitations applies to this type of quiet-title action.[48]

Note that this holding appears to be limited to lien defects that put a cloud on title. Other types of claims—such as breach of contract, negligence, violations of the Fair Debt Collection Practices Act, usury, or fraud—have been held to be subject to the statute of limitations applicable to such claims.[49]

What lender would gamble that a defect will go unnoticed for up to thirty years? It is clear that lenders should be proactive and cure defects found through loan audits or other means.

The Woods petitioned the court for forfeiture of all principal and interest paid on their home equity loan—the nightmare of every lender. The court responded to the petition by referring to its holding in a companion case, *Garofolo v. Ocwen Loan Servicing, L.L.C.*,[50] which we now consider.

IV. The Remedy of Forfeiture Is Strictly Limited

Fortunately, most home equity loan defects can be cured. The law provides for five types of cures for five categories of defects, and a sixth "catch-all" or "do-over" cure for defects that don't fit within the other categories. The "catch-all" allows the lender to cure

> the failure to comply by a refund or credit to the owner of $1,000 and offering the owner the right to refinance the extension of credit with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original extension of credit with any modifications necessary to com

ply with this section or on terms on which the owner and the lender or holder otherwise agree that comply with this section.[51]

But what if none of the cures are applicable, even the "catch-all"? For example, what if the borrower has paid off the loan and the lender fails to comply with some requirement in the statute (such as by failing to provide the cancelled note and a release of lien document)? The Texas Supreme Court decided this issue in *Garofolo.* One of the requirements for a home equity loan to create a valid lien on the homestead is the following:

> within a reasonable time after termination and full payment of the extension of credit, the lender [will] cancel and return the promissory note to the owner of the homestead and give the owner, in recordable form, a release of the lien securing the extension of credit or a copy of an endorsement and assignment of the lien to a lender that is refinancing the extension of credit.[52]

The holder of the loan (Ocwen) failed to give Ms. Garofolo a release of lien upon payment in full of her loan. Ms. Garofolo notified Ocwen of its failure to comply with the statute. When 60 days passed after that notice, ostensibly cutting off Ocwen's ability to cure the defect, Garofolo sued Ocwen in federal court for violation of the Texas Constitution and breach of contract. She asked for forfeiture of all principal and interest paid on the loan, which would have been quite the windfall. At first glance, this seemed to present the court with an interesting predicament. The statute reads as follows:

> [T]he 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 and fails to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply by [performing one of the cures applicable to specific types of violations or the "catch-all" cure for violations that are not covered by the specific cures].[53]

If the court agreed with the plaintiff that the holder failed to give her a release of lien as required by the loan's terms (i.e., failed "to comply with the . . . holder's obligations under the extension of credit"), and failed to correct the failure to comply within sixty days after notice from the borrower, the statute would seem to require the forfeiture of "all principal and interest of the extension of credit."[54] For twenty years, lenders have been terrified by the possibility that they might have to disgorge all principal and interest paid and forfeit the right to any future payments if the lender failed to cure a defect in a home equity loan.[55] And now, thanks to the *Wood* case, the risk would persist for as long as the loan remained in place. This possibility has undoubtedly stunted home equity lending in Texas and has almost certainly kept some lenders out of the market entirely.

The court heard the case on referral of two certified questions from the Fifth Circuit Court of Appeals, which was reviewing the dismissal of Garofolo's case by the district court. The questions were as follows:

> (1) Does a lender or holder violate Article XVI, Section 50(a)(6)(Q)(vii) of the Texas Constitution, becoming liable for forfeiture of principal and interest, when the loan agreement incorporates the protections of Section 50(a)(6)(Q)(vii), but the lender or holder fails to return the cancelled note and release of lien upon full payment of the note and within 60 days after the borrower informs the lender or holder of the failure to comply?
> (2) If the answer to Question 1 is "no," then, in the absence of actual damages, does a lender or holder become liable for forfeiture of principal and interest under a breach of contract theory when the loan agreement incorporates the protections of Section 50(a)(6)(Q)(vii), but the lender or holder, although filing a release of lien in the deed records, fails to return the cancelled note and release of lien upon full payment of the note and within 60 days after the borrower informs the lender or holder of the failure to comply?[56]

The Supreme Court of Texas began its analysis by noting:

> if the failure to deliver a release of lien amounts to a constitutional violation for which a constitutional forfeiture remedy applies[,] . . . the myriad terms and conditions required for a home-equity loan to be foreclosure-eligible would amount to substantive constitutional rights and obligations. As such, a lender's failure to honor them would give rise to not just a breach-of-contract claim, but a violation of the constitution itself. Our constitution's plain language, however, compels us to answer "no."[57]

As in *Wood*, the court asserted that the Texas Constitution "lays out the terms and conditions a home-equity loan must include if the lender wishes to foreclose. . . ."[58] In other words, what is necessary to create a valid and enforceable lien on a homestead. The Constitution "does not, however, create a constitutional cause of action or remedy for a lender's subsequent breach of those terms or conditions. A post-origination breach of those terms and conditions may give rise to a breach-of-contract claim for which forfeiture can sometimes be an appropriate remedy. But when forfeiture is unavailable, . . . the borrower must show actual damages or seek some other remedy such as specific performance to maintain her suit."[59]

Later in the opinion, the court states that:

> [S]ection 50(a) does not directly create, allow, or regulate home-equity lending. Nowhere does it say all home-equity loans must include the constitutional terms and conditions, nor does it prohibit loans made on other terms. It simply describes what a home-equity loan must look like if a lender wants the option to foreclose on a homestead upon borrower default. . . . Those terms and conditions *are not constitutional rights* and obligations unto themselves. They only assume constitutional significance when their absence in a loan's terms is used as a shield from foreclosure. . . . A lender that includes the terms and conditions in the loan at origination but subsequently fails to honor them might have broken its word, but it has not violated the constitution.[60]

The forfeiture remedy is one of those "terms and conditions", and as such, it is not a constitutional right either.[61] In other words, a valid home equity loan must include the condition that the lender shall forfeit all principal and interest if it fails to cure a constitutional defect in a timely manner. The subsequent failure to forfeit principal and interest would be a breach of contract, but the ultimate remedy for that breach might not be forfeiture.

This result is clearly shown in *Garofolo*. The plaintiff had paid the loan in full. The holder never had any reason to foreclose. The court acknowledged that the plaintiff probably could have successfully defended against foreclosure based on the uncured violation of the constitutional provisions, but in this case, there was no foreclosure to fend off. As the court put it: "Section 50(a) simply has no applicability outside foreclosure. . . . [B]orrowers are not without recourse when a lender fails to meet its obligations, they are just without *constitutional* recourse."[62] Therefore, the court answered "no" to the first certified question.[63] This is a remarkable conclusion. In one stroke, the court strictly limited the availability, and therefore the risk, of the forfeiture remedy. Lenders are not entirely out of the woods, however. As the court noted, a breach of the terms or conditions of the loan "may give rise to a breach-of-contract claim for which forfeiture can sometimes be an appropriate remedy."[64]

The court then turned to the second certified question—in the absence of actual damages, does a holder become liable for forfeiture of principal and interest under a breach of contract theory? The court noted that the plaintiff's contract contained both constitutional terms—the holder's obligation to provide a release of lien and the right to the forfeiture remedy if the holder fails to correct the defect within 60 days after notice thereof.[65] The plaintiff conceded that she had not suffered any actual damages as a result of the failure to provide a release of lien but argued that actual damages are not required when the parties have contracted for a forfeiture remedy that was not made contingent on proof of actual damages.[66]

The court gave a close reading of the forfeiture provision in the statute: the holder "shall forfeit all principal and interest of the extension of credit" if the holder "fails to correct the failure to comply" by performing one of the cures applicable to specific types of violations or the "catch-all" cure for violations that are not covered by the specific cures.

In Garofolo's case, none of the cures for specific violations were applicable, and the "catch-all" cure was unworkable. If the failure to comply cannot be cured by any specific cure, the "catch-all" cure requires the holder to give

> a refund or credit to the owner of $1,000 and offer[] the owner the right to refinance the extension of credit with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original extension of credit with any modifications necessary to comply with [Section 50(a)] or on terms on which the owner and the lender or holder otherwise agree that comply with [Section 50(a)].[67]

The plaintiff's loan had been paid in full and the lien extinguished. There was no extension of credit to refinance.

Garafalo argued that the "catch-all" cure should have been performed by the holder, even if it would have only partially remedied the violation and would not have actually resulted in her receiving the release of lien that was the basis of her lawsuit.[68] The court, however, calling the forfeiture remedy "Draconian,"[69] went to great lengths to avoid that result for a technical violation of the home equity requirements by parsing very closely the language of the holder's obligation to cure—"to correct the failure to comply."

First, the court invoked "consumer protection" as a legal shield for lenders to use against forfeiture:

> The obvious intent behind the forfeiture remedy as a whole is to encourage lenders to correct loan infirmities under the threat of the stiff punishment of forfeiture. . . . Allowing lenders to avoid punishment by performing an irrelevant corrective measure at the expense of directly addressing the borrower's complaint frustrates this intent. It follows that the six specific corrective measures exist to give lenders avenues to avoid forfeiture by fixing problems rather than furnishing technicalities that can be manipulated to avoid them. . . . [T]he constitution insists not on technical compliance with a corrective measure but on actually fixing the problem.[70]

Unfortunately, as we shall see, if none of the cures "directly address" the borrower's complaint or "fix the problem," the consumer may be left without any form of remedy or relief whatsoever, which is almost certainly not the intent behind the cure provisions.

The court continued its argument that "to correct" something meant to actually fix the problem; the "performance of an irrelevant corrective measure [such as the "catch-all"] in wil[l]ful blindness to whether it addresses the borrower's complaint can hardly be said to 'correct' anything."[71] Second, the court determined that the "failure to comply" refers to its original obligation, i.e., to provide a release of lien. The "catch-all" remedy would not correct that failure to comply, and therefore the "catch-all" remedy was an "irrelevant corrective measure."[72] Finally, the court concluded that the forfeiture remedy is limited to the context of the constitutional provision. Forfeiture is available only when a lender fails to correct its "failure to comply" by performing one of the corrective measures provided in the statutes. "If none of those measures actually correct the lender's failure to meet its obligations, the lender cannot correct its failure to comply 'by' performing one of them, *and therefore forfeiture is simply unavailable*."[73] This is another remarkable conclusion in the court's campaign to limit the "Draconian" remedy.

On the other hand, the result in *Garofolo* is a very narrow exception. In almost any other situation, if there had been any remaining balance due on the loan there would have been an applicable cure that the lender was obligated to undertake. The failure to provide the release of lien (which is required by subpart (Q)(vii)) is one of the very few defects that is not addressed by subpart (Q)(x).

The court held that Garofolo had other remedies—a suit for breach of contract and the remedies of actual damages or specific performance (subject to the general four-year statute of limitations that applies to contracts in Texas)—but only if

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she could show actual damages.[74] In the end, she was entitled to nothing.

And how did the decision in *Garofolo* affect the holding in *Wood*? The Woods had sought a declaratory judgment for forfeiture of principal and interest under the provisions of the Texas Constitution. Because *Garofolo* held that there is no such cause of action available under the constitution, they had no right to seek forfeiture on that basis, but they could still purse their suit to quiet title.

In a subsequent case applying the holding in *Wood*,[75] the Fifth Circuit noted that *Wood* had eliminated the statute of limitations on a suit to quiet title, but the decision did not address when such a cause of action accrues. The appellants in *Fueuerbacher* asserted a quiet title action and a breach of contract claim, but the court held that those claims accrued at the time the breach occurred and therefore were barred, noting that:

> [A]s Texas courts have explained, a breach of contract claim (the cause of action) is distinct from the availability of forfeiture (the remedy). *See* Garofolo v. Ocwen Loan Servicing, L.L.C., 497 S.W.3d 474, 482 (Tex. 2016) (explaining that the "constitution invokes forfeiture when a lender 'fails to correct the failure to comply' ... [but that] 'failure to comply' is a reference to the lender's original transgression: its 'fail[ure] to comply with the lender's or holder's obligations under the extension of credit'"); Wells Fargo Bank, N.A. v. Robinson, 391 S.W.3d 590, 595 (Tex. App.—Dallas 2012, no pet.) ("A borrower's recourse for a lender's failure to abide by the terms of his loan agreement is to assert traditional tort and breach of contract causes of action, not constitutionally mandated forfeiture.").[76]

It is important to understand the implications of these decisions. The Texas Supreme Court held that, to be a valid lien, the loan documents must provide for the remedy of forfeiture. But that remedy is only available if the borrower timely files a cause of action to quiet title or for breach of contract.[77] For example, in *Inge v. Bank of America, N.A.*,[78] the court held that the plaintiff's "breach of contract claim was not premised on BoA's failure to make the terms of the note and Deed of Trust compliant with the constitutional requirements for creation of a valid lien," but rather on the original lender's failure to comply with those contractual obligations.[79] Therefore, the four-year statute of limitations applied to the breach-of-contract claim (which continued in effect after the loan was assigned to Bank of America), which barred the plaintiff's claim because it was filed six years after the loan closed. Similarly, in *Priester v. Long Beach Mortgage Co.*, ("Priester II"),[80] plaintiffs alleged that *Wood* and *Garofolo* represented change in substantive law that would preclude the application of res judicata to their claims. However, as the court noted:

> Furthermore, even assuming *arguendo* that a change in decisional law entitles Plaintiffs to relitigate their claims, Plaintiffs have not established that *Wood* and *Garofolo* would mandate a different outcome. In *Wood*, the Texas Supreme Court held that no statute of limitations applies to an action to quiet title on a constitutionally invalid home equity lien. *See Wood*, 505 S.W.3d at 547. Although Plaintiffs are correct that *Wood* reflects a change in decisional law regarding the statute of limitations on claims arising from an alleged void lien, the holding in *Wood* is not as broad as Plaintiffs argue. *See generally* Dkt. 148. *Wood* only addressed the issue of *whether* the statute of limitations applies to a quiet-title action and did not address *when* a quiet-title action accrues. *See Johnson v. Citigroup Mortg. Loan Tr. Inc.*, 2017 WL 3337268, at *9 (W.D. Tex. 2017). Moreover, the Texas Supreme Court did not hold in *Wood* that *any* challenge to a constitutional defect avoids the applicable statute of limitations for that cause of action.
>
> As explained in *Garofolo*, Section 50(a) does not create substantive rights beyond a defense to foreclosure, and there is no separate right of action. *Garofolo*, 497 S.W.3d at 484; *see also Wood*, 505 S.W.3d at 546. Instead, the Texas Supreme Court emphasized that borrowers may assert constitutional violations as a defense to foreclosure actions brought by lienholders or by filing their own substantive cause of action, such as a breach of contract or a quiet title action. *Garofolo*, 497 S.W.3d at 484. Thus, a plaintiff does not state a claim merely by alleging constitutional violations of Section 50(a). *See Johnson*, 2017 WL 3337268, at *9. To state a claim, a plaintiff must plead such violations in the context of a properly pleaded cause of action, and the relevant statute of limitations for those causes of action control.[81]

V. Other Notable Cases

State and federal courts in Texas have addressed a number of other interesting issues in recent cases:

- In *Mulvey v. U.S. Bank National Association*, [82] the plaintiff alleged that bank personnel made oral statements that he did not have to make loan payments while his application for a loan modification was pending. The court held that, because the amount in controversy exceeded $50,000, the claims were subject to the Texas statute of frauds requiring such statements to be writing to be enforceable, and therefore, plaintiff could not assert a claim based on those oral statements.[83]
- In *Biedryck v. U.S. Bank National Association*, [84] the court dismissed the plaintiff's argument on appeal that the loan modification agreement was invalid "because it failed to state that it was a security instrument; increased the lien against the property to more than eighty percent of the property value; added fees that could have exceeded the three percent limit; was not preceded by a twelve-day notice; and was signed at his home."[85] The court did not undertake a detailed analysis of these claims; rather, it noted that the new balance included the unpaid principal balance, plus interest "and other amounts capitalized", and that "prior obligations under the note and security instrument were still in force."[86] However, it is worth noting that a loan modification agreement is not "an extension of credit" under Section 50(a)(6) and therefore is not required to be—or be secured by—a written security instrument, preceded by a 12-Day Notice, or signed at the office of the lender, an attorney, or a title company.[87] Secondly, the 80% cumulative loan-to-value ratio only applies as of the closing date

of the original loan.[88] Finally, the state agencies that issue interpretations of the constitutional provisions have made it clear that the cap on fees and charges–despite being applicable to "maintaining" and "servicing" the loan applies only "if the charges are paid at the inception of the loan, or if the charges are customarily paid at the inception of an equity loan but are deferred for later payment after closing."[89]

- In *Hill v. Sword*,[90] the plaintiffs had obtained two loans from a private lender, apparently before the property became their homestead. After plaintiffs defaulted on the notes, the lender obtained a declaratory judgement in the amount of the unpaid principal balance plus prejudgment interest, attorney's fees, and court costs. The plaintiffs and lender then entered into a third promissory note and deed of trust for the amount of the judgment.[91] The plaintiffs contended that this third note constituted a satisfaction and replacement of the prior debts which would make the third note a new extension of credit. The court disagreed, noting that the declaratory judgment was not a foreclosure of the first two deed of trust liens and that the judgment was not paid or satisfied and replaced by the third note and deed of trust; rather, the latter constituted a renewal and extension (without extinguishment) of the existing debts.[92]

Next, the court somewhat extended the reach of *Sims*. First, it held that the capitalization of attorney's fees into the third loan was valid, even though the loan was not a home equity loan, because the lender's right to do that was stated in the loan documents for the first two loans.[93] Second, the court held that various non-monetary obligations that were added in the third deed of trust were valid because they did not involve a new extension of credit under the *Sims* rationale. Arguably, *Sims* is inapplicable to either issue.

VI. Conclusion

The Texas home equity loan statute has always been complex and intimidating, especially in light of the seemingly Draconian penalties that may apply if the statute's requirements are violated. Fortunately for lenders and their attorneys, the Texas Supreme Court has rendered the most Draconian penalty much less toothsome by limiting a borrower's ability to obtain forfeiture of principal and interest. Nonetheless, the cases discussed in this Article should put lenders on notice that they need to have operational processes in place that recognize when a claim of noncompliance is being made and to respond to such claims as promptly as possible. A borrower's claim can still be fatal if it is timely, and the lender does not take prompt and effective steps to cure the alleged defect(s).

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1 For simplicity's sake, we will refer to (closed-end) home equity loans and (open-end) home equity lines of credit (HELOCs) jointly as "home equity loans."

2 Tex. Const. art. XVI, § 50(a)(6).

3 Many early settlers in the area that is now Texas came west because they had lost their homes in the eastern states as a result of unwise borrowing, land speculation, and harsh lending practices. The founders of Texas were determined to prevent that from happening again, especially because the establishment and continuance of homesteads was crucial to the effort to populate and "win" the West. The protections also meant that a widow and her children could keep the home if the paterfamilias abandoned them or died, which was a constant danger on the frontier.

4 Tex. Const. art. XVI, § 50(a)(6) (emphasis added). Forced sale is also permitted for seven other types of liens: (1) purchase money loans and (2) refinances of those loans; (3) taxes due on the homestead; (4) an owelty of partition; (5) home improvements and repairs, including new improvements; (6) reverse mortgages; and (7) the refinance of a lien on a manufactured home that is converted from personal property to real property by "attachment" to the land. Other types of personal debts, judgments, and loans not connected to the homestead are invalid, at least until the property is no longer the debtor's homestead.

5 The implications of this subsection are enormous. For example, an individual buys a home while single. After marriage, their spouse, who is not an owner, moves in, and they establish a family homestead. Now the original owner cannot sell or abandon that homestead without the consent of the spouse. The spouse gains homestead rights (and community property rights), despite the fact that the spouse has no legal title. For another example, suppose the old family home has passed from mom and dad to their kids, who all inherited an equal share. Junior and his wife have moved into the home. Junior cannot sell or "abandon" his homestead without the consent of his siblings *and their spouses*. Apparently, the point of this provision was to prevent a descendant from letting go of the old family home unless none of the siblings *or their spouses* want to live there.

6 This provision will play a key role in one of the Texas Supreme Court decisions discussed below.

7 Each debit or advance must be no less than $4,000; the owner may "not use a credit card, debit card, or similar device," or unsolicited preprinted check to obtain an advance; "any fees described by Subsection (a)(6)(E) are charged and collected only at the time the extension of credit is established and no fee is charged or collected in connection with any debit or advance"; the cumulative loan-to-value (CLTV) of the HELOC and all other debt secured by the homestead as of the date the HELOC closes is not more than 80% of the homestead's fair market value as of the date of closing; the lender or holder may not unilaterally amend the extension of credit; and "repayment is to be made in regular periodic installments, not more often than every 14 days and not less often than monthly, beginning not later than two months from the date the extension of credit is established, and:

(A) during the period during which the owner may request advances, each installment equals or exceeds the amount of accrued interest; and

(B) after the period during which the owner may request advances, installments are substantially equal."

8 Sims v. Carrington Mort. Servs., L.L.C., 440 S.W.3d 10 (Tex. 2014).

9 *Id.* at 12.
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 *Id.* at 12–13. *See* Sims v. Carrington Mort. Servs, L.L.C., 889 F. Supp. 2d 883, 884 (N.D. Tex. 2012).
15 *Sims*, 440 S.W.3d at 13.
16 *Id.* at 13–15.
17 *Id.* at 14–15 (citing Tex. Admin. Code § 153.14).
18 *Id.* at 15.
19*Id.*
20 *Id.* at 16.
21 *Id.*
22 *Id.*
23 *Id.*
24 *Id.*
25 *Id.* at 17.
26 The Department of Banking, Department of Savings and Mortgage Lending, Office of Consumer Credit Commissioner, and Credit Union Department.
27 *Home Equity Lending Guidance: COVID-19 Emergency Measures*, State of Tex. Joint Fin. Regul. Agencies (Nov. 30, 2020) (emphasis added), https://www.fc.texas.gov/sites/default/files/2020-11/jfra_he_covid_emerg_guide.pdf [https://perma.cc/FG76-YA4D].
28 *Home Equity Lending Guidance: Coronavirus Emergency Measures*, State of Tex. Joint Fin. Regul. Agencies (Apr. 22, 2021), https://www.ibat.org/files/PDFs/Home-Equity-Lending-Guidance-Coronavirus-Emergency-Measures.pdf [https://perma.cc/UQ3E-JFS7].
29 45 Tex. Reg. 8307 (Nov. 20, 2020) (amendments to 7 Tex. Admin. Code §§153.11, 153.14).
30 7 Tex. Admin. Code § 153.14(2)(C).
31 Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 4022, 134 Stat. 281, 490 (2020).
32 Press Release, CFPB and FHFA Announce Borrower Protection Program (Apr. 15, 2020), https://www.consumerfinance.gov [https://perma.cc/VT3P-KDQM].
33 *See, e.g.*, Graze v. Nationstar Mortg., LLC, No. 03-15-00329-CV, 2015 WL 6459597, at *5 (Tex. App.—Austin, 2015, pet. denied) ("The modifications at issue in this case did not expand the scope or amount of the debt secured by the original lien, impose additional personal liability on [plaintiffs], or require additional security beyond the existing liens. . . . [The] modified loans do not constitute a new extension of credit under the three elements of the *Sims* test. Consequently, the constitutional requirements of [S]ection 50(a)(6) for new home-equity loans do not apply.").
34 Tex. Const. art. XVI, §§ 50(a)(6)(L), (t)(8).
35 *See, e.g.*, Priester v. JP Morgan Chase Bank, N.A., 708 F.3d 667, 674 (5th Cir. 2013), *abrogated by* Bynane v. Bank of N.Y. Mellon, 866 F.3d 351 (5th Cir. 2017). That panel cited an earlier Texas Supreme Court case that held that a non-compliant lien "can be made valid at a later date." Doody v. Ameriquest Mortg. Co., 49 S.W.3d 342, 346 (Tex. 2001). The panel reasoned that a lien that is void cannot be subsequently validated, so defective home equity liens must be voidable. The Texas Supreme Court expressly disavowed that construction of the statute in the *Wood* case. The panel also noted that "numerous district and bankruptcy courts have . . . applied the four-year limitations period" to defective home equity liens and adopted that position in its own opinion; *see also* Williams v. Wachovia Mortg. Corp., 407 S.W.3d 391, 396–97 (Tex. App.—Dallas, no pet.) (citing *Priester* and numerous other decisions for its conclusion that defective liens are voidable and a four-year statute of limitations applies to claims of defects).
36 Tex. Const. art. XVI, §50(a)(6)(Q) ("[T]he 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 and fails to correct the failure to comply not later than the 60th day after the date the lender or holder *is notified by the borrower of the lender's failure to comply*.") (emphasis added).
37 505 S.W.3d 542 (Tex. 2016).
38 *Id*. at 544.
39 "No mortgage, trust deed, or other lien on the homestead shall ever be valid unless it secures a debt described by this [Section 50] . . . ." Tex. Const. art. XVI, § 50(c).
40 *Wood*, 505 S.W.3d at 547.
41 *Id.*
42 *Id*. at 548.
43 *Id*. at 548–49 (internal citation omitted).
44 *Id*. (internal citations omitted). The court also pointed out that another provision of the Constitution, Section 50(i), overturns the common-law rule that a void deed in the chain of title cuts off the bona-fide purchaser defense. Section 50(i) states that "a purchaser for value without actual knowledge may conclusively presume that a lien securing an extension of credit described by Subsection (a)(6) of this [S]ection was a valid lien securing the extension of credit with homestead property if [certain conditions are met]." *Id*. at 549–50.
45 The "12-Day Notice"; *see* Tex. Const. art. XVI, §§ 50(a)(6)(M)(i), (50)(g).
46 *Wood*, 505 S.W.3d at 549.
47 *Id*.
48 *Id*. at 550 (quoting Ditta v. Conte, 298 S.W.3d 187, 192 (Tex. 2009)).
49 *See, e.g.*, Alexander v. Wells Fargo Bank, N.A., 867 F.3d 593, 603–04 (5th Cir. 2017) (reversing the trial court's refusal to amend its judgment in light of *Wood* as to the plaintiff's claim for quiet title, but affirming the refusal to amend with respect to plaintiff's breach of contract claim that was time-barred); Johnson v. Citigroup Mortg. Loan Tr. Inc., No. 5:16-cv-1114-RCL, 2017 WL 3337268, at *10 (W.D. Tex. Aug 3, 2017) (dismissing claims of breach of contract, negligence, collections violations, usury, and fraud for being time-barred).
50 Garofolo v. Ocwen Loan Servicing, L.L.C., 497 S.W.3d 474 (Tex. 2016).
51 One should also note that the "catch-all" requires only an *offer* to refinance the loan on compliant terms at no cost to the borrower. The refinance does not have to occur. The lender has met its obligation, even if the borrower declines the offer or refuses "to cooperate fully" with the offer. *See* 7 Tex. Admin. Code § 153.95(c) ("A borrower›s refusal to cooperate fully with an offer that complies with Section 50(a)(6)(Q)(x) to modify or refinance an equity loan does not invalidate the lender›s protection for correcting a failure to comply").
52 Tex. Const., art. XVI, § 50(a)(6)(Q)(vii).
53 *Id*. at § 50(a)(6)(Q)(x).
54 *Garofolo*, 497 S.W.3d at 480 (noting that the Court and the Fifth Circuit Court of Appeals both assumed these facts to be true).
55 The Court noted that it had previously described the forfeiture remedy as "Draconian" (citing Fin. Comm'n of Tex. v. Norwood, 418 S.W.3d 566, 572 (Tex. 2013) (the "ACORN" case)). *Id.* at 478. Fortunately, in the case where the lender has refinanced an existing lien, the lender can rely on equitable subrogation to

recover the amount of the debt that was refinanced, whether or not the lender's own lien is invalid. Fed. Home Loan Mortg. Corp. v. Zepeda, 601 S.W.3d 763, 766 (Tex. 2020) ("The doctrine allows a lender who discharges a valid lien on the property of another to step into the prior lienholder's shoes and assume that lienholder's security interest in the property, even though the lender cannot foreclose on its own lien.") (citing LaSalle Bank Nat'l Ass'n v. White, 246 S.W.3d 616, 619 (Tex. 2007) (per curiam)).
56 *Garofolo*, 497 S.W.3d at 476.
57 *Id*. at 476–77; *see also* Kyle v. Strasburger, 522 S.W.3d 461, 466 (Tex. 2017).
58 *Garofolo*, 497 S.W.3d at 475.
59 *Id*.
60 *Id*. at 478 (emphasis added). Tex. Const. art. XVI, § 50(a)(6)(Q).
61 *Garofolo*, 497 S.W.3d at 475. In relevant part, the requirement for a valid lien under subsection (Q) states that the extension of credit must be "made *on the condition that* . . . the lender . . . shall forfeit all principal and interest" if the lender fails to cure the defect in a timely manner (emphasis added).
62 *Id.* (emphasis in the original).
63 *Id.* The first certified question was:

> Does a lender or holder violate Article XVI, Section 50(a)(6)(Q)(vii) of the Texas Constitution, becoming liable for forfeiture of principal and interest, when the loan agreement incorporates the protections of Section 50(a)(6)(Q)(vii), but the lender or holder fails to return the cancelled note and release of lien upon full payment of the note and within 60 days after the borrower informs the lender or holder of the failure to comply?

Id. at 476.
64 *Id.*
65 *Id.*
66 *Id*. at 480. Query how this might be decided in light of *Spokeo, Inc. v. Robins*, 578 U.S. 330 (2016).
67 Tex. Const. art. XVI, § 50(a)(6)(Q)(x)(f); *See also Garofolo*, 497 S.W.3d at 481.
68 *Garofolo*, 497 S.W.3d at 481.
69 *Id.* at 478 (quoting *Norwood*, 418 S.W.3d at 573).
70 *Id.* at 481–82.
71 *Id*. at 482.
72 *Id.*
73 *Id.* (emphasis added).
74 *Id.* at 479.
75 Feuerbacher v. Wells Fargo Bank Nat'l Assoc., 701 Fed. Appx. 297 (5th Cir. 2017).
76 *Id.* at 300–301.
77 Inge III v. Bank of Am., N.A., No. 02-17-00386-CV, 2018 WL 5993329, at *5 (Tex. App.—Fort Worth Nov. 15, 2018).
78 *Id.*
79 *Id.*
80 Priester v. Long Beach Mortg. Co., No. 4:16-CV-449-ALM-KPJ, 2018 WL 1833255 (E.D. Tex. Jan. 23, 2018), *report and recommendation adopted*, No. 4:16-CV-00449, 2018 WL 1081248 (E.D. Tex. Feb. 28, 2018), *on reconsideration in part*, No. 4:16-CV-449, 2018 WL 4469679 (E.D. Tex. Sept. 18, 2018).
81 *Priester II*, 2018 WL 1833255, at *12.
82 Mulvey v. U.S. Bank Nat'l Ass'n, 570 S.W.3d 355 (Tex. App.—El Paso 2018).
83 *Id.* at 363.
84 Biedryck v. U.S. Bank Nat'l Ass'n, No. 01-14-00017-CV, 2015 WL 2228447 (Tex. App.—Houston [1st Dist.] May 12, 2015, no pet.).
85 *Id.* at *6.
86 *Id.* at *7.
87 *See* Tex. Const. art. XVI, §§§ 50(a)(6)(A), (M)(i), (N).
88 *Id.* at § 50(a)(6)(B).
89 7 Tex. Admin. Code § 153.5(9) and (12).
90 Hill v. Sword, 454 S.W.3d 698 (Tex. App.—Tyler 2015, no pet.).
91 *Id.* at 700–701.
92 *Id.* at 703.
93 *Id.*