HOME EQUITY LITIGATION

MOST COMMON VIOLATIONS
DAMAGES AFTER LaSALLE BANK v. WHITE

UNIVERSITY OF TEXAS SCHOOL OF LAW

27th ANNUAL JAY L. WESTBROOK BANKRUPTCY CONFERENCE

© 2008

Michael Baumer
7600 Burnet Road, Suite 530
Austin, TX 78757
512-476-8707
Fax. 512-476-8604

baumer@swbell.net

baumerlaw.com

Home equity lending became legal in Texas effective January 1, 1998. In the beginning, lenders went nuts trying to break into the market. It's only a slight exaggeration to say that the earliest loans were written on the backs of cocktail napkins. (The earliest one I have seen was dated January 2, 1998 and was made by a local Austin credit union. Amazingly enough, it was done correctly.) Home equity loans (especially second liens) are typically lower in dollar amount and are assigned to junior officers or are made by, ahem, lower tier lenders. Mistakes are made. Corners are cut. Dare I say it? Some lenders cheat.

The controlling provision is Article 16, section 50(a)(6) of the Texas Constitution. (Article 16, Section 50 is the provision dealing with homestead issues generally, not just equity loans.) Article 16, Section 50 provides that a homestead is "protected from forced sale for the payment of all debts **except**" an enumerated list. The provisions dealing with equity loans are exacting and provide clear penalties for non-compliance.

In evaluating these cases, I get my client to bring in the entire loan file. I then go through the entire file and attempt to confirm whether the loan documents comply with the statute. Start with the basics. The first basic: **Read the documents. All of the documents. More than once.** Just because a provision is okay in a purchase money mortgage doesn't mean it's okay in an equity loan. Don't take anything for granted. The second basic: Think while you are reviewing the file. Some defects will never be obvious from reviewing the documents, but should give rise to questions. (Appraisals are always suspect. Your client will seldom have a copy.)

The easiest way to review potential violations is simply to go through the statute and point out common mistakes, issues, and questions that arise with respect to each provision. In this article, the part in bold print is the statute which went into effect January 1, 1998. The part in italics is the changes which went into effect on September 29, 2003.

Remember, the law in effect at the time the contract was entered into governs the transaction. In re Adams, 307 B.R. 549, 552 (Bankr.N.D.Tex.2004). This is potentially significant with respect to the cure provisions. For instance, pre-September 2003, the lender had a "reasonable time" to cure. Now they have a flat 60 days. Several of the cases tried under the old law have looked to the new law for guidance, so if the new law helps you, you can cite it in support of your position. (The legislative history makes it clear that the September 2003 amendments were to "clarify" existing law, not to change it.) That said, it would seem prudent that 60 days is a "reasonable time" to cure under the old statute.

"(a)(6)(A) is secured by a voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse".

The debt must be secured by a voluntary extension of credit under a **written** agreement with the consent of each owner **and** each owner's spouse. Who executed the documents? If the borrower was married at the time of the extension of credit, the spouse **must** consent to the lien. It does not matter that the homestead is the separate property of the borrower spouse. I have had several cases where the property was owned by the debtor and a non-spouse family member. Confirm who the owner of

the property was at the time of the extension of credit. You can usually do this online. Even if the real property records are not available online, the tax records usually are.

I have seen cases where the non-borrower spouse executed a power of attorney allowing the borrower spouse to execute loan documents in connection with an equity loan. The Texas Finance Commission interpretation provides: “A lender may accept a properly executed power of attorney allowing the attorney-in-fact to execute closing documents on behalf of the owner.” 7 Tex. Admin Code Sec 153.15(2). But what about the spouse?

> **“(a)(6)(B) is of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made"**

The total principal amount of the equity loan plus the principal amount of any **prior** liens may not exceed 80% of the fair market value on the date the extension of credit is made. The two numbers which set the limits on the amount of the equity loan are the principal balance of the prior lien(s) and the value of the property. If the lender fudges on either, or both, there may be an 80% violation.

The valuation issue will be addressed later, as there is a statutory provision which attempts to address that issue, at least in part.

> **“(a)(6)(C) is without recourse for personal liability against each owner and the spouse of each owner, unless the owner or spouse obtained the extension of credit by actual fraud".**

This is fundamental. Read the documents. Non-recourse is non-recourse. It either is or it isn't. With that said, lenders try to word their notes vaguely enough that the borrower doesn't understand that the loan is non-recourse.

Wells Fargo related entities (and there were/are several) made a large number of loans that were recourse, but after Judge Clark ruled against them in In re Agredano, Adv. No. 03-5155-C (W.D.Tex. 2003) they ***claim*** to have sent out a cure letter to all of their borrowers. They can’t produce a copy of the actual letter, but they will supply an affidavit and a list of borrowers and swear these were the people who received the cure letter.

A home equity loan is non-recourse unless the borrower or spouse obtained the loan by actual fraud. The statute fails to define what constitutes "actual fraud". The Finance Commission has interpreted actual fraud in this context as “encompass[ing] dishonesty of purpose or intentional breaches of duty that are designed to injure another or to gain an undue and unconscientious advantage.” 7 Tex. Admin. Code Sec. 153.4(3). The question here is whether this is intended to be ***a*** definition or ***the*** definition of actual fraud. Note that it does not include any reliance element. (This is included in a

paragraph explaining that the statute requires actual fraud as opposed to constructive fraud, and may only be offered to clarify the distinction.) The actual fraud/constructive fraud distinction may be important as actual fraud generally requires an affirmative act by the borrower and reliance by the lender.

In almost every one of the cases where I have disputed the validity of an equity loan, the reaction of the lender has been to respond that whatever we contend isn't true, but even if it is, the borrower committed fraud. Expect this. Be prepared to deal with it. The usual allegation is the borrower made false statements in the loan application. Failure to disclose all unsecured debts is typical. Check the file. The lender usually knows about the "undisclosed debt" because the lender obtained a credit report. If the lender obtained a credit report, the lender cannot use failure to disclose as "fraud" sufficient to invoke the recourse exception to the article. (No reliance.)

In 80% cases, lenders claim the borrower lied in the loan application about the value of the property. In discovery, lenders will always produce the final, typed up, signed loan application. Ask for the actual loan application filled out by the borrower. You won't get it. It was destroyed by the lender. The value in the final typed up application is always (remarkably) the exact amount of the appraisal obtained by the lender. In these cases, it is my position that the lender is the one who committed fraud, not the borrower.

More recently, I have been seeing loan documents in which the lender defines actual fraud, usually to include ***any*** false statement in ***any*** of the loan documents. Look for such a definition. I'm not sure a court will enforce such a provision if the false statement is not material. Even if it is, the lender still has the burden to show actual reliance.

Judge Monroe addressed the reliance issue in In re Foster, Adv. No. 04-1117-FM (Bankr.W.D.Tex. 2003) where one of the issues was whether a lender was defrauded by a borrower who signed a lengthy affidavit in which they represented (among other things), that the property was not used for agricultural purposes. Judge Monroe found that the lender did not rely on the representation, because among other reasons, no one from the lender appeared at the closing. If the lender never saw the document prior to closing, how could it have relied on it?

Judge Isgur gives a concise summary of Texas law regarding representations by borrowers contrary to the existing facts with respect to the status of a homestead (in an effort to avoid the restrictions on lending against homesteads.) If you are trying one of these, start here. In re Box, 324 B.R. 290, 294 (Bankr.S.D.Tex.2005). (Judge Isgur says a lender may nor rely on "mendacious" recitals which are contrary to facts known to the lender.

> **"(a)(6)(D) is secured by a lien that may be foreclosed upon only by a court order"** Section 50(r) provides: **"The supreme court shall promulgate rules of civil procedure for expedited foreclosure proceedings related to the foreclosure of liens under Subsection (a)(6) of this section..."**

The procedures established by the Supreme Court for foreclosure of home equity loans are located

at Rules 735 and 736 of the Texas Rules of Civil Procedure. Rule 735 provides that the lender may foreclose by (1) filing a suit seeking judicial foreclosure, (2) filing a suit or counterclaim seeking a final judgment which includes an order allowing foreclosure under the security instrument and Tex. Prop. Code Section 51.002; or (3) filing an application under Rule 736 for an order allowing foreclosure.

Rule 736 requires the party seeking to foreclose an equity lien to file a **verified** application in the district court of the county where all or part of the property is located. The rule also includes a list of items which **shall** be included in the application. The lender must serve the application **and** notice on each party who is "obligated to pay the debt" by certified **and** first class mail. If the borrower is represented by an attorney and the lender has knowledge of who the attorney is, the lender must also serve the attorney, although the method of service on the attorney is not specified.

Rule 736(3) provides that a response to the application is due on or before 10:00 a.m. on the Monday after the expiration of thirty-eight (38) days after the date of mailing of the application and notice, exclusive of the date of mailing. If the borrower fails to file a timely response, the court may grant the application without further notice or hearing. If the borrower timely responds, "the application shall be promptly heard after reasonable notice to the applicant and the respondent." Unless the parties agree to an extension, the issue shall be determined within ten business days of the request for hearing. No discovery of any kind is permitted. At the hearing, the applicant has the burden of proof "by affidavits on file or evidence presented". There is no deadline stated in the rule for the filing of affidavits so in theory, the lender could file affidavits the day before the hearing (thus placing them "on file") and go forward with them as the evidence in support of the application. Courts will obviously be called upon at some point to delineate what is acceptable conduct in this regard.

The only issue to be determined at the hearing is "the right of the applicant to obtain an order to proceed with foreclosure." The Rule further provides, however, that any order of foreclosure shall **<u>not</u>** be "res judicata or constitute collateral estoppel or estoppel by judgment in any other proceeding or suit. The granting of an application under these rules shall be without prejudice to the right of the respondent [borrower] to seek relief at law or in equity in any court of competent jurisdiction." It sounds like what the Rule is intended to do is grant the lender an expedited hearing at which the only issue is whether the borrower is in default on the debt. If the lender proves a default, an order will be entered authorizing a sale. Attacks on the validity of the lien would seem to be prohibited in these proceedings.

If the applicant proves the elements of Rule 736(1)(E), the court **shall** grant the application. An order will be entered directing that foreclosure proceed under the security instrument and Tex. Prop. Code Section 51.002 (the non-judicial foreclosure section) and a copy of the order **and** a notice of sale shall be "sent" (not served) to the respondent. No means of "sending" is specified. (Section 51.002 requires that the notice of sale be sent by certified mail.) The notice of sale shall be sent to respondent's counsel by certified mail. The applicant is required to file a certified copy of the order in the real property records within ten business days of entry, but failure to do so does not affect the validity of the sale.

If the borrower wishes to raise an issue other than "the right of the applicant to obtain an order to proceed with foreclosure" and the borrower does so by filing a petition contesting the right to

foreclose in a district court in the county where the application is pending, the application is automatically abated and shall be dismissed.

Although this is the "expedited" procedure for foreclosing an equity lien, the process is still fairly cumbersome and not terribly prompt. The lender has to file an application. The borrower has at least 38 days to respond. The court has to determine the issue within 10 days of a request for hearing. (I have had several cases where we filed a response to the application and the lender took months to set it for hearing.) If the lender prevails at the hearing, it then has to comply with the standard non-judicial foreclosure procedures including giving 21 days notice of a sale which may only occur on the first Tuesday of the month.

If you get a home equity loan that is about to be foreclosed, make sure the lender complied with Rule 736. Did the lender even file an application? I have actually had a couple of these where the lender went straight to non-judicial foreclosure and just skipped the application process. (Apparently, nobody ever bothered to look at the loan documents at any time in the foreclosure process so they just assumed it was a standard foreclosure.)

Did the application contain all of the required information? The rule contains a specific list of items which **must** be included in the application. Review the list and make sure the lender included all of the required items.

The rule concludes: “The verified application and any supporting affidavit shall be made on personal knowledge and shall set forth such facts as would be admissible in evidence, provided that facts may be stated based upon information and belief if the grounds of such belief are specifically stated.” If the verification does not comply with the rule, the application is not in proper form and is objectionable.

There is a case of interest on the procedural issues relating to foreclosure of equity loans. In A Plus Investments, Inc. v. Rushton, 2004 WL 868866 (Tex. App. – Fort Worth, 2004) an order authorizing foreclosure was granted to Associates Financial Services, but the ensuing foreclosure was conducted by Citifinancial, which then sought a writ of possession. The court held that because there was no evidence *in the record* showing how Citifinancial had the right to foreclose, the court could not grant a writ of possession to Citifinancial. This is limited by the facts, so if you represent lenders, make sure you have your proof together. If you represent borrowers, use these kinds of proof issues to smack the lender (or maybe just to buy a little time.)

> **“(a)(6)(E) does not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit".**

The big fight here is what is included or not included in the three percent cap. Interest (including “loan discount”) is not included. Prepayments for escrow are not included. On the HUD-1 Settlement

Statement, line 802 and lines 900 through 1011 are not included. Everything else from line 801 through 1206 is included. Look at line 1301 through 1307 carefully. Fees for surveys, pest inspection, hazardous materials inspections (asbestos siding) are usually listed here and are included in the three percent cap, BUT payments to credit card companies are included listed here, also, but are not included in the three percent cap.

One of the ongoing fights is whether “loan origination fees”, line 801 on the HUD-1, are included. Lenders will always contend that it is “really” a loan discount fee, which is included in interest. The obvious question is if it was intended to be loan discount, why didn’t they put it on the very next line which is conveniently labeled “loan discount”?

In Thomison v. Long Beach Mortgage Co. , 176 F. Supp. 2d 714 (D.W.D.Tex. 2001) vacated, 2002 WL 32138252 (D.W.D.Tex.2002.), Judge Nowlin held that a "loan origination fee" is a "fee... necessary to originate" the loan and is included in the 3% cap. Because that charge put the lender over the cap, he did not reach the issue of whether a "loan discount" is also a fee, although in addressing the loan origination fee, he did opine that whether a charge constitutes interest under the Texas usury statute is not controlling on whether it is interest for the purposes of the equity lending statute. It is important to note that Judge Nowlin focused on the language in the settlement statement. The "loan origination fee" was denominated as such. Judge Nowlin concluded, in part, that if a lender calls a charge a "loan origination fee" they don't get to come back later and say it was really something else. ("When a lender denominates a line item charge... as a fee, a fee it shall be.")

Thomison was appealed by the lender and unfortunately, Long Beach Mortgage came to its senses and settled the case. One of the conditions of settlement was that Judge Nowlin had to withdraw his opinion which he was willing to do to make it go away. It therefore has no precedential value, but it did not come out of the books.

In another opinion, Tarver v. Sebring Capital Credit Corp., 69 S.W.3d 708 (Tex. App. -- Waco 2002), the Waco Court of Appeals held that points are interest and are **not** included in the 3% calculation. The lender submitted evidence that the payment of three "points" actually resulted in a reduction in the interest rate from 12.375% to 9.375%. The borrowers contended that they were never offered any interest rate other than 9.375% so the three points were really just a "fee" for making the loan. Unfortunately for the borrowers, in the written documents the borrowers acknowledged they were buying down the interest rate. The lender also submitted its rate structure which indicated that the borrowers would have paid the higher rate if they did not pay the points. Under the facts as presented, the result is correct. I have seen several cases, however, where the payment of points did not appear to have any direct relationship to the interest rate charged. I would suggest that there should be a different answer under those circumstances, but the only way to develop this issue is through discovery.

In an unpublished opinion, another U.S. District Judge "held" that virtually *all* of the closing costs were interest, (and therefore not subject to the 3% cap) including the loan origination fee, the loan fee, the tax certificate fee, and the processing fee. The basis for this reasoning was apparently a leap of logic of from state court decisions that under the Finance Code that "interest" includes "any lender-retained fees or charges that are not supported by separate and distinct consideration for the loan and the lender's ordinary overhead and expenses." Breaux v. United Companies Lending Corp., Civ. No.

H-99-3384 (D.S.D. Tex. 2001). One can only conclude that the court never bothered to read the statute which specifically provides that a fee to originate or evaluate the loan is included within the 3% limit, and the opinions in Stringer and Doody which apply the plain meaning test to statutory construction. (No other court has followed this.)

Lenders routinely contract for fees and expenses which significantly exceed 3%, then on the settlement statement there is a line item titled something like "expenses paid by lender" or "lender's allowance" or "lender credit" which, when deducted from the fees, reduce the amount to exactly 3%. (Look for lender credits in the 200 section on the HUD-1.) It would seem that under the statute, a lender may "charge" whatever fees and expenses it wants, as long as it does not require the borrower to "pay" those fees. If the lender pays the fees rather than the borrower, the language of the statute is not violated. 7 Tex. Admin. Code Sec. 153.5(5).

Watch for items on the HUD-1 with the notation "p.o.c.", which stands for "paid outside closing." Paid by whom? I have had cases where the borrower paid for an appraisal or survey "p.o.c.", but if the fee for that service was added to the fees on the HUD - 1, it would put the lender over the 3% cap. The statute says a lender may not require a borrower ro pay more than 3% for closing costs, it does not make an exception if the fees were "p.o.c." 7 Tex. Admin. Code Sec. 153.5(7) provides, in part: "Charges an owner or an owner's spouse is required to pay *to third parties* for separate and additional consideration for activities relating to originating a loan *are fees subject to* the three percent limitation." [Emphasis added.]

> **"(a)(6)(F) is not a form of open-end account that may be debited from time to time or under which credit may be extended from time to time** *unless the open-end account is a home equity line of credit***".**

This is simple. Under the 2003 amendments, lenders may structure an equity loan as a revolving line of credit. More on this later. (They should have just taken this section out when they did the 2003 amendments. Basically, the statute now says you can't do a line of credit secured by a homestead unless you do it as a line of credit secured by a homestead.)

> **"(a)(6)(G) is payable in advance without penalty or other charge".**

The loan has to be payable in advance without a prepayment penalty. I have never had a note with this defect, but it would be obvious on the face of the note and the Truth in Lending disclosure and I always look for it.

> **"(a)(6)(H) is not secured by any additional real or personal property other than the homestead".**

The Finance Commission "clarified" this provision in 2004 by enumerating a list of "items" a lender "may acquire an interest in" (an "interest", not a security interest) which are not considered to be additional real or personal property. That list includes "insurance *proceeds* related to the homestead." [Emphasis added.] 7 Tex. Admin. Code Sec. 153.8(1)(C).

Look for cross collateralization clauses. These are most common with credit unions so if the debtor also has a car loan, the lender has a problem. Many of the equity loans have a clause which says that the borrower grants a security interest in all deposit accounts to the lender. If your debtor client doesn't have an account with the lender, tell them to go open one. Most of the banks and credit unions have a provision in the equity loan documents which waives any cross-collateralization rights they might otherwise have, a provision which should save them, but don't assume it's there. Make sure and find it. If it's not there, they have a problem.

> **"(a)(6)(I) is not secured by homestead property designated for agricultural use as provided by statutes governing property tax, unless such homestead property is used primarily for the production of milk".**

If the debtor owns ten or more acres, he/she may "ag exempt" the property in excess of the one acre with the house on it, assuming certain use restrictions are met. The debtor should be able to take an equity loan against the acre with the house, but if the lien extends to any additional property which has been designated as ag exempt, then the lender may violate this provision. This is one that won't be obvious from the documents, you just have to recognize the potential situation and ask the questions.

The relevant Texas Tax Code sections are Subchapter C, Sections 23.41, et seq. and Subchapter D, Sections 33.51, et seq. The distinctions between the two subchapters are basically that C is for property used for ag purposes ***and*** agriculture is the primary source of income for the owner. Subchapter D is an "open space" exemption for ag use property where agriculture is ***not*** the primary source of income of the owner.

Judge Monroe addressed this issue in Foster, in which he held that property which is subject to the open space exemption, but is not the primary source of the owner's income is still "property designated for agricultural use as provided by statutes governing property tax" and a lender was barred from taking a lien on it. (Say what you want, this is the correct answer.) See, also, Lasalle Bank, N.A. v. White, 2006 WL 1152337 (Tex.App. – San Antonio, 2006).

> **"(a)(6)(J) may not be accelerated because of a decrease in the market value of the homestead or because of the owner's default under other indebtedness not secured by a prior valid encumbrance against the homestead".**

I have never had the issue regarding a decline in value come up. As long as the borrower is making the monthly payments, most lenders aren't going to be too concerned if the property value declines.

I have had several cases where the loan documents contained either a provision which said that a default on any debt was a default on the equity loan or a "general insecurity provision" which said the lender could declare a default for any reason or no reason. Either of these should be a violation. (Lenders always cure this one when you send a demand letter.)

> **"(a)(6)(K) is the only debt secured by the homestead at the time the extension of credit is made unless the other debt was made for a purpose described by Subsections (a)(1)-(a)(5)** *or Subsection (a)(8)* **of this section."**

You can only have one equity loan at a time. As obvious as this is, I have actually had a case where a lender took an equity lien subject to its own prior equity lien.

The 2003 amendments provide that a lender may "cure" violations of this section by sending the borrower a written acknowledgment that the accrual of interest and all of the borrower's obligations under the extension of credit are abated while any prior lien prohibited under this section remains secured by the homestead, but the (statutorily prohibited) inferior lien is still valid.

> **"(a)(6)(L)(i) is scheduled to be repaid in substantially equal successive** *periodic* **installments,** *not more than every 14 days and not less 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 installments** *or*
>
> *(ii) if the extension of credit is a home equity line of credit, in periodic payments described under Subsection (a)(8) of this section;*"

The loan has to amortize, unless it is a home equity line of credit. (It can't be interest only with a principal balloon at some point in the future.) The payments only have to be "substantially equal" because variable interest rates are permitted. Payments must be made at least monthly, but not more frequently than every two weeks.

> **"(a)(6)(M) is closed not before:**
>
> **(i) the 12th day after the later of the date that the owner of the homestead submits an application to the lender for the extension of credit or the date that the lender provides the owner a copy of the notice prescribed by Subsection (g) of this section; and"**

Home equity loans have two "cooling off" periods. This is the first one. The lender has to wait at least twelve days from the **later of** the date of the loan application **or** the date the Subsection (g) disclosure is delivered to the borrower. Equity lenders frequently solicit loans by cold calling homeowners and through television advertising. They take the loan application over the phone. There is no requirement

in the statute that the loan application be in writing. The Finance Commission interpretation expressly provides: “A loan application may be given orally or electronically.” 7 Tex. Admin. Code Sec. 153.12(2). The other requirement is that the lender must provide the borrower with a copy of the Subsection (g) disclosure. This is not an either/or situation. The borrower **must** submit an application ***and*** the lender **must** provide the borrower with a copy of the disclosure. The lender has to wait to close until at least twelve days after the later of the two.

If you represent lenders, you should advise them to keep clear records on what happened when. The best practice is to have the potential borrower fill out the loan application and sign it and date it and to make the borrower acknowledge receipt of the Subsection (g) disclosure by signing and dating it. Watch for backdating. I'm not sure this is "wrong", but it looks bad. (It is fairly common for lenders to take telephone applications and when the borrowers come in to close, they sign a loan application and back date it to the date that they supposedly submitted the application. The better practice is to have the borrower sign a statement that the application was submitted by telephone on the date it actually happened and date the statement the date they actually sign it.)

> “*(ii) one business day after the date that the owner of the homestead receives a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously modified documentation on the date of closing; and* “

This is new and it was apparently actually intended to protect borrowers. The lender has to provide the borrower with the information contained in a HUD-1 at least one business day before closing. Then there is the exception you can drive a truck through: unless an emergency or “another good cause” exists and then the lender can provide it at closing. Watch for this one. This is **not** the “good faith estimate.” (I have had several cases where the “good faith estimate” of closing costs was substantially different from the HUD-1 actually executed at closing.) This has to be the ***actual*** fees, points, interest and costs. If the numbers on this disclosure do not match the final HUD-1, there is a (curable) violation. Amazingly enough, the Finance Commission may have actually tried to help consumers with the interpretation on this section. That interpretation provides that if a lender modifies the timing of this disclosure, the lender *should* obtain written consent from the owner that describes the emergency and specifically states that the owner consents to receive the disclosure at closing. 7 Tex. Admin. Code Sec. 153.13(3). The interpretation also provides that an owner may consent to receive a modified preclosing disclosure on the date of closing if the disclosed fees, costs, points and charges do not vary from the initial preclosing disclosure by more than the greater of (i) $100 of the amount charged at closing or (ii) .125 percent of the principal amount of the loan, or if the actual fees or charges is less than the disclosed rate or amount. 7 Tex. Admin. Code Sec. 153.13(4).

> **“(iii) the first anniversary of the closing date of any other extension of credit described by Subsection (a)(6) of this section secured by the same**

homestead property, *except a refinance described by Paragraph (Q)(x)(f) of this subdivision***";**

You can't refinance a home equity loan with another home equity loan within one year of the closing on the prior loan. Watch for this, especially in cases where the loan was solicited by cold calling. I had a client who had a home equity loan closed within a year of a prior equity loan which was closed within a year of a prior equity loan. (Two violations in less than two years.) This provision does not apply if the new loan is a cure by the same lender or holder of an existing defective loan.

"(a)(6)(N) is closed only at the office of the lender, an attorney at law, or a title company".

This is pretty straightforward. It happened there or it didn't. Watch out for the smaller and out of state lenders on this one. I had one loan that was closed at the borrower's home. This usually isn't a problem with banks, credit unions or the larger regulated lenders.

"(a)(6)(O) permits a lender to contract for and receive any fixed or variable rate of interest authorized under statute".

Equity loans can have a variable interest rate.

"(a)(6)(P) is made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loan is located in a certain area:

(i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or the United States;

(ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans;

(iii) a person licensed to make regulated loans, as provided by statute of this state;

(iv) a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase; or

(v) a person who is related to the homestead property owner within the second degree of affinity or consanguinity; or

(vi) a person regulated by this state as a mortgage broker;"

This section sets out who can make equity loans. First, the lender cannot have been found to have

engaged in redlining. Second, the lender has to be authorized to make these kinds of loans. Some lenders are obvious. Bank of America, N.A., for instance, is a bank doing business under the laws of the United States. First State Bank of Smalltown, Texas is a bank doing business under the laws of the State of Texas. What about Citifinancial, Inc.? It doesn't fit into subsections (i), (ii), (iv),(v) or (vi), so it has to be (iii) if they are, in fact, authorized.

To find out if a lender under subparagraph (iii) is licensed, go to www.occc.state.tx.us, click on Searches and License Verifications, then click on Search for Licensees. This can get real interesting. Each office of a regulated lender is licensed individually. When I wrote the first version of this article in 2003, Citifinancial, Inc, had 170 licensees in Texas. (Including several with an address in Baltimore, Maryland.)

This is the ***only*** violation a lender ***cannot*** cure. Of course, this is one of the few violations I have never found.

> **"(a)(6)(Q) is made on the condition that:**
> **(i) the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender;"**

A lender cannot require a borrower to pay off any particular debt with the proceeds of the equity loan **except** debts secured by the property **or** debts to another lender. I have had several where the lender simply listed a prior unsecured signature loan owed to the same lender on the settlement statement as a debt to paid at closing without ever discussing it with the borrower. Borrowers generally don't ask about this, they simply assume that it is a condition of the loan and they don't have any choice. I doubt you could convince most courts that the borrower's "assumption" that it is a condition of the loan equals a "requirement" by the lender

There are a couple of good cases on this issue. See In re Box, 324 B.R. 290 (S.D.Tex. 2005), aff'd, 340 B.R. 782 (D.S.D.Tex. 2006), which undertakes an analysis of what "requires" means and concludes that notwithstanding recitals signed by the debtor that paying off other debt was voluntary, the lender would not have made the loan without the proceeds being applied to pay off unsecured debt to the same bank. Judge Isgur concluded that "mendacious recitals and affirmations" may not be used to validate a constitutionally prohibited lien. 324 B.R. at 294. (I would think the same analysis would apply to claims that the borrower committed fraud by making false statements in the loan application, loan agreement, acknowledgment of value or an affidavit.) Judge Monroe also had to deal with this issue in Umbrella Bank v. Jamison, Adv. No. 04-1055 (W.D.Tex. 2005) although in that case the court was required to undertake an extensive analysis of what really happened to the loan proceeds to conclude that the borrower was required to pay off an unsecured loan to a related entity as a condition of making the equity loan.

The Finance Commission interpretation provides that if the borrower "applies for a debt consolidation loan, it is the owner, not the lender, that is requiring that proceeds be applied to another debt. If the proceeds of a home equity loan are used in conformity with the owner's credit application, the

limitations of this section do not apply.” This one is ripe for abuse. All the lender has to do is put a line in the loan application that says the borrower wants to pay this debt, and the lender should be covered, regardless of whether repayment of the debt was voluntary or not.

> **“(ii) the owner of the homestead not assign wages as security for the extension of credit;”**

I have never seen this. I have had loan agreements which say that if the loan was obtained by fraud, it is recourse and the lender may pursue collection by any legal means “including wage garnishment”. Clearly not enforceable, but what are the borrower’s damages? This may be a violation where you can demand that the lender cure and if they don’t they lose their lien, but I’m not going to be in a hurry to file this case if this is the only violation.

> **“(iii) the owner of the homestead not sign any instrument in which blanks are left to be filled in;”**

I get closing folders all of the time which have incomplete documents. My personal favorite is the acknowledgment of fair market value of the property without signatures by the borrower or the lender and the value left blank. The lenders always say that in the final document signed at closing the value was filled in, but this is still a (curable) violation of the requirement that the borrower receive copies of the documents. I have actually had instances where the copy of the acknowledgment of fair market value provided to the borrower ***was*** signed by the borrower and the space for the value was blank. I even had one that was notarized with a blank value and a blank "as of" space for the date. Under the 2003 amendments, this is all curable.

> **“(iv) the owner of the homestead not sign a confession of judgment or power of attorney to the lender or to a third person to confess judgment or to appear for the owner in a judicial proceeding;”**

I have never seen this. (I have had cases where the borrower gave the lender a power of attorney to execute documents to correct “clerical” mistakes in the loan documents. That strikes me as susceptible to abuse, but not a per se violation.)

> **“(v) the lender, at the time the extension of credit is made, provide the owner of the homestead a copy of all documents signed by the owner related to the extension of credit;”**

This is the section that gives me the most heartburn. On very few occasions has my borrower

received a complete set of executed documents. In fact, on very few occasions has my borrower received a complete set of documents, executed or not. This is going to be one of those plain language fights, but my reading is that the lender has to provide the borrower with copies of the actual documents ***with the signatures***. Lender's attorneys argue that the statute doesn't say "copies of the signed documents", just copies of the documents which were signed. Lenders rarely provide copies of everything, executed or not.

The Finance Commission made a bonehead interpretation on this one. Their interpretation says: "At closing, the lender must provide the owner with a copy of all documents that are signed ***at closing*** in connection with the equity loan. The lender is not required to give the owner copies of documents that were signed by the owner prior to closing, such as those signed during the application process." [Emphasis added.] 7 Tex. Admin. Code Sec. 153.22. I'm sorry, but I keep going back to the actual plain English of the statute which says that the lender shall provide the borrower with copies of all documents signed by the borrower "***related to*** the extension of credit." At least to my simple little brain, the **loan application** would seem to be **related to** the extension of credit.

A related problem area here is appraisals. Lenders (more accurately, their attorneys) sometimes refuse to provide copies of appraisals. The statute says they have to provide copies of all documents signed by the borrower. The borrower doesn't sign the appraisal, so arguably, the lender is not required to provide a copy. (Never mind that the lender required the borrower to pay for the appraisal.) I get this argument more often than I would expect. A 2004 exam notice usually solves this fight promptly.

This is another one of those problems that was "fixed" by the amendments. As long as the lender provides copies within 60 days of demand by the borrower, the violation is cured.

> **"(vi) the security instruments securing the extension of credit contain a disclosure that the extension of credit is the type of credit defined by Section 50(a)(6), Article XVI, Texas Constitution;"**

The deed of trust has to say that the loan was made under the home equity loan statute. (Its usually at the top of the first page in all caps in bold print.) This is a no brainer, but I have actually had a couple of loans that did not comply, although they were all fairly soon after January 1, 1998. I

have had a couple of cases where a home equity loan was closed on documents that are simply not equity loan documents. (Recourse, prepayment penalty, no Rule 736 foreclosure provisions, not statutory disclosures, no right of rescission, etc.) The cure is for the lender to pay the borrower or credit to the loan $1000 and to re-close the loan with documents which comply. If you get one of these cures, read the documents. I am suing Washington Mutual on a case where they did not pay or credit and provided new documents which we contend still do not comply (including the release which WaMu demanded as part of the cure. I don't find that in the cure provision.)

> **"(vii) within a reasonable time after termination and full payment of the extension of credit, the lender 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 creditor a copy of an endorsement and assignment of the lien to a lender that is refinancing the extension of credit;"

The lender has to release the lien and return the note promptly after the debt is paid in full. I have only had a couple of these that actually paid off (always by another equity loan), and the new lender always makes sure to get a release from the prior lender, so this hasn't been an issue.

"(viii) the owner of the homestead and any spouse of the owner may, within three days after the extension of credit is made, rescind the extension of credit without penalty or charge;"

This is the other cooling off period. I have never had a client try to rescind. You should look for an "Election Not to Rescind" or similar document. I have had several cases where the borrower was "required" to execute such an election at the closing, but post-dated to more than three days later. (I had a couple who could prove they were out of town on the day the election was supposedly signed and notarized by an employee of the lender.) By itself, that may fall into the "no harm, no foul" category, but when added to numerous other violations, it can significantly add to the stink factor.

"(ix) the owner of the homestead and the lender sign a written acknowledgment as to the fair market value of the homestead property on the date the extension of credit is made; and"

This is the only document required to be signed by the lender. Look for it. I had one where the copy provided to the borrower at closing didn't even have a space for the lender to sign, but the copy we received in discovery had a space and it was executed. Will wonders never cease?

If the basis for disputing an equity loan is that the value simply wasn't sufficient to satisfy the 80% loan to value ratio, the lender will always point to the acknowledgment of value and contend that the borrower committed fraud by representing that the property was worth more than it really was or, at a minimum, the borrower is estopped to dispute the valuation. Talk to your client about this. In most of the cases where I have seen this, the value listed in the loan application and the acknowledgment of value is the value found by the lender's appraisal.

Watch for cases where there was more than one appraisal. (This happens more frequently than I would have imagined.) The typical scenario is borrower goes in and applies for an equity loan and says we want to borrow $40,000 to pay off credit card debt. An appraisal is ordered and it comes back with a valuation that will not support the loan as requested because it violates the 80% limit. Lender says the appraisal is "wrong" or there was a "mistake" and orders another appraisal, which magically comes in just high enough to support the $40,000 loan.

The amendments also "fixed" this issue as a lender may cure an 80% violation by sending the borrower a written acknowledgment that the "lien is valid only in the amount that the extension of credit does not exceed [the 80% limit]". What if the lender sends an acknowledgment that uses the exact language of the statute? They have "cured", but what is the balance of the loan? What if the borrower and lender cannot agree on what the property was worth on the date the extension of credit was made? Sounds like somebody has to file a declaratory judgment action.

More on this issue later.

> **"(x) 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** *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;* **"** (FYI, the 60 day deadline used to read "within a reasonable time after".)

This is the remedy section, including the 2003 cure provisions. The cure provisions basically gut the equity lending statute restrictions ***if*** the lender is prepared to make the cure.

> *"(a) paying to the owner an amount equal to any overcharge paid by the owner under or related to the extension of credit if the owner has paid an amount that exceeds an amount stated in the applicable Paragraph (E), (G), or (O) of this subdivision;*

Paragraph E is the 3% limit on closing costs. Paragraph G is the prohibition against prepayment penalties. Paragraph O is a lender may only charge an interest rate permitted by statute. The lender or holder may cure any of these violations by simply giving the money back within 60 days after demand. (A lender can cure a usury violation by simply paying back the excess interest.)

> *(b) sending the owner a written acknowledgment that the lien is valid only in the amount that the extension of credit does not exceed the percentage described by Paragraph (B) of this subdivision, if applicable, or is not secured by property described under Paragraph (H) or (I) of this subdivision, if applicable;*

The paragraph B part of this was discussed previously in the section on the 80% limit. H and I are the paragraphs which prohibit other collateral and securing an equity loan with ag exempt property. The cure on the ag exemption may not be as simple as our legislature seems to think. On ag exempt property, the county carves out one hypothetical acre with the house on it which is not ag exempt, but the remaining property is. Except there is no "one acre" with the house. There is just an unspecified 43,560 square feet of dirt which has a house on it.

(c) sending the owner a written notice modifying any other amount, percentage, term, or other provision prohibited by this section to a permitted amount, percentage, term, or other provision and adjusting the account of the borrower to ensure that the borrower is not required to pay more than an amount permitted by this section and is not subject to any other term or provision prohibited by this section;

If the loan is usurious, but the borrower hasn't actually paid the usurious interest, the lender has to send a written statement that reduces the interest rate to an acceptable level. If the note doesn't call for monthly payments, the lender has to send a statement that calls for monthly payments. If the note is recourse, the lender has to send a statement that says it is non-recourse.

Judge Clark has weighed in on this issue. Although the opinion is based upon the pre-amendment statute, Judge Clark looks to the 2003 amendments for guidance on interpreting the pre-amendment version. The debtor sent a letter to the lender essentially saying: "My note is recourse and the deed of trust can be foreclosed without a court order. Please fix this." Wells Fargo's response was to send a letter that said: "Your loan is subject to the restrictions you mention in your letter." This is the actual language from the letter. At trial, Wells Fargo contended that this was a "cure" of the defects contained in the loan documents. Judge Clark disagreed. In re Agredano.

(d) delivering the required documents to the borrower if the lender fails to comply with Subparagraph (v) of this paragraph or obtaining the appropriate signatures if the lender fails to comply with Subparagraph (ix) of this paragraph;

Subparagraph (v) is the provision which requires the lender to provide copies of all documents signed by the borrower related to the extension of credit "at the time the extension of credit is made." Subparagraph (ix) is the provision which requires that the acknowledgment of value be signed by the borrower and the lender. As mentioned above, I have seen several of these which were not executed by the lender. Now they can cure by signing it after the fact.

(e) sending the owner a written acknowledgment, if the failure to comply is prohibited by Paragraph (K) of this subdivision, that the accrual of interest and all of the owner's obligations under the extension of credit are abated while any prior lien prohibited under Paragraph (K) remains secured by the homestead; or

Paragraph (K) is the provision which prohibits more than one equity loan at a time. If the lender takes a second home equity lien, it must send the borrower a statement that the accrual of interest and "all of the owner's obligations" under the loan are abated until the prior lien is released. The penalty for this violation is that the borrower doesn't have to make payments on the junior lien and no interest accrues until the prior lien is released, but the lender still gets a second equity lien on the debtor's property. I am about to file an adversary where the lender sent the cure letter and promptly violated the cure by threatening foreclosure, sending the debt to a collection agency, then sending it to

another collection agency, and reporting the loan as delinquent on the borrowers' credit reports. If the lender "cures" and then repeatedly violates the cure, is there an effective "cure"?

> *(f) if the failure to comply cannot be cured under Subparagraphs (x)(a)-(e) of this paragraph, curing 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 comply with this section or on terms on which the owner and the lender or holder otherwise agree that comply with this section; and*

This is the catch all cure provision. If the lender cannot cure under any other provision, they can refund or credit (apparently lender's choice) $1,000 and offer to refinance the loan at the same interest rate with documents which comply with the statute. Apparently the offer to refinance is the cure. They have to *offer* within 60 days after demand, but there is no deadline in the statute for the lender to actually make it happen. The Finance Commission interpretation does include a deadline of sorts by providing: "*After the borrower accepts an offer* to modify or refinance, the lender must make a good faith attempt to modify or refinance within a reasonable time not to exceed 90 days." 7 Tex. Admin. Code Sec. 153.96(d).

A borrower cannot demand that a lender cure and then refuse to accept the cure. In re Adams, 307 B.R. 549 (Bankr.N.D.Tex. 2004). In that case, the borrower sued without making a cure demand and rejected the lenders offer to execute new loan documents, contending that the lender could only make cures which involved *unilateral* acts by the lender. Judge Jones rejected this argument, concluding: "The borrower may not refuse to comply with a reasonable offer to cure by the lender." Adams, at 557. The Finance Commission opines: "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." 7 Tex. Admin. Code Sec 153.95(c).

Notice is an important issue. Look at the loan documents. There will typically be a specified address where notices are to be sent. The Finance Commission really did help on this issue. It opines: "At closing, the lender or holder may make a ***reasonably conspicuous*** designation in writing of the location where the borrower may deliver a written ***or oral*** notice of a violation under 50(a)(6)(Q)(x). The designation may include a mailing address, physical address, and telephone number. In addition, the lender may designate an email address or other point of contact for delivery of a notice." [Emphasis added.] 7 Tex. Admin. Code Sec. 153.93(a). Note the requirement that the address the lender designates must be "reasonably conspicuous." This should help if the lender buries the notice address in ninety pages of documents.

The Finance Commission also dropped a little bomb in the notice interpretation by providing: "The borrower may always deliver written notification to the registered agent of the lender or holder *even if the lender or holder has named a delivery location*." [Emphasis added.] 7 Tex. Admin. Code Sec 153.93(c). I have had several cases over the years (not just on equity loans) where I have sued lenders and served their registered agent and the stuff never got to the right person and they defaulted. This

could be a major trap for unwary lenders.

The Finance Commission has also weighed in on what constitutes adequate notice to a lender of a violation. Their interpretation provides that a notice “must include a reasonable: (1) identification of the borrower; (2) identification of the loan; and (3) description of the alleged failure to comply.” 7 Tex. Amin. Code Sec. 153.91(a). It goes on to state that a borrower is not required to cite the section of the Constitution that was allegedly violated. Sec 153.91(b).

The Finance Commission has also opined that delivery of the notice “by certified mail return receipt or other carrier delivery receipt, signed by the lender or holder, constitutes a rebuttable presumption of receipt by the lender or holder.” 7 Tex. Admin. Code Sec. 153.93(e). “If the borrower opts for a location or method of delivery other than set out in subsection(e), the borrower has the burden of proving that the location and method of delivery were reasonably calculated to put the lender on notice of the default.” Sec. 153.93(f).

> *(xi) 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 extension of credit is made by a person other than a person described under Paragraph (P) of this subdivision or if the lien was not created under a written agreement with the consent of each owner and each owner’s spouse, unless each owner and each owner’s spouse who did not initially consent subsequently consents”;*

There is a violation which is curable but the cure isn’t within the control of the lender. If the lien was not consented to by each owner and each owner’s spouse, the violation is cured if the nonconsenting spouse or owner consents after the fact.

Note that the statute provides that the forfeiture penalty applies to "the lender or any holder of the note". There is an important distinction between the two, however, as in many of these cases there may be fraud and/or DTPA claims against the original lender, but only a forfeiture claim against the subsequent holder.

Courts which addressed the issue have uniformly held that the forfeiture includes not only the outstanding balance on the loan, but also allows recapture of all principal and interest **previously** paid on the loan. See, e.g., Thomison v. Long Beach Mortgage, and Foster.

> **(f) A refinance of debt secured by the homestead, any portion of which is an extension of credit described by Subsection (a)(6) of this section, may not be refinanced by a valid lien against the homestead unless the refinance of the debt is an extension of credit described by Subsection (a)(6)** *or (a)(7)* **of this section.**

Once an equity loan, always an equity loan. I have actually seen a loan that violated this provision. There was no cash to the borrower from the subsequent equity loan, so the lender treated it as a

straight refinance with a lower rate. Oops.

> **(g) "An extension of credit described by Subsection (a)(6) of this section may be secured by a valid lien against homestead property if the extension of credit is not closed before the 12th day after the lender provides the owner with the following written notice on a separate instrument:**

The disclosure is rather long. In order to save a small tree, I will refer you to the notice rather than reprinting the whole thing here.

> **If the discussions with the borrower are conducted primarily in a language other than English, the lender shall, before closing, provide an additional copy of the notice translated into the written language in which the discussions were conducted."**

This is wonderful, but basically worthless. It might be more helpful if some of the other documents were translated into the other language (like the truth in lending statement.)

> **(h) "A lender or assignee for value may conclusively rely on the written acknowledgment as to the fair market value of the homestead property made in accordance with Subsection (a)(6)(Q)(ix) of this section if:**
>
> **(1) the value acknowledged to is the value estimate in an appraisal or evaluation prepared in accordance with a state or federal requirement applicable to an extension of credit under Subsection (a)(6); and**
>
> **(2) the lender or assignee does not have actual knowledge at the time of the payment of value or advance of funds by the lender or assignee that the fair market value stated in the written acknowledgment was incorrect."**

This is likely to be the primary focus of factual disputes in home equity litigation, because many of the other issues are legal rather than factual. Whether the note is non-recourse is not a fact question. How much the property was worth on the date of the loan may be subject to factual dispute.

This provision can make a lender bullet proof ***if*** (1) it obtains an appraisal or "evaluation" prepared in accordance with a state or federal regulation applicable to this type of loan ***and*** (2) the lender does not have actual knowledge that the value is incorrect.

The lender rarely provides the borrower with a copy of any appraisal, so if you are sending off a demand letter, toss in a demand for a copy of any appraisal(s). Be very careful on this one. Lenders will get all kinds of written opinions regarding the value of the property, but I have seen all kinds of stuff which did not qualify as "an appraisal or evaluation prepared in accordance with a state or

federal requirement applicable to an extension of credit under Subsection (a)(6)."

In reality, I'm not sure there really is any state or federal law applicable to a lot of these loans. The legal analysis is long and convoluted, but suffice to say that if there are any standards, they are that the appraisal be prepared "in accordance with generally accepted appraisal standards as evidenced by the appraisal standards promulgated by the Appraisal Standards Board of the Appraisal Foundation." 12 USC Section 3339(1). So even if there is an appraisal prepared by a state certified or licensed appraiser, you can still attack the appraisal if the appraiser played enough games with the appraisal. Copies of the current "Uniform Standards of Professional Appraisal Practice" published by the Appraisal Standards Board of the Appraisal Foundation are available by calling 1-800-805-7857 or at www.appraisalfoundation.org. The standards do change a little, so you need to make sure that you get a copy of the standards for the year the appraisal in question was prepared. Prior years versions of the Uniform Standards can be ordered by calling 1-800-348-2831.

Ask your client if they provided the lender with a copy of any prior appraisals. I have had several cases where the equity loan was incurred a year or eighteen months after the borrower bought the house and the borrower provided the equity lender with a copy of the appraisal from the purchase money loan.

Look at the numbers. I actually had a loan where the value in the acknowledgment was stated to be based upon a specific "appraisal" (it wasn't actually an appraisal), the acknowledged value was $500 higher than the broker's written opinion, and that extra little $500 put the lender over the 80% loan to value limit. The loan officer was apparently too lazy to redo all of the documents, so he/she just lied about the value in the acknowledgment. I not only sued for an 80% violation, but threw in a fraud claim, as well. Prompt settlement followed.

> **(i) "This subsection shall not affect or impair any right of the borrower to recover damages from the lender or assignee under applicable law for wrongful foreclosure. 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 section was a valid lien securing the extension of credit with the homestead property if:**
>
> **(1) the security instruments securing the extension of credit contain a disclosure that the extension of credit secured by the lien was the type of credit defined by Section 50(a)(6), Article XVI, Texas Constitution;**
>
> **(2) the purchaser acquires the title to the property pursuant to or after the foreclosure of the voluntary lien; and**
>
> **(3) the purchaser is not the lender or assignee under the extension of credit."**

Foreclosure of the lien does not terminate the borrowers rights as against the lender for a wrongful foreclosure, although the house may be gone forever if it was sold to a third party. I haven't had to address this since we are typically hired to stop the foreclosure, not after the fact..

(j) "Subsection (a)(6) and Subsections (e)-(i) of this section are not severable, and none of those provisions would have been enacted without the others. If any of those provisions are held to be preempted by the laws of the United States, all of those provisions are invalid. This subsection shall not apply to any lien or extension of credit made after January 1, 1998, and before the date any provision under Subsection (a)(6) or Subsections (e)-(i) is held to be preempted."

A savings clause.

(r) "The supreme court shall promulgate rules of civil procedure for expedited foreclosure proceedings related to the foreclosure of liens under Subsection (a)(6) of this section and to foreclosure of a reverse mortgage lien that requires a court order."

See (6)(D) above.

(s) "The Finance Commission of Texas shall appoint a director to conduct research on the availability, quality, and prices of financial services and research the practices of business entities in the state that provide financial services under this section. The director shall collect information and produce reports on lending activity of those making loans under this section. The director shall report his or her findings to the legislature not later than December 1 of each year".

It will come as no surprise that lenders made a whole bunch of home equity loans. They do not compile statistics on haw many lawsuits were filed or demand letters sent, or any other information helpful to determine if lenders actual comply with the law.

(t) A home equity line of credit is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which:

(1) the owner requests advances, repays money, and reborrows money;

(2) any single debit or advance is not less than $4,000:

(3) the owner does not use a credit card, debit card, preprinted solicitation check, or similar device to obtain and advance;

(4) any fees described by Subsection (a)(6)(E) of this section 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;

(5) the maximum principal amount that may be extended under the

account, when added to the aggregate total of the outstanding principal balances of all indebtedness secured by the homestead on the date the extension of credit is established, does not exceed an amount described under Subsection (a)(6)(B) of this section;

(6) no additional debits or advances are made if the total principal amount outstanding exceeds an amount equal to 50 percent of the fair market value of the homestead as determined on the date the account is established;

(7) the lender or holder may not unilaterally amend the extension of credit;

(8) 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 made substantially equal.

Many people are of the opinion that equity lines of credit is the really big change to the equity lending statute. I am of the opinion that the cure provision changes will effect far more borrowers, but only time will tell. The key elements of the equity line of credit amendments are:

1. You can't use the equity line of credit like a debit card - advances must be taken in increments of at least $4000 and you (probably) have to go to the lender to get the advance.
2. All fees must be charged and collected at the inception of the loan.
3. The original principal amount of the line of credit may not exceed 80% of the fair market value of the homestead, ***and*** any subsequent advances may not total more than 50% of the fair market value of the homestead ***as determined at the time the loan was established***. For example, a debtor owns a homestead valued at $100,000 at the time the line of credit is established. There is a first lien of $60,000. How much can the owner draw at the time the line is established? Answer: $20,000. 80% of $100,000 minus the prior lien of $60,000. Five years later, the homestead is worth $140,000, the principal balance of the first lien is $47,000 and the owner wants to draw on the line which has been paid to zero. How much can he draw? Answer: Nothing. The current value of the property is irrelevant. The value at the time the line was established is controlling. 50% of $100,000 minus the prior lien of $47,000 would allow him to draw $3000 on the line, but the minimum amount of any advance must be $4000.

(u) The legislature may by statute delegate one or more state agencies the power to interpret Subsections (a)(5)-(a)(7), (e)-(p), and (t), of this section. An act or omission does not violate a provision included in those subsections if the act or omission conforms to an interpretation of the provision that is:

> *(1)* *in effect at the time of the act or omission; and*
> *(2)* *made by a state agency to which the power of interpretation is delegated as provided by this subsection or by an appellate court of this state or the United States.*

Tex. Finance Code Sec. 11.308 provides: “The finance commission may, on request of an interested person or on its own motion, issue interpretations of Sections 50(a)(5)-(7), (e)-(p), (t) and (u), Article XVI, Texas Constitution.” This statute was effective September 13, 2003, when the amendments to the equity lending statute went into effect. Pursuant to this section, the Finance Commission issued interpretations which went into effect on January 8, 2004 and are located at 7 Tex. Admin. Code Chapter 153.

An issue for later determination: what if there are conflicting interpretations? If a state agency authorized to interpret the statute issues an interpretation which conflicts with an appellate court decision? What if there are conflicting opinions from two state appellate courts? What if there are conflicting opinions between a state appellate court and the Fifth Circuit? Can a lender rely on one opinion if there are five conflicting opinions?

RELATED ISSUES

1. Attorneys fees

Send a demand letter. Texas Civil Practice and Remedies Code Section 38.002(3) requires a 30 day written demand for "payment" in order to recover attorneys fees. Section 38.001(8) provides that a person may recover attorneys fees for an oral or written contract. You should also request declaratory relief (the lien is void) under the Texas Declaratory Judgment Act which provides that a court may award attorneys fees "as are equitable and just". Judge Monroe addressed this issue in Foster. Foster is must reading if you are filing an adversary on a home equity loan. (Practice tip: know what your judge has done on these. State court may be safer at least in terms of getting attorneys fees.)

2. Arbitration

Almost every one of these I have seen has included a written agreement to arbitrate any disputes arising under the contract. Read the arbitration agreement carefully. Read the loan agreement and/or deed of trust at the same time. If the arbitration agreement specifically refers to the federal Arbitration Act, 9 USC Section 1, et seq., you will probably get to arbitrate. If the arbitration agreement does not refer to the federal act, you may still be under the act if the dispute involves "interstate commerce." Suffice it to say that you can find opinions all over the place on what constitutes interstate commerce.

You may actually get lucky and have an agreement which refers to the Texas Arbitration Act. If it doesn't but the arbitration agreement or the loan agreement or deed of trust contains a choice of law provision and it says Texas law, see Texas Civil Practice and Remedies Code section 171.002, which

provides that the Texas Arbitration Act ***does not apply*** to "an agreement for the acquisition by one or more individuals of property, services, money, or credit in which the total consideration to be furnished by the individual is not more than $50,000, except as provided by Subsection (b)" which provides that this type of agreement is subject to the act if: "(1) the parties to the agreement agree in writing to arbitrate; and (2) the agreement is signed by each party and each party's attorney." In other words, if the principal amount of the home equity loan is $20,000 and the total payments of principal and interest are $40,000, the arbitration agreement is unenforceable unless the borrower was represented by counsel and the attorney signed the agreement.

I must say that although almost all of the equity loans I have seen have had an arbitration agreement, most lenders do not invoke it. I have only had one case actually go to arbitration. It was an 80% violation with Wells Fargo. The arbitrator scraped the $50,000 second lien off my clients' homestead, but did not award attorneys' fees. (My clients are happy to pay me $50 a month for the rest of my life, but they got rid of the $546 equity loan payment.)

There can be a timing issue if the lender does not invoke the arbitration promptly or there are other claims. See In re Centex Home Equity Lending Co., LLC, 2004 WL 2945702 (Tex. App. – San Antonio 2004.) This is a mandamus proceeding in which the court of appeals held that the trial judge should have enforced an arbitration provision even though it was not invoked until many months into the lawsuit. The ruling was based upon the wording of the arbitration agreement which was not "implicated" by the pending litigation until the debtor amended its pleadings to raise additional claims.

But, see Davila v. Beneficial Texas, Inc., Adv. No. 01-6005 (Bankr.N.D.Tex.2002), where the court denied a motion to compel arbitration where there were claims which were subject to arbitration and claims which were not. This ruling was based upon principals of judicial economy. I haven't tried this yet, but I'm looking for the case to do it. I usually send a demand letter to the lender, list a claim against the lender under B. 21. in the schedules and list the claim as disputed on Schedule D. I then get the trustee to hire me on behalf of the estate (or get them to hire somebody else and let them go along for the ride) and then we sue on behalf of the debtor borrowers and the trustee. The arbitration agreement is a contract entered into by and between the borrower and the lender (but not the trustee.) It seems like the Davila analysis might work to avoid an arbitration under that scenario.

See, also, People's Choice Home Loan, Inc. v. Jiminez, 2005 WL 2012924 (Tex.App. – El Paso, 2005); and In re People's Choice Home Loan, Inc., 2005 WL 2012769 (Tex.App. – El Paso, 2005).

3. Texas Deceptive Trade Practices/Consumer Protection Act

In Doody, the Texas Supreme Court touts the DTPA as a remedy for home equity borrowers, stating; "... a lender's unlawful business activities may subject it to liability under federal and state laws. *See, e.g.,* Tex. Bus. & Com. Code section 17.46." Is this the same bunch that has held that most of the 17.46 provisions of the DTPA do not apply to extensions of credit because they are not "goods" or "services" as defined in section 17.45(1) and (2)? Of course, Doody only says that lenders "may" be subject to liability under the DTPA.

Lenders always trot out the Texas Supreme Court opinion in Riverside National Bank v. Lewis, 603

S.W.2d 169 (Tex. 1980) for the proposition that a person who borrows money is not a consumer for the purposes of the DTPA. That reliance is misplaced, however, as Riverside Bank specifically states that a person who seeks ***only*** to acquire a loan is not a consumer. The court declined to address the issue of whether seeking or acquiring additional goods or services in connection with the loan brought the borrower under the definition of a consumer because there was no evidence in the record on that issue. (The argument was raised for the first time during the appeal.)

The Texas Supreme Court made clear the limited nature of the holding in Riverside Bank in Flenniken v. Longview Bank and Trust Co., 661 S.W.2d 705, 707 (Tex. 1983) in which the court distinguishes Riverside Bank in which "the *sole* basis of Lewis' complaint was the Bank's failure to lend him money as it had promised it would." [Emphasis in original.] In Flenniken, "the Flennikens did not seek to borrow money; they sought to acquire a house. The house thus forms the basis of their complaint." 661 S.W.2d at 708. The court was also careful to point out that the consumer does not have to seek or acquire the goods or services *from the lender*, only that the goods or services sought or acquired by the consumer form the basis for the complaint.

In most of the cases where I have dealt with equity loans the lender obtained and/or required other "services" (appraisal, survey, credit reports, tax certificates, legal document preparation, etc.), which may bring the whole transaction under the DTPA. There is a caveat, however, as the cases have generally requires that the goods or services which make the debtor a consumer also have to form the basis for the complaint. For instance, if the debtor is claiming an 80% violation, the appraisal is part of the basis for violation, but if the violation is a violation of the 3% cap on closing costs, the appraisal in and of itself has no relation to the violation, unless the appraisal fee pushed the closing costs over 3%. (In this case, the services of the title company might form the basis for the DTPA violation, because they should have caught the 3% violation.)

4. **Equitable Subrogation**

On December 21, 2007, the Texas Supreme Court issued its opinion in LaSalle Bank, N.A. v. White, 246 S.W.3d 616 (Tex.2007), in which the court held "the forfeiture penalty does not preclude the lender's recovery of the refinance portion of the loan proceeds that were used to pay the debtor's constitutionally permissible pre-existing debt because the lender was equitably subrogated to the prior lienholders' interests." Unfortunately, having told us that equitable subrogation applies, the court then neglects to tell us how to apply it. This is not as simple as one might think. My theory (which I have argued more than once) is that the parties are placed in the position that the borrower and the prior lender were in on the date the invalid loan was made. The amount of the cured loan is equal to the prior valid liens which were paid off. In LaSalle Bank v. White, that apparently included a prior purchase money loan and unpaid ad valorem taxes.

The problem with LaSalle Bank v. White is how to apply equitable subrogation where there are two prior creditors. Assume the new loan paid off a prior mortgage of $100,000 at 7% interest and ad valorem taxes of $10,000 which would have accrued interest at the statutory rate of $12%. What interest rate do we apply to the subrogated loan of $110,000?

Remember to check the HUD-1 for loan discount. This is interest and must be considered in the forfeiture. LaSalle Bank v. White does not address what happens to this interest, but the language of

the opinion states that the lender is not precluded from "recovery of the refinance portion of the loan proceeds ***that were used to pay the debtor's constitutionally permissible pre-existing debt.***" [Emphasis added.] The loan discount or points were not used to pay a pre-existing lien and should be added to any amounts the borrower can recover from past over-payments.

One thing to look for is what kind of loan was paid off with the proceeds of the equity loan. In LaSalle Bank v. White, the equity loan paid off a purchase money loan and ad valorem taxes. Equitable subrogation is in the nature of an affirmative defense - the lender has the burden of pleading and proving that the equitable exception applies. In Foster, Judge Monroe held that although equitable subrogation applies, the lender failed to prove that the prior lien which was paid with the equity loan proceeds was a "valid" prior lien. (It is significant that in Foster, the violation in question was a lien on ag exempt property and the prior lien which was paid was also an equity loan. Since he just held that the current equity loan violated the Constitution, he was not prepared to assume that the prior lien was valid as it probably suffered from the same defect.) If the prior loan was a purchase money mortgage, I generally do not require the lender to prove that the prior lien was valid. If the prior lien was an equity loan, I insist as loud as I can.

5. **Statute of Limitations**

Two cases have addressed when the statute of limitations runs for the purposes of contesting home equity loan violations. Both held that if the violation occurred at closing, limitations begins to run at closing and those causes of action are subject to the four year limitations provisions for contract claims. See, Rivera v. Countrywide Home Loans, Inc., 262 s.W.3d 834 (Tex. App.-Dallas, 2008) and In re Ortegon, 398 B. R. 431 (Bankr.W.D.Tex.2008).

As mentioned above, I am about to file an adversary where the borrowers have two home equity loans, we sent a demand letter to cure, the lender sent an abatement letter, and then violated the cure. The loan was closed more than four years ago, but the violation of the cure occurred since then. Does the cure or the violation of the cure extend limitations?

HOME EQUITY LOAN CHECKLIST

1. Who is/are the borrower(s).

   Was he/she the **only** owner of the property at the time of the extension of credit? (Check the appraisal district website. Not foolproof, but a starting place.)

   Was he/she married at the time of the extension of credit? (Separated with divorce pending is still married.)

2. Did **all** of the owners and **all** of their spouses consent to the extension of credit? (By at least executing the deed of trust.)

3. Who is the lender/holder? There is a better than 50/50 chance that the mortgage company that is sending all of the bills and letters to the borrower is a servicer, not the lender or holder. (I send the 60 demand letter to both the holder and the servicer, if I know who the holder is.)

4. What was the value of the property **at the time the extension of credit was made**?

   What was the tax appraisal at the time the extension of credit was made? (Check the appraisal district website. Lots of them give you several years. Look at trends.)

   Was more than one appraisal obtained by the lender? (Ask how the appraisal(s) was paid for. Was it "p.o.c."? There may be one on the HUD - 1 and another that was paid for off the books.)

   Does the client remember there being any "problems" with the appraisal? (ie, delay in getting it. Comments by the lender/mortgage broker that it had a "mistake" that had to be "fixed.") This is a warning sign.

   Get an MLS list of sales. Be specific and limit the search to the subdivision and the year of the loan.

5. Confirm the loan balance on any prior lien which was not paid with the equity loan proceeds.

6. Is the note non-recourse? If not, did the borrower receive any later communications from the lender on that issue? (They won't know what you are talking about, but you have to ask. This is particularly important with Wells Fargo.)

7. Can the deed of trust be foreclosed without a court order? (A lot of the early loans have the standard non-judicial foreclosure provisions and then a provision that says this is all subject to whatever rules the Texas Supreme Court promulgates.)

8. If you are at the foreclosure stage, did the lender comply with all of the requirements of Rule 736? Check the application. Is it verified? Does it have all of the required information. Who did the verifying? Did they have the capacity to make the verification?

9. Does the deed of trust say that this is an extension of credit under Texas Const. Art. 16, Sec. 50(a)(6)?

10. Look at the HUD - 1 Settlement Statement. Do the fees and expenses exceed three percent of the new loan balance? (Be careful here. The three percent **does not** include points or "loan discount", prorated interest, prorated taxes or prepaid insurance premiums. Loan origination fees **are** included, as are title insurance premiums. (These will usually be the largest two line items.)

11. Ask the client if they paid any fees or expenses outside closing. Ask them to check their check register. (Having the borrower pay expenses which are not disclosed on the HUD - 1 is more common than you would expect.)

12. If the loan is a second lien, check the itemized charges against the list of allowed charges listed at the end of the article.

13. Is there any other collateral? Look for cross-collateralization provisions. (Also look for provisions that waive the cross-collateralization. These are fairly common.)

14. Is the property ag exempt? You can usually check this on the appraisal district website. If the borrower has ten or more acres in the country and the loan includes more than an acre, there may be a problem.

15. Check the default provisions in the deed of trust. The debt may **not** be accelerated because of a decrease in value of the property or because the debtor has defaulted on any debt which is not a prior lien on the homestead. A "general insecurity" clause is a violation.

16. Is this the only equity loan on the property? If there is a prior lien, look at the documents to see if it is an equity loan or not.

17. What are the payment terms? Loan payments must start within two months after the extension of credit and must be in an amount which at least equals the accrued interest on the loan. Payments must be at least monthly, but not more often than every fourteen days.

18. Did the lender comply with the 12 day cooling off period? There are two requirements and the 12 days runs from the **later** of the two. They are: (1) the date the loan application is submitted to the lender and (2) the date the statutory notice is provided to the borrower.

19. If the client is Hispanic, were the loan discussions conducted primarily in Spanish? If so, was

a copy of the notice in Spanish provided to the borrower?

20. Was there a prior equity loan. Was it closed within a year prior to the existing loan?

21. Was the loan closed at the office of a lender, an attorney, or a title company? Most loans from major banks are closed at a title company. Citifinancial and Beneficial close their loans at their offices. Some of the loans made by independent mortgage brokers are made at the office of the broker, not at the office of the lender or a title company.

22. If the lender is somebody you never heard of, make sure they are licensed.

23. What were the proceeds used for? Did the lender require the debtor to pay off an unsecured loan to that lender with the proceeds? (There will be a written acknowledgment that any such payment was voluntary, but ask what the real deal was. Some of the smaller lenders tell the borrower the lender will not make them the loan unless the borrower makes the "voluntary" payment.)

24. Look for instruments with blanks. (This seems to be most common with the acknowledgment of value, but the copy provided to the borrower is rarely an executed copy, so the copy you will get from the lender will be filled in.)

25. Did the lender provide the borrower with a "a copy of all documents signed by the owner related to the extension of credit" at the time the extension of credit was made? Failure to comply with this requirement is one of the most common.

26. Was there a notice of right to rescind? Is there an election not to rescind? Is it dated the same day as the loan? If it is dated later, did the borrower go back to sign it, or was it just post-dated?

27. Is there a written acknowledgment as to the fair market value of the property signed by the borrower **and** the lender? Does it reference a source for the value stated? (If there is an 80% issue, you will want a copy.)

28. If there is an appraisal, look at it with a magnifying glass. Is the description of the subject accurate? (ie, check the square footage.) Are the comps really comparable? (Are they the same size? In the same subdivision? The same age and condition?) Did the comps really happen? Is the appraisal signed? Was the appraiser licensed?