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## **TEXAS 50(A)(6) HOME EQUITY UPDATE**

**BY:**

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# **WOOD vs. HSBC & OCWEN LOAN SERVICING**

- **OPINION DELIVERED: MAY 20, 2016**
- **QUESTION BEFORE THE COURT:**
  - DOES A STATUTE OF LIMITATIONS APPLY TO AN ACTION TO QUIET TITLE WHERE A LIEN SECURING A HOME EQUITY LOAN DOES NOT COMPLY WITH THE TEXAS CONSTITUTION?
  - WERE PETITIONERS (WOOD) ENTITLED TO A DECLARATION THAT RESPONDENTS (HSBC & OCWEN) FORFEITED ALL PRINCIPAL AND INTEREST ON THE LOAN?
- **COURT'S HOLDING: 6-3. LIENS SECURING CONSTITUTIONALLY NON-COMPLIANT HOME EQUITY LOANS ARE INVALID UNTIL CURED, AND THUS NOT SUBJECT TO ANY STATUTE OF LIMITATIONS.**

## **FACTS (WOOD CASE)**

- Borrowers obtained a \$76,000 home equity loan in July 2004.
- Nearly eight years later, borrowers notified the note holder and the servicer (“Lender”) that the loan did not comply with the Texas Constitution in several respects. . .including that the fees exceeded 3% of the loan amount. **Lender did not attempt to cure.**
- In 2012, the borrower sued seeking. . . among other things. . . to quiet title and a declaratory judgment that the lien was void and that Lender had forfeited all principal and interest.
- Lender countered that the lien was “voidable”, not “void”, and that a four year statute of limitations barred all claims.
- Trial court and Court of Appeals sided with Lender, citing a series of Texas appellate cases which have held that a 4 year SOL applies to home equity violations.

# **COURT'S REASONING (WOOD CASE)**

- Supreme Court reversed the Court of Appeals on the question of the statute of limitations.
- The SC agreed with borrowers that a lien securing a constitutionally non-compliant home equity loan is not valid before it is cured, and no statute of limitations applies. The lien is void, not voidable.
- SC cited the plain language of Texas Constitution, Article XVI, Section 50(a) and 50(c):
  - Article XVI, Section 50(a): *“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. . .”*
  - Article XVI, Section 50(c): *“No mortgage, deed of trust, or other lien on the homestead shall ever be valid unless it secures a debt described in this section. . .”*
- *“Holding otherwise would essentially permit lenders to ignore the Constitution and foreclose on the homesteads of unwitting borrowers who do not realize that their home equity loans violate the Constitution.”*

# **GARAFOLO vs. OCWEN LOAN SERVICING, L.L.C.**

## TEXAS CONSTITUTION, ARTICLE XVI, SECTION 50(A)

Sec. 50. HOMESTEAD; PROTECTION FROM FORCED SALE; MORTGAGES, TRUST DEEDS, AND LIENS. (a) **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: . . .

. . .(Q) **is made on the condition that: . . .**

. . . (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 credit or a copy of an endorsement and assignment of the lien to a lender that is refinancing the extension of credit; . . .

# **GARAFOLO vs. OCWEN LOAN SERVICING, L.L.C.**

- **OPINION DELIVERED:** May 20, 2016
- **QUESTIONS BEFORE THE COURT:**
  - Does Article XVI, Section 50(a)(6) of the Constitution grant a homestead owner a constitutional right of forfeiture for a noncompliant Texas home equity loan?
  - Is forfeiture available as a remedy in a common-law breach of contract claim brought in connection with a noncompliant Texas home equity loan?
- **COURT'S HOLDING:** 7-2. No, the Texas Constitution does not create a constitutional cause of action or remedy for a lender's subsequent breach of the terms and conditions of a Texas home equity loan. 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.

## **FACTS (GARAFOLO CASE)**

- Borrower obtained home equity loan in 2010. She paid off the loan in 2014.
- Following loan payoff, servicer recorded a release of lien, but borrower did not receive a copy of the release of lien in recordable form. . . as required by the loan terms, pursuant to Texas Constitution, Article XVI, Section 50(a)(6)(Q)(vii).
- Borrower notified servicer that she had not received the document. Upon passage of 60 days following the notification, and still without the release, borrower sued servicer for violating Texas Constitution, Article XVI, Section 50(a)(6), and for breach of contract.
- Borrower sought forfeiture of all principal and interest she paid on the loan.

## **COURT'S REASONING (GAROFALO CASE)**

- Texas Constitution, Section 50(a) creates only one constitutional right: freedom from forced sale to satisfy debts other than those described in its exceptions.
- The terms and conditions of a home equity loan delineated in Section 50(a)(6) serve only to set the boundaries of that right. They are not constitutional rights and obligations unto themselves.
- Section 50(a) does not constitutionally guarantee a lender's post-origination performance of a loan's terms and conditions.
- From a constitutional perspective, compliance is measured by the loan as it exists at origination and whether it includes the terms and conditions required to be foreclosure-eligible.

## **COURT'S REASONING (GAROFALO CASE)**

- Forfeiture is not a constitutional remedy in and of itself on a home equity loan. . . rather, it is just one of the terms and conditions that a home equity loan must include to be foreclosure-eligible.
- Although not a constitutional remedy, forfeiture may be available as a remedy in a breach of contract claim, when the breach is of one of the contractual requirements contained in Section 50(a)(6)(Q)(x).
- In this case, borrower's breach of contract claim for forfeiture also fails, however, because forfeiture does not apply to a failure to a deliver a release of lien under Section 50(a)(6)(Q)(x).
- None of the six corrective measures in Section 50(a)(6)(Q)(x) would have corrected the complained-of deficiency.

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