No. 14-0714

IN THE SUPREME COURT OF TEXAS

ALICE M. WOOD AND DANIEL WOOD,

Petitioners,

v.

HSBC BANK, USA, N.A. AND OCWEN LOAN SERVICING, L.L.C.,

Respondents.

On Petition For Review from the Fourteenth Court of Appeals, Houston, Texas, No. 14-13-00389-CV

BRIEF OF AMICUS CURIAE J. PATRICK SUTTON

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CERTIFICATION OF AMICUS CURIAE

J. Patrick Sutton regularly represents borrowers in cases arising under Tex. Const. art. XVI, § 50(a)(6). The cases include individual claims and class actions in the state and federal courts, including his service as lead counsel in a statewide MDL whose representative case is currently on expedited appeal. *See In Re Nationstar Mortgage, LLC Texas Home Equity Loan Modification Litigation*, No. 03-15-00329 (Tex. App. - Austin) (MDL No. 13-0427, Case No. D-1-GN-005248 (261st Dist. Ct., Travis County, Tex.)); Tex. R. Jud. Admin. 13.9(c) (2005) (expedited review required).

Most of Sutton's pending Section 50 cases involve allegations that home equity loans, which are required to have "substantially equal" payments, were amended after origination to have balloons and teaser-periods of interest-only payments for several years. *See* Section 50(a)(6)(L); 7 Tex. Admin. Code § 153.1(1) (2015) (definition of "balloon"); 7 Tex. Admin. Code § 153.11 (2008); 7 Tex. Admin. Code § 153.16 (2004).

All costs and fees associated with the preparation of this brief are being paid by *amicus curiae* Sutton.

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ARGUMENT

Amicus endorses the positions taken in the Brief of Petitioners. *Amicus* discusses different fact scenarios affected by a four-year limitations period to further show why this Court's review is important.

I. SOME OF SECTION 50(a)(6)'S PROVISIONS ARE PERPETUAL FOR THE LIFE OF THE LOAN

The Texas Constitution forbids foreclosure of the homestead subject to a few exceptions, important ones for purposes here being purchase-money mortgages and, as of 1997, home equity loans. Tex. Const. art. XVI, § 50(a)(1), Tex. Const. art. XVI, § 50(a)(6). Unlike home equity loans in other states, Texas home equity loans are nearly always the primary, first-lien 30-year mortgage, either because they pay off and supplant a purchase-money mortgage, or because someone who owns their home outright later decides to borrow against it. People use the money from home equity loans to

buy goods and services (cars, boats, vacations) or else pay off other debts (credit cards). Importantly, however, if a consumer defaults on the home equity loan, she gets to keep the car -- but loses her home. Because treating the homestead like a piggy-bank poses a serious risk of dispossession to the poorest and least sophisticated consumers, Section 50(a)(6) contains a number of borrower protections as preconditions to a foreclosable lien. *See* Section 50(a)(6)(A)-(Q).

Many if not all of Section 50's protections are, for all intents and purposes, mandatory loan terms that apply irrespective of what the loan documents say. Some of the protections are more than just mandatory: they are perpetual for the life of the loan and intrinsic to the nature of a Texas home equity loan. *Compare* Section 50(a)(6)(B) (applies only "on the date the extension of credit is made") *and* Section 50(a)(6)(Q)(v) (applies "at the time the extension of credit is made") *with* Section 50(a)(6)(D) (no express expiry date on bar on nonjudicial foreclosure) *and* Section 50(a)(6)(L) (no express expiry date on "substantially equal"

schedule of payments).[1]

II. SOME VIOLATIONS OF SECTION 50 ARE TOO PROFOUND TO BE BARRED BY A LIMITATIONS PERIOD INCEPTING AT ORIGINATION

A troubling situation arises if limitations starts to run on all types of violations of Section 50(a)(6) from the date of closing: a loan radically and existentially out of compliance with the Texas Constitution cannot be challenged after four years. The things that define a Texas home equity loan as unique would have a brief shelf life even though such loans typically span decades. Yet the presence of a cure procedure that can be invoked at any time during the life of the loan undermines the idea that Section 50(a)(6)-related claims should be cut off after four years. The cure provision would border on surplusage since it wouldn't apply for most of a loan's life.

Amicus therefore calls to the Court's attention several fact scenarios that shouldn't exist at all under Section 50(a)(6) but which now threaten to become routine and, even worse, immune from legal challenge by the mere passage of a few years at the

[1] This brief refers interchangeably to a loan being "made," "closed" and "originated."

beginning of the loan.

A. The two-home-equity-loan problem

Section 50 prohibits two home equity loans on the same homestead by requiring that each home equity loan be the only home equity loan at the time each loan is made. Section 50(a)(6)(K); *see McDonough v. JPMorgan Chase Bank, N.A.*, No. 3:12-CV-189, 2013 WL 1966930, at *3 (S.D. Tex. May 13, 2013). The second loan should never be able to exist at all.[2] Yet at least two cases hold that second home equity loans become immune from challenge four years after the closing of the second loan. *See id.*; *Prutzman v. Wells Fargo Bank, N.A.*, No. CIV.A. H-12-3565, 2013 WL 4063309, at *3 (S.D. Tex. Aug. 12, 2013). Thus, the bedrock principle of Section 50(a)(6) that a Texas homestead cannot have two home equity loan liens placed upon it has been gutted by *Priester*. *See Priester v. JP Morgan Chase Bank, N.A.*, 708 F.3d 667 (5th Cir. 2013), *cert. denied*, 134 S. Ct. 196 (2013).

Undersigned counsel has represented borrowers stymied by

[2] Title companies and lenders view the second loan as a cloud on the title and won't lend money or issue title coverage. *See McDonough, id.,* at *1 ("The McDonoughs realized the mistake in the summer of 2011 when their attempt to refinance their home was rejected due to a cloud on the property's title that the second loan created.").

Priester in their attempts to refinance two home equity loans into one combined loan in order to clear title problems and get better interest rates. *See* Section 50(a)(6)(Q)(x)(f) (lender must refinance at no cost to borrower a 2-loan violation).[3] No Texas homestead should ever have two home equity loans encumbering it precisely because the prohibition on such loans is facially mandatory and perpetual.

B. Personal recourse home equity loans

A home equity borrower is never personally liable for a home equity loan absent fraud in obtaining the loan. Section 50(a)(6)(C). Lenders occasionally botch the origination of such loans in a big way, employing the wrong loan forms or otherwise including language with fundamentally illegal terms, such as personal recourse. *See, e.g.*, *In re Adams*, 307 B.R. 549, 552-54 (Bankr. N.D. Tex. 2004) (lender used purchase-money forms to refinance a home equity loan but later cured the many violations by offering a new, compliant loan). But as *In re Adams* shows, such terms conflict

[3] That said, in other instances, particular lenders have recognized the borrower's untenable position following *Priester* and have voluntarily agreed, at no cost to the borrower, to combine the two loans with a refinance anyway. But relying solely on lender generosity in such cases is not a satisfactory answer for borrowers stuck in the two-home-equity-loan quandary.

with Section 50's requirements and therefore have no effect. It would thwart Section 50's fundamental purposes for a personal recourse clause to become enforceable against the borrower after four years, yet that's exactly what a statute of limitations that runs from the time of closing would allow.

C. Nonjudicially foreclosable home equity loans

A clause permitting nonjudicial foreclosure violates Section 50(a)(6)(D), which mandates judicial foreclosure for home equity loans. *See, e.g.*, *In re Adams*, *id.*; *In re Cadengo*, 370 B.R. 681, 697-98 (Bankr. S.D. Tex. 2007). In *Cadengo*, the lender employed the wrong forms and didn't even call the loan a home equity loan (it was a pretended "sale"), yet the court delved into the nature of the transaction to determine that home equity was being collateralized, rendering all of Section 50(a)(6) applicable. *Id.* One of the violations there was that the "deed of trust"[4] permitted non-judicial sale. *Id.* Had a statute of limitations barred a challenge to the *Cadengo* loan, the lender would have been entitled to foreclose without a court order. *See* Section 50(a)(6)(r) (giving this Court

[4] In home equity parlance, there is a "security instrument" making the homestead the collateral for the note, and not a "deed of trust" as in the case of purchase-money loans.

power to adopt judicial foreclosure rules); Tex. R. Civ. P. 736 (2011) (expedited judicial foreclosure proceeding). It is hard to see how that is possible under Section 50(a)(6); the premise of such loans is that they cannot be foreclosed without a court order.

D. Calling in the loan upon a decrease in market value

A fire that burns down a house doesn't allow a home equity lender to accelerate the note and foreclose. Section 50(a)(6)(J); 7 T.A.C. § 153.9 (2004). Nor would a decrease in the homestead's market value owing to any other cause, such as a severe recession. *Id.* Yet lenders could insert such clauses into home equity loans and, if limitations applies, render them immune from challenge after four years. While *Amicus* is not aware of a specific case involving this issue, this borrower protection on its face serves a purpose for the entire life of a home equity loan.

E. Balloons, negative-amortization, and interest-only payment schedules

Section 50(a)(6)(L) prohibits payment schedules that create payment shocks. It requires that payments be "substantially equal," pay some principal with each installment, and pay all interest coming due with each installment. *See also* 7 T.A.C. §§

153.1(1), 153.11; 153.16 (Constitutionally-authorized regulations concerning Section 50(a)(6)(L)). These requirements necessarily rule out balloons, negative amortization (wherein accrued but unpaid interest gets shunted into later payment periods), and payments that prevent the loan from being "repaid" because they include no principal.[5]

Since balloons, payment spikes, and other varieties of payment shock can occur at any point in the decades-long life of a typical home equity loan, Section 50(a)(6)(L) would be undermined if the statute of limitations bars quiet title claims. An obvious subterfuge is scheduling a large balloon due upon maturity, which keeps payments artificially low for 30 years but creates a payment shock when the borrower is older. A more insidious danger is a loan with a "teaser" period of low-interest, no-interest, or interest-only payments for the first five years. A borrower would be thrilled

[5] Such violations in the context of loans that were modified after closing to abandon "substantially equal" payments are at issue in a statewide MDL and in two federal cases. *See In Re Nationstar*, cited above; *see, e.g., Hawkins v. JPMorgan Chase Bank, N.A.*, No. 13-50086, 2015 WL 3505353 (5th Cir. June 4, 2015) (dismissing in part, remanding in part), *cert. filed* (September 1, 2015) (issue whether recent decision of this Court legalizes modifications that impose balloons and interest-only payments -- *see Sims v. Carrington Mortg. Svcs., LLC*, 440 S.W.3d 10, 13 (Tex. 2014), *reh'g denied* (Oct. 3, 2014)). Undersigned *amicus* represents the plaintiffs in these cases.

to have low initial payments and would have no incentive to bring suit, but the piper would have to be paid in year five -- right after limitations has expired. Section 50(a)(6)(L) protects borrowers from the folly of teaser payments, balloons, and other unequal payment schedules that entice them into loans they can't afford or whose risks down the road they don't fully appreciate. *See Cerda v. 2004-EQR1 L.L.C.*, 612 F.3d 781, 791 (5th Cir. 2010) (discussion of Section 50(a)(6)(L)'s multiple forms of protection against payment shocks); *see generally* Ann Graham, *Where Agencies, the Courts, and the Legislature Collide: Ten Years of Interpreting the Texas Constitutional Provisions for Home Equity Lending*, 9 Tex. Tech Admin. L.J. 69, 84 (2007) (balloons and teaser periods generating "shocking" payments are not permitted).

F. The mandatory disclosures tell borrowers what they don't know they don't know

As to one other requirement, there would seem to be no doubt about its continuing importance even after origination, yet *Priester* all but dismisses its significance: Section 50(a)(6)(M)(i) requires the lender to provide the borrower a copy of the elaborate notice contained at Section 50(g). The required disclosures explain to the

borrower what Section 50(a)(6) says. The problem is, without the disclosures, borrowers don't know what they don't know.

Priester brushed aside such concerns: "[T]he [lenders] did not 'conceal' the fact that they did not provide the required constitutional notices. It is difficult to imagine how a party would conceal a lack of disclosure." *Priester,* 708 F.3d at 677; *cf.* Tex. Bus. & Com. Code § 26.02(e), (f) (1999) (statute of frauds exclusive to loan agreements involving financial institutions does not apply *at all* if lender does not provide certain mandatory disclosures in a separate document signed by the borrower). But it's not at all difficult to imagine how a sophisticated lender would conceal a lack of disclosure: not including the disclosures is the essence of the concealment and the reason the requirement exists in the first place. Nothingness, by definition, does not alert the borrower.[6]

[6] Though the mere failure to provide the Section 50(g) disclosures would not in and of itself amount to much in the absence of any other violations, the violation is absurdly easy to cure: the lender just has to send the borrower a copy of the notice within the 60-day cure period. Section 50(a)(6)(Q)(x). While the penalty of forfeiture is severe if the lender doesn't provide the disclosures, the price of compliance could hardly be cheaper. A lender has no one to blame but itself for not mailing the disclosures to the borrower if the borrower never got them the first time around.

G. The massively-noncompliant or misnomer loan

Finally, as already alluded to in some of the above examples, the entirely non-compliant home equity loan should never be subject to a limitations period. In situations where a lender structures a home equity loan as some other variety of loan, or else scribbles the loan on a cocktail napkin, that loan is so misleading and so noncompliant that applying limitations would be patently unfair. *See* Section II.C., above (discussion of *In re Adams*, *In re Cadengo*); *see generally* J. Alton Alsup, *Pitfalls (and Pratfalls) of Texas Home Equity Lending*, 52 Consumer Fin. L.Q. Rep. 437, 463 (1998) (inadvertent extensions of credit are 50(a)(6) loans).

CONCLUSION

Some of the borrower protections in Section 50(a)(6) are facially perpetual for the life the loan and intrinsic to the nature of Texas home equity loans. Allowing provisions that violate those protections to become immune from challenge four years after closing defeats the fundamental purposes of Section 50(a)(6). There are already examples where two simultaneous home equity loans are validated, leaving borrowers stuck with loans they

cannot refinance -- *ever*. It's reasonable to suppose, if *Priester* is not overruled, that there will come into being home equity loans that are nonjudicially foreclosable, or that subject the borrower to personal liability, or that structure payments to include a large balloon due at maturity. In addition, a limitations period renders the existing cure scheme all but superfluous, since a lender would have no need to cure the loan after four years -- all the illegalities would have been rendered legal by the mere passage of time. The Court should grant review of this case and stop the damage being done daily by *Priester* and its state and federal progeny.

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CERTIFICATE OF COMPLIANCE

This brief complies with the word-count limitation of Tex. R. App. P. 11(a) and 9.4(i)(2)(B) because it contains 2500 words, excluding the parts of the brief exempted by Tex. R. App. P. 9.4(i).

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