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DEVELOPMENTS IN TEXAS HOME EQUITY LITIGATION IN BANKRUPTCY COURT

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Publications

- *Judicial Profiles, Hon. Tim Minikos*, Tarr. Ct. Bar J. (Dec. 2015)
- *Judicial Profiles, Hon. David Haggerman,* Tarr. Ct. Bar. J. (Nov. 2015)
- *Judicial Profiles, Hon. Bob McCoy and Hon. David Cook*, Tarr. Ct. Bar J. (Oct. 2015)
- *Judicial Profiles, Hon. Mark Hanover and Hon. Carey Walker,* Tarr. Ct. Bar J. (Sept. 2015).
- *Judge Mark Pittman,* Tarr. Cty. Bar J. (July-August 2015)
- *Justice Anne Gardner - Outstanding Jurist Award*, (Tarr. Cty. Bar J., (May/June 2015).
- *Associate Justice Sidney Farrar,* Tarr. Cty Bar J, (April 2015).
- *Judge Maryellen Hicks,* Tarr. Cty. Bar J. (March 2015).
- *Fifth Circuit Casts Doubt on Borrower's Resurrection of Time Barred Defenses,* Dateline Austin, TLTA (June 11, 2014).
- *Home Equity Loans - Plan Your Strategy Before Filing That Proof of Claim,* Dateline Austin, TLTA (March 14, 2014).
- *Home Equity Loans With Borrower's Non-Compliance Complaints: Unintended Consequences of Filing Bankruptcy Proof of Claim,* TLTA (December 11, 2013).
- *Home Equity Litigation,* Fort Worth Business Press, (April 27, 2013).
- *Texas AG Buys Time for Lenders, Borrowers, Investors,* FW Bus. Press (Nov 2010).
- *Prior Liens on Properties Can Land Lenders in Court,* FW Bus Press (Oct 2010).
- *A Government Contract and Bankruptcy Law Conundrum: Interpretation of the Anti-Assignment Act and Related Matters,* The Procurement Lawyer, Vol. 43, No. 1, (Fall, 2007).
- *Repeat Bankruptcy Filers Face Changes to Automatic Stay,* Texas Lawyer, (Jan 2006).
- *The Motion in Limine in Bankruptcy Litigation,* Am. Bankr.Instit. J. (Mar 2005).

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DEVELOPMENTS IN TEXAS HOME EQUITY LITIGATION IN BANKRUPTCY COURT

I. OVERVIEW

A. Background. Since home equity lending was introduced in Texas one should not be surprised to learn that there is a body of bankruptcy court opinions construing the Texas constitutional home equity laws and deciding the validity of home equity security interests. The chances of a lender with an insured home equity lien navigating in the bankruptcy court can be expected because upon default and foreclosure efforts by the lender, borrowers will use the bankruptcy forum to reinstate their home equity debt, walk away from them or litigate the validity of them through adversary proceedings or contested matters.

B. Creditor Representation. The lienholder's own retained counsel usually arrives early in the bankruptcy proceeding and possibly unaware that they could be prosecuting a home equity loan with a latent constitutional violation. They take the initial role of filing the proof of claim, defending against claims objections, preserving the collateral by moving to lift the automatic stay or to seek adequate protection, to remove or remand state court in rem proceedings under Tex. R. Civ. P. 736, examining the validity of state or federal exemptions, defending confirmation proceedings, defending claims that the title insurance company does not defend, obtains the proper final judgment, supercedeas bond challenges and appeals. Such representation can include sending curative letters in response to a notice of violation by the debtor. If the home equity lien has no constitutional issues then the process of handling a home equity lien can be handled in the same way as a traditional recourse debt. But if the lien has an alleged constitutional violation the lender must be extremely careful not to jeopardize the ability to defend the home equity lien if the lien is challenged by claims objection or adversary proceeding. There is presently no particular advantage in litigating the validity of a home equity lien in the bankruptcy forum as will be explained further. *A lienholder with a potential constitutional violation should avoid litigating the validity of the lien in the bankruptcy forum.*

C. Title Insurance Defense. Be ready because some disputes will be defended following a claim being made on the mortgagee's title policy of insurance after an objection is made to a claim or an adversary proceeding is instituted usually by the debtor or trustee to invalidate the lien.

The attorney retained under a title insurance policy to defend the insured's home equity lien has a different role than the attorney retained as creditor representation to enforce and seek repayment of the debt. When defending under a title insurance policy, the T-42 and T-42.1 endorsements contain a list of covered items and do not provide a defense for every possible violation of the Texas Constitution regarding home equity loans. Title insurance companies will not defend violations that are the responsibility of the lender such as whether the loan violates the 80% fair market value rule under Section 50(a)(6)(B); if the loan provides for personal liability in violation of Section 50(a)(6)(C); if the loan provides for acceleration because of decrease of fair market value in violation of Section 50(a)(6)(J) or if the lender violated the

consumer protection laws. The title insurance defense counsel defends the covered claims set out by a retention letter and based on the pleadings in the case usually filed by the debtor or trustee with the objective to invalidate the lien and to recover prior payments made against the home equity loan. Often times the debtor will raise numerous violations in the pleadings that specific requests for clarification will need to be made to the title insurance company to make sure that all claims and defenses are properly assigned.

Title insurance defense counsel will work with the insured's own retained counsel during the same case and each may prosecute or defend certain parts of the litigation in either the adversary proceeding/contested matter or in the general administration of the case. They may work to respond to notices to cure a violation of the constitution. They may also attend the first meeting of creditors, be in charge of certain aspects of discovery, and try different aspects of the case together at trial. The best thing you can hope for is that the lienholder's own retained counsel has either litigated home equity cases before or has served as a title insurance defense counsel retained by a title insurance company and understands the role of tendered defense counsel and the role of the lienholder's retained counsel. There are instances where the lienholder's retained counsel does not understand these roles and has had no experience with home equity litigation and may assume that they can handle a home equity lien in the same way they would handle a traditional recourse loan. This can be a mistake in certain situations.

In some cases title insurance companies have taken actions to affirmatively prosecute debtors in the bankruptcy court under 11 U.S. C. §523(a) based on fraud in home equity loans and such actions are not covered defenses under the title insurance policies entitling the insured to such a proceeding being filed on their behalf.

D. Key Decisions. The Fifth Circuit has been on the front lines having to make some of the key decisions in interpreting Tex. Const. art. XVI, §50. By relying on certified questions from the Texas Supreme Court in *Doody v. Ameriquest Mortgage Co.*, 49 S.W.3d 342 (Tex.2001) the court determined that a constitutional violation under Section 50(a)(6) the Texas Constitution results in a (1) voidable rather than a void lien, (2) the legal injury occurs when the lien is created, and (3) there is nothing undiscoverable about the lien. *Priester v. JP Morgan Chase Bank, N.A.*, 708 F.3d 667, 674 (5th Cir. 2013), *cert. denied sub nom. Priester v. JPMorgan Chase Bank, N.A.*, 134 S. Ct. 196, 187 L. Ed. 2d 256 (2013).

The net effect is that even if a home equity lender makes a patently invalid home equity loan and the borrower fails to discover it within four years after the closing the lien is valid because it was not invalidated by timely action taken by the borrower. The borrower's remedy is to timely notify the lender of the constitutional violation, give the lender the opportunity to cure the violation within sixty days of notification and then take action in court to invalidate the lien. The failure to cure within the sixty days of notification results in the forfeiture of lien. There is nothing inherently undiscoverable about the constitutional violation because the borrower is given a complete package of the loan documents at the closing and has the ability to examine the closing documents for the next four years to determine if there are possible violations. This area of the law is causing the greatest concern at the present moment in the court. The Texas

Supreme Court may decide the issue of limitations as they recently granted review in the case of *Wood v. HSBC Bank USA, N.A.*, 439 S.W.3d 585, 596 (Tex. App.—Houston [14th Dist.] 2014, pet. granted) where the petitioners challenge the *Priester* decision and the *Erie* guess involving the void vs voidable rule involving home equity liens and that no statute of limitations applies in suits to quiet title and to invalidate invalid liens.

E. Conflict in Statute of Limitations. As noted in the prior section, the most troublesome issue going on presently in the bankruptcy courts and in state and federal courts is the application of the four year statute of limitations to constitutional complaints that are more than four years old. Waiting more than four years after the closing to move to invalidate a home equity loan based on a constitutional violation is, for the most part, too late except in the bankruptcy court for the Eastern District of Texas where one bankruptcy judge has found an exception to the four year statute of limitations by allowing a debtor to raise constitutional violations defensively in response to a proof of claim. This has occurred in two cases so far. The first was in the case of *In re: Johnson,* 62 C.B.C. 2d 1380 (Bank. E. D. 2009). The second was in the case of *In re Shankles,* 11-43075, 2013 WL 5348879 (Bankr. E.D. Tex. Sept. 23, 2013).

The court reasoned in those cases that Section 16.069(a) of the Texas Civil Practices and Remedies Code allows for constitutional complaints to be asserted defensively against a proof of claim which operates as a federal complaint. But this analysis does not apply if the debtor or Trustee files suit against the creditor to invalidate the lien. In that case then the creditor can raise the four year statute of limitations as a defense to an adversary proceeding complaint as was done in the case of *In re Chambers*, 419 B.R. 652, 668 (Bankr. E.D. Tex. 2009), *subsequently aff'd*, 544 Fed. Appx. 347 (5th Cir. 2013). This is true even if the creditor files a proof of claim. The court in *Chambers* held that the four year statute of limitations barred the debtors and Chapter 7 trustee's adversary action against the lender brought to invalidate a home equity lien. The bankruptcy court held that the court had jurisdiction over the complaint and the exempt homestead property *because the lender filed a proof of claim* and the court's jurisdiction over exempt property had not ended at the time of the filing of the complaint.

The bankruptcy court in the Eastern District did not apply the case of *In re Ortegon*, 398 B.R. 431, 434 (Bankr. W.D. Tex. 2008) where the bankruptcy court applied the four year statute of limitations to bar a complaint filed by the debtor and Chapter 13 trustee. The trustee sought to recover payments made against the loan. The creditor in the *Ortegon* case filed a proof of claim in the bankruptcy proceeding and there was no discussion by the bankruptcy court of the effect of the lender's proof of claim operating as a federal complaint. Section 16.069(a) of the Texas Civil Practices and Remedies Code was not raised or discussed in that opinion.

The result is that the bankruptcy court in the *Johnson* and *Shankles* decisions forfeited two home equity liens where the borrower's complaints would not have been forfeited had the lienholder simply have waited for the debtor's discharge to be granted and the automatic stay lifted and then proceeded to foreclose the lien in state court under rule 736 of the Texas Rules of Civil Procedure.

The defensive use of constitutional violations argument used in the *Johnson* and *Shankles* decisions has caused some borrowers to ask that the Fifth Circuit revisit the *Priester* decision and argue that it was wrongly decided or that no statute of limitations should apply at all to home equity violations. So far the Fifth Circuit has refused to deviate from its *Priester* decision. *Nunez v. CitiMortgage, Inc.*, 606 Fed. Appx. 786, 789 (5th Cir. 2015).

The Texas Supreme Court may address this issue in the case of *Wood v. HSBC Bank USA, N.A.*, 439 S.W.3d 585, 596 (Tex. App.—Houston [14th Dist.] 2014, pet. granted). An *Amicus Curiae* brief filed by the Texas Family Council Project argued:

> The need for this Court to address *Priester* is particularly compelling because most foreclosures are initiated using the expedited procedures in Rule 736. Under the newest procedures, a homeowner cannot assert a counterclaim. Thus, the only way a homeowner can prevent foreclosure based on an unconstitutional (or otherwise invalid) lien is by filing a separate proceeding. But all such claims are now barred by *Priester* after four years from loan closing.
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> * * *
>
> While some might argue that lenders will not consider this factor when deciding whether to foreclose on a home equity lien, within months of the *Priester* decision, one creditor lawyer publicly cautioned lenders against filing a proof of claim or motion to lift stay in a bankruptcy when the home equity loan was more than four years old because this might permit the debtor to assert his time-barred claim defensively …

For time being expect borrowers to challenge the *Priester* decision and to continue to litigate the concept that Texas Legislature never intended for patently invalid home equity liens to become valid because the borrower failed to challenge the invalidity within four years of the closing. Attorneys handling home equity litigation should have a good understanding of the following cases when involved in litigation in the bankruptcy court regardless of the role they may be retained: (1) *In re Ortegon*, 398 B.R. 431, 434 (Bankr. W.D. Tex. 2008); (2) *In re: Johnson*, 62 C.B.C. 2d 1380 (Bank. E. D. 2009); (3) *In re Chambers*, 419 B.R. 652, 668 (Bankr. E.D. Tex. 2009), *subsequently aff'd*, 544 Fed. Appx. 347 (5th Cir. 2013); (4) *In re Shankles*, 11-43075, 2013 WL 5348879 (Bankr. E.D. Tex. Sept. 23, 2013); and (5) *In re Erickson*, 566 Fed. Appx. 281, 283 (5th Cir. 2014).

F. Preferred Forums. For the bankruptcy debtor or trustee, the preferred forum in determining the validity of a home equity lien is the bankruptcy court. For the lender the preferred forum should be state court because of a new case from the Texas Supreme Court that allows for the recovery of legal fees against the borrower who seeks to invalidate a home equity lien under the Texas Declaratory Judgment Act. *Wells Fargo Bank, N.A. v. Murphy*, 458 S.W.3d 912 (Tex. 2015). The cottage industry of debtors attacking home equity liens and remaining in the property during the long involved judicial proceedings for years free of charge or the worry

of paying the lender's legal fees except as *in rem* against the real property appear to be coming to an end.

II. THE CLAIMS PROCESS

A. The Proof of Claim. The filing of a proof of claim is analogous to the filing of a complaint in a civil action and the debtor's objection is the same as the answer. *In re Simmons*, 765 F.2d 547, 552 (5th Cir.1985); *In re Eads*, 417 B.R. 728, 741 (Bankr. E.D. Tex. 2009). If the claimant complies with Bankruptcy Rule 3001 and Official Form B–10, then they may rest on the proof of claim as it will have independent evidentiary effect, like a verified complaint, the lienholder need not present any additional evidence at the hearing on the objection. *In re Gulley*, 436 B.R. 878, 893 (Bankr. N.D. Tex. 2010); *In re Leverett*, 378 B.R. 793, 797 (Bankr. E.D. Tex. 2007). The lien will pass through the estate as if no claim were filed. Home equity lenders claim form will include a copy of the note, security instrument, closing affidavits and a payoff statement to the claim with redactions of the borrower's personal information. These documents will entitle them to prove the debt and lien without having to produce additional evidence.

B. Standing to File Claim. A loan servicer is an agent for a creditor and is considered a creditor with standing to file a proof of claim. *In re Gulley*, 436 B.R. 878, 893 (Bankr. N.D. Tex. 2010); *Loan Servicing, L.L.P. v. Eads (In re Eads)*, 417 B.R. 728, 739 (Bankr. E. D. Tex. 2009).

C. The Objection. A lien will pass through the estate unaffected unless the debtor or trustee objects. *Long v. Bullard*, 117 U.S. 617, 6 S.Ct. 917, 29 L.Ed. 1004 (1886). When a proof of claim fails to comply with the requirements of Bankruptcy Rule 3001(c), the claim will not be considered prima facie valid as to the claim or amount. *McGee v O'Connor,* 153 F. 3d 258, 26-61 (5th Cir. 1998); *In re White*, 06-50247RLJ13, 2008 WL 269897, at *3 (Bankr. N.D. Tex. Jan. 29, 2008); *In re Tran*, 369 B.R. 312, 317–18 (Bankr.S.D. Tex 2007), *aff'g* 351 B.R. 440, 445 (Bankr.S.D.Tex. 2006); *In re Leverett*, 378 B.R. 793, 802 (Bankr. E.D. Tex. 2007); *In re Armstrong*, 320 B.R. 97, 109 (Bankr. N.D. Tex. 2005)(proof of claim lacking documentation shall not enjoy prima facie assumption of validity under Bankruptcy Rule 3001(f)).

A debtor must present evidence to overcome the prima facie validity of the claim. If no validity exists, such as if there are no documents attached to the claim or if the lien is clearly invalid under the Texas Constitution (i.e. the lien is on agricultural property), the debtor need only object to the claim pursuant to the applicable rules, or statute and a lienholder will need proof to establish the validity of its lien. Chapter 13 trustees generally object to claims that have no supporting documentation.

The claimant will prevail unless the objecting party produces evidence of equal or greater probative force to that of the proof of claim to refute some aspect of the proof of claim. The Supreme Court has ruled that "[O]ne who asserts a claim is entitled to the burden of proof that normally comes with it. *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 20, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000); *In re Morales*, 520 B.R. 544, 547-49 (Bankr. W.D. Tex. 2014). If the

objector comes forward with such probative evidence, then whichever party has the burden of proof respecting assertion of the claim outside of bankruptcy bears the burden in the contested matter from that point. *In re Gulley*, 436 B.R. 878, 893 (Bankr. N.D. Tex. 2010).

In the Southern District of Texas lenders must file notices for post-petition fees, expenses, and charges. The rule of prima facie validity does not apply because these claims are deemed to be *supplementary claims.* In the case of *In re Rodriguez*, 2013 WL 3430872, at *4 (Bankr. S.D. Tex. July 8, 2013) the court held that the presumption of prima facie validity of a proof of claim under Bankruptcy Rule 3001(f) does not apply to supplemental claims for post-petition fees, expenses and charges. The claimant will bear the burden of proof under Bankruptcy Rule 3002.1(h) at the hearing and may not rely on the claim itself to establish the amount due under the claim.

D. Creditor's Failure to Answer Claims Objection. The bankruptcy court cannot forfeit a home equity lien based on the creditor's failure to answer the debtor's objection to the proof of claim. Such an action is akin to a default judgment in favor of the debtor. *In re Eads*, 417 B.R. 728, 741 (Bankr. E.D. Tex. 2009). The Fifth Circuit views default judgments with disfavor as a drastic remedy not favored by the Federal Rules and resorted to by the courts only in extreme situations. *Sun Bank of Ocala v. Pelican Homestead & Sav. Ass'n,* 874 F.2d 274, 276 (5th Cir.1989). The Fifth Circuit has adopted a policy in favor of resolving cases on their merits and against the use of default judgments. *Rogers v. Hartford Life and Acc. Ins. Co.,* 167 F.3d 933, 936 (5th Cir.1999). The court must satisfy that the debtor has stated a legally sufficient ground for claim disallowance. *In re Brunson*, 486 B.R. 759, 768 (Bankr. N.D. Tex. 2013). The bankruptcy court could order the objection overruled and order the debtor to file an adversary proceeding.

To extinguish the lien the debtor must pay the claim or initiate an adversary proceeding with the procedural requirements of due process to extinguish a lien under 11 U.S.C. §506(d). Fed. R. Bank. P. 7001 provides that a proceeding to obtain an injunction or to determine the validity, priority, or extent of a lien, or other interest in property is an adversary proceeding. The exception for an adversary proceeding under Fed. R. Bank. P. 4003(d) to avoid a lien or other transfer of property exempt under 11 U.S.C. §522(f) to be brought by motion does not apply to consensual liens on real property. *Case No. 14-42646, In re Jabbarnizhad*, (Bankr. E. D. Tex. Sept. 11, 2015). In the recent claims objection case of *In re Jabbarnizhad* the bankruptcy court declined to invalidate the home equity lien based on the objection and the lienholder's failure to respond to the claims objection. The court overruled the objection and ordered the debtor to file an adversary proceeding.

E. Trustee Objections to Home Equity Lien Claims. If the loan is potentially invalid both the debtor and trustee may object to the claim or file an adversary proceeding to invalidate the lien. The reason is that the Trustee could recover the payments made by the debtor against those loans. Tex. Const. art. XVI, §50(a)(6)(Q)(x) provides for a forfeiture of all principal and interest of the extension of credit if there is a failure to comply with the obligations under the

loan and if there is failure to correct not later than the 60th day after the date of notification by the borrower of the lender's failure to comply.

In the 2002 non-bankruptcy case of *Thomison v. Long Beach Mortgage Co.* 176 F.Supp.2d 714, 718 (W.D.Tex.2001), *vacated by* 2002 WL 32138252 (W.D.Tex.2002) the federal district court ruled that there "[N]o distinction is made between principal and interest already paid and that yet to be paid. Therefore, Defendant shall forfeit both sums per the constitutional requirement that "all" principal and interest be forfeited." The *Thomison* decision was vacated on appeal.

Bankruptcy courts have cited the *Thomison* case for the possibility of recovering prior mortgage payments but none included the recovery of past payments made by the borrower. In the 2004 bankruptcy case of *In re Adams*, 307 B.R. 549, 553 (Bankr. N.D. Tex. 2004) the court discussed Section 50(a)(6)(Q)(x) where the lender could not only forfeit the right to collect any future payments called for under the note "but also having to disgorge any amount already paid under the note." In that case the court found that the lender properly took curative steps and that the home equity lien would not be forfeited and granted summary judgment for the lender. In the 2004 case of *In re Chambers*, 419 B.R. 652, 668 (Bankr. E.D. Tex. 2009), *subsequently aff'd,* 544 Fed. Appx. 347 (5th Cir. 2013) the trustee filed suit to invalidate the mortgage and to recover all mortgage payments made by the debtor. The bankruptcy court recognized the possibility and cited to *Thomison* but remanded the case to state court making no decision. In the 2008 case of *In re Ortegon*, 398 B.R. 431, 434 (Bankr. W.D. Tex. 2008) the court noted that the debtor and the Chapter 13 trustee filed a complaint to invalidate the lien and for a return of all payments of principal and interest made by the debtor on the loan refunded. The court found that the debtor's claims were barred by the four year statute of limitations.

F. Subrogation. If the bankruptcy court invalidates a proof of claim because the lien violates the Texas constitution, the claimant has standing to assert a claim to recover ad valorem taxes paid on the homestead under common law equitable subrogation. This occurred in the case of *In re Gulley*, 436 B.R. 878, 896 (Bankr. N.D. Tex. 2010) where the bankruptcy court found that the debtor did not sign the home equity lien and this was not caused by the lender. Being sympathetic to the lender's position the court approved subrogation for the payment of ad valorem taxes and reserved whether the court would grant legal fees with regard to the lien under 11 U.S.C. § 506. See also, *LaSalle Bank National Association v. White,* 246 S.W.3d 616 (Tex.2007); *In re Chambers*, 419 B.R. 652, 679 (Bankr. E.D. Tex. 2009), *subsequently aff'd,* 544 Fed. Appx. 347 (5th Cir. 2013); *In re Johnson*, 62 C.B.C. 2d 1380 (Bankr. E.D. 2009).

G. Tips in Filing Home Equity Lien Claims.

1. No Market Value Established by Proof of Claim. One can only imagine the cost that could be saved by a lender if it could simply insert the property value of its collateral in the proof of claim. This would dispense with having to offer costly expert testimony during a hearing in the bankruptcy court. This would save a lot of time and expense for the lender if this were so, but the bankruptcy court said no to this in the case of *In re Morales*, 520 B.R. 544, 549-

50 (Bankr. W.D. Tex. 2014) where the court held that while the proof of claim is prima facie evidence of the validity and the amount of the creditor's claim it does not establish the fair market value of the real property to make the claim fully secured. Secured status is determined by following the procedure under 11 U.S.C. § 506(a) and requires more than the filing of a proof of claim. Fed. R. Bankr.P. 3001(f); *In re Hudson,* 260 B.R. 421, 430 (Bankr.W.D.Mich.2001) (secured proof of claim is not a determination of the value of a secured creditor's claim).

2. No Legal Fees By Proof of Claim. A home equity lender places their claim at risk if they file a claim including legal fees that have not been established by a court as this could be a violation of the Fair Debt Collection Act. In the case of *In re Saldivar*, 11-10689, 2013 WL 2452699, at *6 (Bankr. S.D. Tex. June 5, 2013) the court declined to dismiss a complaint based on an alleged violation of section 392.304(a)(13) of the Fair Debt Collection Act because legal fees were added to the claim and such fees could only be included in a judicially approved judgment. Legal fees are only recoverable if the value of the real property exceeds the debt against the real property under 11 U.S.C. §506(b) and separate procedures to recover legal fees are required to obtain such fees.

3. Forced Insurance. In the case of *In re Saldivar*, 11-10689, 2013 WL 2452699, at *5 (Bankr. S.D. Tex. June 5, 2013) the court found that the debtor stated a valid objection to the claim by arguing that the lender who received a portion of the premium for the cost of forced placed insurance had received a kickback. In this case the lender could request adequate protection from the bankruptcy court and secure a court order permitting the lender to incur this expense or to require the debtor to procure insurance.

III. CHAPTER 7 PROCEEDINGS

Upon the filing of a chapter 7 case the debtor will discharge in personum liability for its debts listed in the bankruptcy schedules, unless a creditor files a complaint to determine dischargeability of debt or an objection to discharge. The automatic stay as to the debtor will not lift until relief is granted under 11 U.S.C. §362(d) or the case is closed, dismissed or the debtor's discharge is granted or denied under 11 U.S.C. §362(c)(2).[1]

A. The Proof of Claim. As noted earlier, it is not necessary for a creditor to file a proof of claim in the chapter 7 proceeding because the home equity lien as a pre-petition lien and unless it is disallowed or avoided, will pass through the bankruptcy case unaffected. *Long v. Bullard*, 117 U.S. 617, 6 S.Ct. 917, 29 L.Ed. 1004 (1886). In Chapter 7 proceedings the lienholder must decide when it is appropriate to start the process of recovering the collateral

[1]11 U.S.C. §362(c): Except as provided in subsections (d), (e), (f), and (h) of this section--(1) the stay of an act against property of the estate under subsection (a) *of this section continues until such property is no longer property of the estate;* (2) the stay of any other act under subsection (a) of this section continues until the earliest of-- (A) the time the case is closed; (B) the time the case is dismissed; or (C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied.

against the debtor. This includes deciding if it is proper to file a proof of claim. Two home equity liens were forfeited by the Bankruptcy Court for the Eastern District of Texas because the creditor filed a proof of claim to assert the home equity lien that had latent constitutional violations that resulted in debtors asserting constitutional violations defensively. *In re: Johnson,* 62 Collier Bankr. Cas. 2d (MB) 1380 (Bank. E. D. 2009); *In re Shankles,* 11-43075, 2013 WL 5348879 (Bankr. E.D. Tex. Sept. 23, 2013). If the home equity loan has a possible violation or if the creditor has received notice of a possible constitutional violation even more than four years after the closing then the creditor should not file a proof of claim in a Chapter 7 proceeding.

As noted earlier, a claim objection will initiate a contested matter. Fed. R. Bank. P. 9014. If a creditor files no proof of claim then an objection to an unfiled claim cannot attack a lien as a lien can only be attacked in an adversary proceeding to satisfy due process. *See* Fed. R. Bankr.P. 3007, 7001(2). *In re Dennis,* 286 B.R.793, 795 (Bankr.W.D.Okla.2002); *In re Chukes,* 305 B.R. 744 (Bankr.D.Dist.Col.2004).

The failure to file a proof of claim will not affect the lien. A home equity lien has no deficiency to resort to in the estate and recovery will be based on the debtor paying the note in full or realizing on the collateral by foreclosure. For recourse loans the failure to file a proof of claim will only affect the ability to recover a deficiency in satisfaction of its debt after realization of its collateral. *In re Quintana*, 05-42417-DML-13, 2006 WL 2620505, at *2-3 (Bankr. N.D. Tex. Sept. 12, 2006), *subsequently aff'd*, 247 Fed. Appx. 564 (5th Cir. 2007).

B. Reaffirmation Agreements. Reaffirmation agreements in Chapter 7 cases are not necessary since they cannot change the non-recourse nature of the debt and have no legal effect. They violate public policy in Texas. *In re Pfeil*, 07-51241-C, 2007 WL 2034295, at *2 (Bankr. W.D. Tex. July 10, 2007). Creditors are authorized and permitted to renegotiate the terms of the indebtedness with the debtors as long as the renegotiated indebtedness remains solely an *in rem* liability of the debtors. Renegotiating the indebtedness, providing a payoff of debt for the sale of the underlying property is not a violation of the discharge injunction pursuant to section 524(a) of title 11. *In re Kohler*, BNKR. 10-51409-C, 2010 WL 2853893, at *1 (Bankr. W.D. Tex. July 19, 2010).

C. Stay Litigation. A home equity lien creditor may in some instances choose to move to lift the automatic stay so that it can proceed with foreclosure in state court or it may be seeking adequate protection during the administration of the case. In some cases the lender does not want to foreclose but wants the debtor to resume payments on the home equity note. In some cases this is appropriate even in a chapter 7 proceeding.

1. Requirements. Section 362(d) of the Bankruptcy Code provides that on request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay— (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; (2) with respect to a stay of an act against property under

subsection (a) of this section, if— (A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization.

The party requesting relief from the automatic stay has the burden of proof on the issue of the debtor's equity in the property. The party opposing relief has the burden of proof on all other issues. 11 U.S.C. § 362(g). Since the debt is non-recourse and because the Texas Constitution provides that a decline in value is not an event of default, the debtor should argue that the lack of equity is not grounds to lift the stay as long as the debt is being paid either during the chapter 7 case or through an approved bankruptcy plan. Some courts have granted adequate protection and required the debtor maintain payment of the taxes and property insurance through an account with the lender.

A lender must have a valid lien before it can obtain relief from the automatic stay. The bankruptcy court in the case of *In re Box*, 324 B.R. 290 (Bankr. S.D. Tex. 2005) denied relief from the automatic stay to a lender when it found that the lender violated Tex. Const. art. XVI, § 50(a)(6)(Q)(i) that prohibited the lender from requiring the owner of the homestead to apply the loan proceeds to pay another debt to the same lender.

Be careful and make sure that the holder of the note is the owner of the note at the time before filing a motion to lift stay is filed. In the case of *In re Brown*, 444 B.R. 691, 693 (Bankr. E.D. Tex. 2009) the debtor moved for sanctions against the creditor who attempted to withdraw a motion to lift the co-debtor stay in a chapter 13 case after discovering that the note had been transferred prior to the lender filing the motion to lift the stay. The court sanctioned the law firm and lender $650 for the debtor having to respond under 28 U.S.C. § 1927.

2. Automatic Stay Not Lifted. In the chapter 7 case of *In re Morris*, 12-35217-H3-7, 2012 WL 3262785, at *2 (Bankr. S.D. Tex. Aug. 8, 2012) the creditor moved to lift the stay based on the absence of the debtor's equity in the property. The movant offered evidence of a non-judicial foreclosure and a judgment of possession. The court found that the movant did not establish the lack of equity and the lifting of the stay would not be granted.

In the chapter 7 case of *In re: O'Neill,* 12-80628-G3-7, 2013 WL 1136953, at *1 (Bankr. S.D. Tex. Mar. 19, 2013) the evidence showed a lack of equity. There the homestead was valued between $218,000 and $240,000. The lienholder's claim was for $282,588.56. The court conditioned the stay being lifted based on monthly adequate protection payments of $2,200 and maintaining homeowners insurance and flood insurance on the property.

3. Automatic Stay Lifted. In the Chapter 7 case of *In re Ruthven*, 15-80172-G3-7, 2015 WL 5706955, at *2 (Bankr. S.D. Tex. Sept. 28, 2015) the lienholder filed a motion for relief from the automatic stay because the debtor failed to make payments and provide a certificate of insurance. The court found these grounds constituted cause for granting relief from the automatic stay and to permit a judicial foreclosure. The court found that the debtor "may assert in state court whatever defenses she believes she may have with respect to such an action

… in state court." The court did not examine the validity of the lien as the bankruptcy court did in the case of *In re Box.*

The automatic stay was lifted in the case of *In re Lowe*, 09-37600-H3-7, 2010 WL 817168, at *2 (Bankr. S.D. Tex. Mar. 4, 2010) where the debtor scheduled the property was not listed as exempt property and had a negative equity of $104,240.24.

4. Order Denying Relief Will Not Trump 11 U.S.C. §362(c). If the bankruptcy court denies lifting the stay in a motion to lift stay proceeding and keeps the automatic stay in effect in the stay order, this limitation cannot override the lifting of the stay when the debtor's discharge is granted or the case is closed. Under 11 U.S.C. § 362(c) the stay is lifted when these operative events occur. In such case the language in the bankruptcy stay order denying the lifting of the automatic stay becomes meaningless. This occurred in the case of *In re Erickson*, 566 Fed. Appx. 281, 283 (5th Cir. 2014) where the bankruptcy court ordered that the stay not be lifted in the main bankruptcy case while the validity of the home equity lien was being litigated in the adversary proceeding. The bankruptcy court lifted the stay in the final judgment ordering a foreclosure of the home equity lien in the adversary proceeding. This issue is academic because even if the discharge is issued or the case is closed and the automatic stay is no longer in effect during the adversary proceeding the lender cannot foreclose the property without an order allowing the foreclosure to proceed.

D. Exemption Issues. Under 11 U.S.C. §522 the debtor can exempt property of the estate using federal or state exemptions. Under Bankruptcy Rule 4003(a) the debtor shall list the property claimed as exempt under 11 U.S.C. §522 of the Bankruptcy Code on the schedule of assets. A party in interest may file an objection to the list of property claimed as exempt within 30 days after the meeting of creditors held under 11 U.S.C. § 341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later. Fed. R. Bankr. P. 4003(b)(1).

1. Jurisdiction over Exempt Property. The bankruptcy court's jurisdiction over exempt property ends when the time to object to the claim of exemption has expired. *Taylor v. Freeland & Kronz*, 503 U.S. 638, 643, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992)(Chapter 7 trustee could not contest the validity of claimed exemption after 30–day period for objecting had expired and no extension had been obtained, even though debtor had no colorable basis for claiming exemption); *In re Erickson*, 566 Fed. Appx. 281, 283 (5th Cir. 2014)(if no objection to the exemptions then the bankruptcy court loses jurisdiction).

Although jurisdiction of the bankruptcy court ends the lienholder cannot proceed *in rem* to enforce the lien in state court because the automatic stay still applies as to the *debtor* and will not lift until the stay is lifted, the discharge is granted or denied or the bankruptcy case is closed. 11 U.S.C. §362(c). Some creditors will wait for the discharge to be granted and will proceed in state court. Others have moved to lift the automatic stay so they can proceed earlier. Moving to lift the stay and filing a proof of claim can be a dangerous thing to do if the lien has a latent constitutional defect. This action could effectively allow the debtor to determine the validity of

the lien in the bankruptcy court and assert a constitutional violation more than four years after the closing of the loan.

In the case of *In re Chambers*, 419 B.R. 652, 667 (Bankr. E.D. Tex. 2009), *subsequently aff'd*, 544 Fed. Appx. 347 (5th Cir. 2013) the bankruptcy court found that property claimed as exempt may be removed from the estate if the exemption is properly claimed and the time to object to the claim of exemption has expired. The court found that it had jurisdiction over the exempt property because the time period had not ended and the creditor filed a proof of claim. The bankruptcy court had jurisdiction to determine the validity of the lien.

2. Capping the Homestead Exemption. In the case of *In re Shankles*, 554 Fed. Appx. 300 (5th Cir. 2014)(nfp) the debtor's chain of title was voided in probate court litigation and was revested in her name based on a compromise settlement agreement with her heirs within 1,215 days of the bankruptcy filing. The home equity loan was taken out during the litigation and the debtor affirmed the home equity lien in the settlement agreement.

The bankruptcy court disallowed the debtor from claiming the 100 acre exemption under Texas law and subjected the debtor to a federal statutory cap of $146,500 based on 11 U.S.C. §522(p)(1). The bankruptcy court made oral findings and entered a two page order denying the Texas exemption and applying the federal cap. The Fifth Circuit affirmed the bankruptcy court's decision in a non-published two sentence memorandum that the prior deeds, conveyances and agreements were rendered null and void and that the parties could not contract around the 1,215-day "look-back" period under 11 U.S.C. § 522(p)(1). The exemption hearing did not affect the lienholder's lien but the debtor challenged the lien in a subsequent adversary proceeding. *In re Shankles*, 11-43075, 2013 WL 5348879 (Bankr. E.D. Tex. Sept. 23, 2013).

Creditors should check the bankruptcy schedules to make sure that the debtor does not claim an exemption to real property as homestead when in fact the property has already been foreclosed by the lender prior to the bankruptcy filing. After foreclosure the debtor has no legal, equitable interest or possessory interest in the property and cannot exempt it so that it can subject it to the protections of bankruptcy. In order to be exempt, the property must have been part of the bankruptcy estate and the debtor would need to have legal or equitable title prior to filing the bankruptcy petition. *In re Morris*, 12-35217-H3-7, 2014 WL 1429867, at *3 (Bankr. S.D. Tex. Apr. 10, 2014); *In re Osuagwu*, 2012 WL 3394030 (Bank. N.D. Tex. 2012). Occupancy alone does not make the property a homestead. *In re Yamin*, 65 B.R. 938 (Bankr.S.D.Tex.1986).

IV. CHAPTER 13

A. Overview. Chapter 13 is a good option for debtors desiring to cure the default of their home equity loan over the life of the plan. The most serious issue ongoing in Chapter 13 cases is if there is real property that supports the home equity lien which is typically a second lien on the homestead. There are certain procedures that need to be followed in the Southern District of Texas involving the ability to recover legal fees in the bankruptcy proceeding and for post-confirmation defaults. Repayment of the lien is required if there is some value to support the

home equity lien. There is one limited exception to repayment of the entire debt in Chapter 13 proceedings when the loan becomes due before the final payment under the plan. In the latter case the debtor can bifurcate the claim into a secured and unsecured claim.

The Supreme Court in *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 961 (1997) provides that valuation is to be determined in light of the purpose of the valuation as well as the proposed use or disposition of the property.

The stay litigation and exemption issues discussed above under the Chapter7 proceedings will apply in this proceeding as well. Filing a proof of claim in a chapter 13 proceeding that may have a constitutional violation should be discussed further with the client and the debtor's counsel to determine if the debtor is going to cure the home equity lien or attempt to invalidate the lien.

B. Equity: No Lien Stripping. In the non-home equity loan case of *Bartee v. Tara Colony Homeowners Assoc. (In re Bartee)*, 212 F.3d 277, 296 (5th Cir. 2000) the Fifth Circuit held that a lien not supported by at least some value in the home is not subject to the anti-modification clause in § 1322(b)(2). The bankruptcy court concluded that the second lien was supported by at least some value and the debtor may not modify the second lien's rights under Section 1322(b)(2) of the Bankruptcy Code. The court denied confirmation of the plan. This same analysis would apply in handling home equity loans.

C. No Equity. If there is no equity in the real property to pay the home equity loan then the debtor can classify the loan as an unsecured claim to be paid through the plan at the percentage that is approved. The lien is stripped from the real property. *In re Bernal*, 11-35691-H3-13, 2012 WL 1999266, at *3 (Bankr. S.D. Tex. June 4, 2012); *In re Huriega*, 12-53080-CAG, 2015 WL 4130866, at *4 (Bankr. W.D. Tex. June 1, 2015); *In re Hassan*, 14-73711-REG, 2015 WL 5895481 (Bankr. E.D.N.Y. Oct. 8, 2015). The Debtor has the burden of demonstrating that "there is not even one dollar of value" in the property in excess of the amount owed on the first mortgage. *In re Hassan*, 14-73711-REG, 2015 WL 5895481 (Bankr. E.D.N.Y. Oct. 8, 2015)(court accepted Debtor's values of the property being less than the debt by averaging comparable sales and reducing value by property being near a busy road and near commercial property). When two appraisal reports conflict, a court should carefully compare "the logic of their analyses" and "the persuasiveness of their subjective reasoning." *In re Park Ave. Partners Ltd. P'ship*, 95 B.R. 605, 610 (Bankr.E.D.Wisc.1988).

In the case of *In re Smith*, 524 B.R. 125, 138 (Bankr. S.D. Tex. 2015) an adversary proceeding was brought after objections were made by the debtor to the claim by the first lienholder after the property was refinanced. The first lienholder filed a claim of $116,471.73 and the second lienholder filed a claim for $88,776.12. The court noted that the property on the debtor's Schedule A that the property was valued at $111,646.00 leaving the home equity lender as under-secured with no ability to recover on the claim.

D. Exception to Anti-Modification Provision. In the case of *In re Domingue*, 2012 WL 3961212, at *1-3 (Bankr. S.D. Tex. Sept. 10, 2012) the court allowed a home equity lien to be modified into secured and unsecured amounts payable at different amounts because the last payment due on the loan was before the date on which the final payment was due under the Chapter 13 plan. The lienholder objected on the grounds that the debt could not be modified under 11 U.S.C. § 1322(b)(2) and 11 U.S.C. § 1325(a)(5). The court found that the reverse mortgage became due approximately 73–99 days into the plan term and therefore the debtor could bifurcate the claim into secured and unsecured claims. 11 U.S.C. §§ 506, 1325(a)(1).

At confirmation the debtor offered expert appraisal testimony that the property was worth $15,000. The debtor testified that the property was worth between $15,000 - $16,000 and had defects including major foundation failures, a non-operating plumbing system, termites and electrical system failures. The lienholder claimed that the property was worth either $41,565.00, based on the current ad valorem tax data maintained by the Harris County Appraisal District or $25,000, based on the Debtor's original Schedule A. The debtor's expert testified that the ad valorem tax data was unreliable.[2] The bankruptcy court found the debtor's valuation more reliable and confirmed the plan based on the value of $15,000.

The plan bifurcated lender's claim in the amount of $15,000 as the secured claim and payment over the life of the plan at 5.25%. The balance of the claim was a general unsecured claim that would be paid 1% of the claims under the plan. The court allowed the lender's claim to be modified over the lender's objection. The bankruptcy court found that under 11 U.S.C. § 1322(b)(2) a debtor must pay the full amount of its claim if the collateral is the principal residence. Section 1322(c)(2) provided an exception to Section 1322(b)(2) which allows a home mortgage claim to be bifurcated into secured and unsecured components if the mortgage comes due prior to the expiration of the plan term. *American General Finance, Inc. v. Paschen (In re Paschen),* 296 F.3d 1203 (11th Cir.), *cert. denied,* 537 U.S. 1097, 123 S.Ct. 696, 154 L.Ed.2d 648 (2002). The case of *In re Domingue* shows the importance of expert valuation testimony if the value is in dispute and the property will not support a fully secured status. The difficulty with this case as in many chapter 13 confirmation proceedings is the cost to the lender to secure expert testimony.

E. Post-Petition Legal Fees. Post-petition legal fees are allowed if the lender is over-secured. In the case of *In re Boyd*, 12-80400-G3-13, 2013 WL 1844076, at *4 (Bankr. S.D. Tex. May 1, 2013) the court held that to recover fees and costs in addition to its secured claim

[2]Tax valuations have been held not to be evidence of fair market value. *Hous. Lighting & Power Co. v. Fisher*, 559 S.W.2d 682, 686 (Tex.Civ.App.1977, writ ref'd n.r.e .)("[I]t is generally held that the value placed upon real property for the purposes of taxation by assessment without participation of the landowner is not evidence of its value for purposes other than taxation."); *United States v. Curtis*, 635 F.3d 704, 718 (5th Cir.), *cert. denied*, 132 S. Ct. 191 (2011)(value placed upon real property for tax assessment purposes is not evidence of its value for purposes other than taxation); *Penrod v. Bank of New York Mellon*, 824 F.Supp.2d 754 (S.D.Tex.2011)(appraisal from a public appraisal district was relevant to valuation for taxation purposes only and does not establish market value); *Poswalk v. GMAC Mortg., LLC*, 3:11-CV-0465-D, 2012 WL 2193982, at *3 (N.D. Tex. June 15, 2012), *aff'd sub nom. Poswalk v. GMAC Mortg., L.L.C.*, 519 Fed. Appx. 884 (5th Cir. 2013).

pursuant to Section 506 of the Bankruptcy Code, the burden of proof is on the over-secured creditor to show that such fees and costs are reasonable. In determining whether fees are reasonable within the meaning of the Bankruptcy Code, the court must determine whether the creditor took the kinds of actions that similarly situated creditors might reasonably conclude should be taken under the circumstances and that the fees and costs claimed are reasonable amounts to charge for the services rendered. An *under-secured lienholder* is not entitled to recover its legal fees because 11 U.S.C. §506(b) allows for interest and legal fees if the property is greater than the amount of the claim. This applies even as to preparing a proof of claim and reviewing a chapter 13 plan prior to confirmation.

In the case of *In re Fuentes*, 509 B.R. 832, 833-36 (Bankr. S.D. Tex. 2014) the home equity lender filed a motion to determine post-petition mortgage fees, expenses and charges in the amount of $475. The debtor argued that the home was worth $88,603.00 and the lender's debt was $139,409.99 and therefore under 11 U.S.C. §506(b) the debt was under-secured and nothing was owed to the creditor. The home equity lender argued that the debt was governed by the anti-modification provisions of 11 U.S.C. 1322(b)(2) that provides that a chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence...." 11 U.S.C. § 1322. The debtor argued that § 1322(b)(2) only applied post-confirmation but not pre-confirmation. Section 506 is made applicable to chapter 13 by 11 U.S.C. § 103 and applies only from the date of filing through confirmation. *In re T–H New Orleans Ltd.*, 116 F.3d 790, 797 (5th Cir.1997). The court held that the under-secured home equity lender was not entitled to recover its post-petition, pre-confirmation attorney's fees and related costs.

F. Post-Petition Charges in Chapter 13 Cases. In the Southern District of Texas a lienholder has to file a supplemental claim for post-petition charges accruing on residential mortgage claims within 60 days after the Trustee files its annual report. *See* Chapter 13 Trustee Procedures for Administration of Home Mortgage Payments. A creditor who files a notice of post-petition fees, expenses and charges must prove those charges at the hearing because supplemental claims do not enjoy the presumption of validity.

G. Chapter 13 Surrender of Property Allowed. In the case of *In re Bell*, 11-30402-H3-13, 2013 WL 6898251, at *2 (Bankr. S.D. Tex. Dec. 31, 2013) the court approved of the Chapter 13 debtor surrendering its homestead back to the home equity lender in satisfaction of the claim. The debtor had made payments to the Chapter 13 trustee. The lender filed a claim for $63,740.98 and notice of post-petition fees, expenses and charges for $325. The home equity lender objected on the grounds that the payments to the Chapter 13 trustee that were not disbursed should go to the home equity lender. The court allowed the modification without the payment of the funds previously tendered by the debtor because the debtors were not personally liable on the note in the event of foreclosure. The court found that the surrender of the principal residence did not violate Section 1322(b)(2)'s prohibition.

V. ADVERSARY LITIGATION

A. Home Equity Liens Forfeited.

1. Requiring Application of Proceeds. The first reported forfeiture of a home equity lien in bankruptcy court was in 2005 in the case of *In re Box*, 324 B.R. 290 (Bankr. S.D. Tex. 2005) where the lender required the debtors to apply the proceeds of a home equity loan to a debt with the same lender. This violated §50(a)(6)(Q)(i) of the Texas Constitution and resulted in forfeiture of the lien because it could not be cured.

2. Multiple Violations. In *Arnold v Quigley*, 2011 Bankr. LEXIS 1004 (Bankr. N.D. Tex. 2011) the bankruptcy court found that (1) the lender was not an authorized home equity lender in Texas, (2) the lender conducted a non-judicial foreclosure sale, (3) the lender failed to provide a right of rescission, and (4), the lender failed to provide written acknowledgement of the value of the property. All of these violations were incurable. The court forfeited all principal and interest. The opinion did not address the issue of whether past payments made against the loan were to be refunded to the estate.

3. Second Home Equity Lien. In *Lovelace v USAA Fed. Sav. Bank*, 443 B.R. 494 (Bankr. W.D. Tex. 2011) the bankruptcy court forfeited the second home equity lien finding that it was invalid because there could only be one home equity lien against the homestead under Tex. Const., Art. XVI, § 50(g) and that no further home equity loans could validly be placed on the property.

4. No Signature. In the case of *In re Gulley*, 436 B.R. 878, 890 (Bankr. N.D. Tex. 2010) the court forfeited the lien after finding that the wife did not sign the home equity loan documents. The court noted the consequences for violating the home equity provisions under the Texas Constitution at Section 50(a)(6)(Q)(xi).[3] The Court found that the lienholder would still be entitled to a secured claim and lien to the extent it paid off any valid existing taxing liens on the homestead.

5. Agricultural Property. As noted earlier, the home equity liens in the cases of *In re: Johnson,* 62 Collier Bankr. Cas. 2d (MB) 1380 (Bank. E. D. 2009) and *In re Shankles,* 11-43075, 2013 WL 5348879 (Bankr. E.D. Tex. Sept. 23, 2013) were forfeited because they were taken on property that was designated as agricultural property at the time of the loan and were incurable as a matter of law.

B. Lender Defenses.

The failure to comply with the Texas Constitution is not necessarily fatal to a home equity lender because a lender has an opportunity to cure any failure on its part to comply with its constitutional obligations after receiving notification from the borrower of a violation. Tex. Const. art. XVI, § 50(a)(6)(Q)(x).

[3] "… 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 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.

1. Notice of Home Equity Loan Violation. The cure provision of section 50(a)(6)(Q)(x) of the Texas Constitution is triggered upon notice of the non-compliance to the lender by the borrower. *Wells Fargo Bank, N.A. v. Leath*, 425 S.W.3d 525, 530 (Tex. App.—Dallas 2014, pet. denied). Proper notice of non-compliance requires that the notice includes a reasonable: (1) identification of the borrower; (2) identification of the loan; and (3) a description of the alleged failure to comply. 7 Tex. Admin. Code § 153.91(a).[4] If the borrower provides the lender or holder inadequate notice, the 60-day period does not begin to run. 7 Tex. Admin. Code § 153.92(b).The notice must give factual detail of how the loan is non-complaint so that the lender can cure the alleged deficiency.

The lienholder has sixty days to take curative measures to bring the loan into compliance with the constitution after receiving proper notification to avoid forfeiture of the principal and interest on the loan. Tex. Const. art. XVI, § 50(a)(6)(Q)(x); 7 Tex. Admin. Code § 153.91(b) (effective November 11, 2004); *Doody v. Ameriquest Mortg. Co.*, 49 S.W.3d 342, 346 (Tex.2001).

In *Curry v. Bank of Am., N.A.*, 232 S.W.3d 345, 353 n. 6 (Tex. App.-Dallas 2007, pet. denied) the court held that it is not enough to say that an attorney has made a "preliminary determination" that the loan did not comply with the Texas Constitution.

In the case of *In re Eads*, 417 B.R. 728, 745 (Bankr. E.D. Tex. 2009) the court denied relief when there was a failure to articulate legal or factual grounds for concluding that the note and lien were invalid or to show reasonable steps taken to notify lender and or its predecessor-in-interest with a description of any alleged failure to comply.

In the case of *In re Chambers*, 419 B.R. 652, 681 (Bankr. E.D. Tex. 2009) *subsequently aff'd*, 544 Fed. Appx. 347 (5th Cir. 2013) the bankruptcy court questioned whether the borrower complied with proper notice by sending notice of noncompliance when the borrower's petition in state court referred to violations regarding one loan and not violations regarding the second loan.

The case of *In re Adams*, 307 B.R. 549 (Bankr. N.D. Tex. 2004) shows that it is possible to cure the defective loan unilaterally by providing an offer to cure along with the motion to lift stay and the borrower cannot prevent the lender from curing the loan. There the loan did not provide 12 days- notice as required and the lender offered to redo the entire loan. The debtor argued that the loan was incurable.

2. Method of Notice. Courts have allowed different time frames for the 60 days-notice of defect to be made. These have ranged from when the adversary proceeding was filed, *In re Gulley*, 436 B.R. 878, 890 (Bankr. N.D. Tex. 2010); *In re Adams*, 307 B.R. 549, 558 (Bankr. N.D. Tex. 2004), to the filing of the first amended original complaint, *Puig v. Citibank, N.A.*, 2012 WL 1835721 (N.D. Tex. May 21, 2012) *aff'd*, 514 Fed. Appx. 483 (5th Cir. 2013) and in

[4] The borrower is not required to cite to section 153.91 in the notice letter. 7 Tex. Admin. Code § 153.91(b). See other requirements at § 153.92, 153.93.

response to the application for the in rem foreclosure in state court. *In re Shankles*, 11-43075, 2013 WL 5348879, at *7 (Bankr. E.D. Tex. Sept. 23, 2013).

3. Curative Method Proper. Under Tex. Const. art. XVI, § 50(a)(6)(P)(x) a lender forfeits all principal and interest if they fail to cure not later than the 60th day after the date of notification. Curing can be by paying the amount of overcharge; validating the lien that does not exceed the percentage; or not secured by property not permitted; modifying the percentage, term or other prohibited provision, delivering required documents for signature, sending written acknowledgement if the failure to comply is prohibited, that the accrual of interest and all of the owner's obligations under the extension of credit are abated while the prohibited lien remains secured by the homestead. If the failure to comply cannot be cured then refunding $1,000 and offering a right to refinance for the remaining terms necessary to comply with the law.

The court in *In re Chambers*, 419 B.R. 652, 679 (Bankr. E.D. Tex. 2009), *subsequently aff'd*, 544 Fed. Appx. 347 (5th Cir. 2013) found that if a lender makes an offer to modify or refinance an equity loan that complies with § 50(a)(6)(Q)(x)(f), "a borrower's refusal to cooperate fully ... does not invalidate the lender's protection for correcting a failure to comply." 7 Tex. Admin. Code § 153.95 (effective November 11, 2004). The court found that the Defendant's offer to cure the alleged violations of the Texas Constitution in connection with the 2004 home equity loan complied with § 50(a)(6)(Q)(x) and that the debtor's failure to cooperate with the lender did not invalidate the attempted cure.

The case of *In re Erickson v. Wells Fargo Nat. Ass'n*, 09-11933-CAG, 2011 WL 1599657, at *1 (Bankr. W.D. Tex. Apr. 27, 2011) involved an offer to cure to correct the allegations that the loan created personal liability and the missing language that allowed the non-judicial foreclosure of the loan that had been whited out by someone after or during the closing. The debtor refused to sign a new security agreement that would have validated the lien and made his adversary proceeding moot. The court wrote that "Wells Fargo provided Erickson with timely written notice that it was waiving and renouncing any right or claim to pursue personal recourse against him with respect to any obligations arising under the deed of trust." *See* Tex. Const. art. XVI, § 50(a)(6) (Q)(x) (providing lenders with right to cure noncompliance with constitutional requirements, thereby validating lien); *Doody v. Ameriquest Mortg. Co.*, 49 S.W.3d 342, 346 (Tex.2001); *In re Erickson*, 09-11933, 2012 WL 4434740, at *6 (W.D. Tex. Sept. 24, 2012), *aff'd*, 566 Fed. Appx. 281 (5th Cir. 2014).

4. Pre-2003 Amendment Cures. In the case of *In re Adams*, 307 B.R. 549 (Bankr. N.D. Tex. 2004) issued prior to the 2003 constitutional amendments to the home equity laws where the opportunity to cure a loan was required within 60 days after notice instead of a "reasonable time" after notice, the court found that the lender's efforts to lift the automatic stay to provide a curative letter to numerous defects in the loan was a "reasonable time" and sufficient to avoid the lien be forfeited. The court noted that the lender took action within 60 days after being served with the suit and having notice of the alleged defective lien and that such actions were within a reasonable time given the circumstances of the case. See also *Fix v. Flagstar Bank, FSB*, 242 S.W.3d 147, 158 (Tex. App.—Fort Worth 2007, pet. denied)(offered to bring

loan into compliance; pay $1,000, give same or better interest rate; reclose the transaction at no cost was a sufficient offer to cure defects).

5. Inability to Cure. When the loan fails to meet the constitutional requirements and the lender cannot cure within sixty days, then the lien can be declared invalid, and all principal and interest are forfeited. Tex. Const. art. XVI § 50(a)(6)(Q)(x). As noted above the debtor or trustees have attempted to recover the payments made by the debtor as was suggested in the case of *Thomison v. Long Beach Mortgage Co.* 176 F.Supp.2d 714, 718 (W.D.Tex.2001), *vacated by* 2002 WL 32138252 (W.D.Tex.2002).

6. Statute of Limitations. As discussed in the overview of this paper, the Texas Constitution does not address the proper statute of limitations in home equity litigation cases but state and federal court cases are consistent in their holdings that the four-year statute of limitations to constitutional claims under Tex. Civ. Prac. & Rem. Code §16.051 applies.

The Fifth Circuit applies the four-year statute of limitations under Section 16.051 of the Texas Civil Practices and Remedies Code and holds that accrual runs at the creation of the home equity lien. *Kramer v. JP Morgan Chase Bank, N.A.*, 13-50920, 2014 WL 2872905 (5th Cir. 2014); *Priester v. JPMorgan Chase Bank,* 708 F.3d 667, 674–75 (5th Cir.2012), *cert. denied,* 134 S.Ct. 196 (2013); *Sigaran v. U.S. Bank Nat'l Ass'n,* 560 Fed. Appx. 410 (5th Cir. 2014); *Thompson v. Deutsche Bank Nat'l Trust Co.,* 775 F.3d 298, 307 (5th Cir.2014); *Nunez v. CitiMortgage, Inc.*, 14-50261, 2015 WL 3526102, at *2 (5th Cir. Apr. 21, 2015) Texas appellate courts in Dallas,[5] Texarkana[6] and Houston[7] have adopted the *Priester* rationale and apply the four year limitations to constitutional violations because invalid home equity liens are voidable rather than void.

As noted earlier in this paper, the bankruptcy courts are in conflict over the application of the statute of limitations. If the debtor or trustee files an adversary proceeding to invalidate a home equity lien against the lienholder and the closing of the loan occurred more than four years prior to the suit then the lienholder can defend based on the four year statute of limitations even if it files a proof of claim. *In re Chambers*, 419 B.R. 652, 668 (Bankr. E.D. Tex. 2009), *subsequently aff'd*, 544 Fed. Appx. 347 (5th Cir. 2013); *In re Ortegon*, 398 B.R. 431, 434 (Bankr. W.D. Tex. 2008).

[5]*Williams v. Wachovia Mortg. Corp.*, 407 S.W. 3d 391, 397 (Tex. App. – Dallas 2013, pet. denied)("because a cure provision exists in the Texas Constitution, homestead liens that are contrary to the constitutional requirements are *voidable* rather than void from the start[.]"); *Santiago v. Novastar Mortg ., Inc.*, 443 S.W.3d 462, 470 (Tex.App.-Dallas 2014) (*Priester* supports "our conclusion that liens created in violation of section 50(a)(6) were voidable rather than void.").*Nunez v. CitiMortgage, Inc.*, 14-50261, 2015 WL 3526102, at *2 (5th Cir. Apr. 21, 2015).

[6] *In re Estate of Hardesty,* 449 S.W.3d 895 (Tex.App.—Texarkana 2014) ("We adopt the reasoning of *Priester* and that of our sister courts.").

[7] *Wood v. HSBC Bank USA, N.A.,* 439 S.W.3d 585 (Tex.App.—Houston [14th Dist.] 2014, pet. filed) ("We too find the *Priester* court's analysis persuasive").

If the lender initiates an adversary proceeding against the debtor based on a home equity loan that has a constitutional defect then the debtor can assert the violation defensively in response to the proof of claim, *In re Johnson*, 08-40492, 2009 WL 2982783 (Bankr. E.D. Tex. Sept. 11, 2009) and can counterclaim for declaratory judgment relief that the home equity lien is void even though no prior notice of a violation was made within four years of the closing. *In re Shankles*, 11-43075, 2013 WL 5348879 (Bankr. E.D. Tex. Sept. 23, 2013)(debtor filed counterclaim in February 2012 to invalidate home equity lien made in July 2007 and notice of violation was made in September 2011, in response to creditor's complaint for fraud under 11 U.S.C. §523).

The bankruptcy court in *Shankles* reasoned as follows:

> Here the counterclaims challenging the validity of the bank's lien under the Texas Constitution are logically related to the bank's action seeking to have its claim liquidated by this Court, determined nondischargeable, and the automatic stay lifted so that the bank can enforce the Court's judgment by foreclosing on the debtor's home. The debtor and trustee are challenging the validity of the very transaction that gave rise to the debt the bank is seeking to enforce. Either the facts show that the bank has a valid lien and is entitled to foreclose, as the bank claims, or the facts show that bank does not have a valid lien and is not entitled to foreclose, as the debtor and trustee counterclaim.

In re Shankles, 11-43075, 2013 WL 5348879.

The bankruptcy court held that *Priester* had no application in the bankruptcy context. It held that the debtor's notice in September 2011 made more than four years after the closing was valid and therefore the lender's failure to respond within sixty days resulted in the forfeiture of the lien. The bankruptcy court held that the lien was incurable as a matter of law because it was made on property designated as agricultural at the time of the loan.

Has the lienholder in *Shankles* taken no action whatsoever and waited for the debtor's discharge to be granted under 11 U.S.C. §362(c) then it could have filed a proceeding to foreclose under Tex. R. Civ. P. 736. If the debtor had raised the constitutional violation in state or federal court then under *Priester* the violation would have been barred by limitations.

The bankruptcy court in the case of *In re Smith*, 524 B.R. 125, 146 (Bankr. S.D. Tex. 2015) held that Section 16.069 prevented the statute of limitations from barring a claim of negligence and discharge by tender of payment being raised between the competing lenders with claims against the homestead property that was subject to a home equity lien.

In *Moran v. Ocwen Loan Servicing, LLC,* 560 Fed. Appx. 277, 279–80 (5th Cir. Mar. 24, 2014) the court held that a borrower could not use a declaratory judgment action under the Texas Constitution as a defense to foreclosure to circumvent the four-year statute of limitations. The debtors argued that the lender breached their agreement by failing to refund or cure the alleged

violation within the 60–day cure period. The court found that *Priester* recognized that the application of the statute of limitations is different for contract claims. The court found that where the parties frame their contract as to make prior demand an integral part of a cause of action or a condition precedent to a right to sue then the statute of limitations does not begin to run until demand is made. *Priester* noted that it is the general rule that in such a case a demand must be made within a reasonable time after it may lawfully be made and that a reasonable period of time relates to the statute of limitations. The court found that where demand is a condition precedent to suit, the plaintiff may not, by failing or refusing to perform the condition, toll the running of the statute and reserve the right to sue within the statutory period from such time as he decides to make a demand. See *Aetna Cas. & Sur. Co. v. State*, 86 S.W.2d 826, 831 (Tex.Civ.App.–Fort Worth 1935, writ dism'd).

7. Waiver of Acceleration. Under Texas law, a secured lender "must bring suit for ... the foreclosure of a real property lien not later than four years after the day the cause of action accrues."Tex. Civ. Prac. & Rem.Code § 16.035(a). Effective acceleration occurs when the holder sends a notice a notice of intent to acceleration and notice of acceleration. *Holy Cross Church of God in Christ v. Wolf*, 44 S.W.3d 562, 566 (Tex. 2001). Acceleration can be abandoned by agreement or other action of the parties, *Khan v. GBAK Props.*, 371 S.W.3d 347, 353 (Tex Civ. App. – Houston [1st Dist.] 2012, no pet.). Abandonment of acceleration has the effect of restoring the contract to its original condition, including restoring the note's original maturity date. *San Antonio Real Estate Bldg. & Loan Ass'n v. Stewart*, 94 Tex. 441, 445, 61 S.W. 386, 388 (1901); *Denbina v. City of Hurst*, 516 S.W.2d 460, 463 (Tex.Civ.App.-Tyler 1974, no writ). A lender waives its earlier acceleration when it puts the debtor on notice of its abandonment by requesting payment on less than the full amount of the loan. *Leonard v. Ocwen Loan Servicing, L.L.C.*, 2015 WL 3561333, at *3 (5th Cir. Jun. 9, 2015) (per curiam) (unpublished).

Effective June 17, 2015, Tex. Civ. Prac. & Rem. Code Ann. § 16.038(a) (West) provides that if the maturity date of a series of notes or obligations payable in installments is accelerated and the accelerated maturity date is rescinded or waived in accordance with this section before the limitations period expires, the acceleration is deemed rescinded as if no acceleration had occurred. Section 16.038(b) and (c) provides that rescission or waiver of acceleration is effective if made by a written notice of rescission or waiver served by first class or certified mail addressed to the debtor's last known address. See *Boren v. U.S. Nat. Bank Ass'n*, 14-20718, 2015 WL 6445721, at *5 (5th Cir. Oct. 26, 2015).

8. Discovery Rule. In *Priester v. JP Morgan Chase Bank, N.A.*, 708 F.3d 667, 674 (5th Cir. 2013), *cert. denied sub nom. Priester v. JPMorgan Chase Bank, N.A.*, 134 S. Ct. 196, 187 L. Ed. 2d 256 (2013) the court held that there is nothing undiscoverable about the lien. Texas law has been clear that parties to a real estate closing and any resulting injury would not be inherently undiscoverable. *Dunmore v. Chicago Title Ins. Co.*, 400 S.W.3d 635, 642 (Tex. App.—Dallas 2013, no pet.). Recently the Texas Supreme Court held in *Cosgrove v. Cade*, 14-0346, 2015 WL 3976719, at *1 (Tex. June 26, 2015) that a grantor who signs an unambiguous deed is presumed as a matter of law to have immediate knowledge of material omissions.

In 2011 one bankruptcy court in the case of *In re Jema Enterprises, LLC*, 11-70218, 2011 WL 5023846 (Bankr. S.D. Tex. Oct. 19, 2011) denied leave to amend a complaint to allege home equity loan violations on the grounds that the claims were barred by limitations. The court found that the discovery rule concerned the discovery of new facts not previously known to the plaintiffs and did not pertain to the sudden realization that previously known facts violated the law. The court found that the debtor offered no reason why the lienholder would have had a duty to disclose a prior violation of the home equity laws.

9. Estoppel. Under Tex. Const. art. XVI, § 50(a)(6)(Q)(xi), (d), a lender may rely upon a non-homestead affidavit only if it is without knowledge of the borrower's right to claim a homestead and the borrower is not in actual use and possession of the homestead property. The homestead affidavit for which conclusive reliance under Article XVI, Section 50(d) of the Texas Constitution is not treated the same as the closing affidavit that states property is not of agricultural use as shown by these cases.

a. Conclusive Reliance on Homestead Affidavit. In the case of *In re Erickson v. Wells Fargo Nat. Ass'n*, 09-11933-CAG, 2011 WL 1599657, at *5 (Bankr. W.D. Tex. Apr. 27, 2011) the bankruptcy court found that the lender could conclusively rely on an affidavit of the borrower that property is homestead.[8] In that case the debtor provided different affidavits claiming that his home and his mother's home were his homestead at different times in order to obtain financing against the property. The court found that the debtor was barred from making an assertion contrary to his affidavit since he had the opportunity to verify the contents of the affidavit, the debtor admitted that he was not forced to sign the affidavit, and that he had the opportunity to read the affidavit if he had chosen to do so, the lender was bona fide purchaser of the note without knowledge of the affidavit's inaccuracy and the debtor did not contend that the lender knew that the affidavit was not true or that the transaction between the mortgage originator and the owner was in bad faith or fraud. The court found that the lender made a prima facie showing that it could conclusively rely on the affidavit.

On appeal the district court held that to invoke equitable estoppel, a party must prove: (1) a false representation or concealment of material fact; (2) made with knowledge, actual or constructive, of the facts; (3) to a party without knowledge or the means of knowledge of the real facts; (4) with the intention that it should be acted upon; and (5) the party to whom it was made must have relied upon or acted upon it to his prejudice. The court affirmed finding that there was no evidence that the lenders knew that his affidavit was false.

b. No Conclusive Reliance on Non-Agricultural Affidavit. In the case of *In re Shankles*, 11-43075, 2013 WL 5348879, at *9 (Bankr. E.D. Tex. Sept. 23, 2013) the bankruptcy court found that the Texas Constitution did not include a provision for conclusive reliance on a non-agricultural use affidavit. There the debtor had 180 acres and had a two acre homestead

[8] Article XVI, Section 50(d) of the Texas Constitution states that "[a] purchaser or lender for value without actual knowledge may conclusively rely on an affidavit that designates other property as the homestead of the affiant and that states that the property to be conveyed or encumbered is not the homestead of the affiant."

taxed as homestead property. The 178 acres was taxed as agricultural. The debtor requested that the appraisal district to remove eight acres as agricultural but never designated a particular eight acres. The taxing authority taxed 170 acres as agricultural and ten acres as homestead. A surveyor surveyed ten acres on the property that was used to secure the home equity loan. The surveyor's property description was correct. The debtor signed an affidavit that the ten acres for her loan was not agricultural property. The appraisal district removed the agricultural exemption on eight acres of property designated as "Poor Pasture" in order to minimize the tax impact on the debtor. The court found that nothing in the records of the appraisal district revealed which eight acres were reclassified as exempt property.

The bankruptcy court wrote that the Texas Constitution "does not include any provision allowing a lender to conclusively rely on such an affidavit in the context of the agricultural-use designation. Furthermore, as a general rule, lenders may not rely on an estoppel defense to secure a lien on a homestead." *In re Shankles*, 11-43075, 2013 WL 5348879, at *9 (Bankr. E.D. Tex. Sept. 23, 2013).

10. After Acquired Property. Although it did not help in the outcome of the case, the court in the case of *In re Shankles*, 11-43075, 2013 WL 5348879, at *6 (Bankr. E.D. Tex. Sept. 23, 2013) recognized the validity of the doctrine of *after acquired property.* The debtor forged her husband's name to her husband's will and conveyed the real property to herself through the administration of the estate that she took out in probate court in 2004. In 2007 she took out a home equity lien disclosing the pending litigation in the probate court and then removing the pending litigation prior to the loan closing. The heirs contested the validity of the conveyance and she settled with them in 2009. Her title was voided but the settlement agreement validated the home equity lien and conveyed the real property to her. The bank was not a party to the probate litigation.

The *lis pendens* discovered at the closing referenced the property description into the debtor's deceased husband when he acquired the property in 1977 and 1978. It did not reference the property description in the bank's home equity lien. It turned out that conveyances into the debtor's deceased husband in 1977 and 1978 were actually incorrect and that the surveyor for the bank for the home equity loan prepared the only correct property description. The title company mistakenly closed the loan believing that the *lis pendens* pertained to other property and not the property subject to the home equity lien. The title company could have taken the survey to the appraisal district and had a separate account set up, had the agricultural designation removed and then closed the loan. Instead the loan was allowed to close leaving the agricultural designation in place. Since the settlement agreement validated the home equity lien against the property the court held that the debtor's arguments to invalidate the lien were barred by the doctrine of after acquired property. But, as noted above the court forfeited the lien because the debtor gave notice of the violate during the state court proceedings in September 2011 more than four years after the closing and the bank did not respond to the notice within sixty days by offering to cure or taking any curative action.

11. Subrogation. If the lien is forfeited the lender is entitled to subrogation to the extent that there was payment of a valid lien against the homestead. *LaSalle Bank Nat. Ass'n v. White*, 246 S.W.3d 616 (Tex. 2007); *In re Johnson*, 08-40492, 2009 WL 2982783, at *5 (Bankr. E.D. Tex. Sept. 11, 2009); *In re Gulley*, 436 B.R. 878, 896 (Bankr. N.D. Tex. 2010)(ad valorem taxes).

12. Declaratory Judgment Relief. Recovery of legal fees is allowed *in rem* in connection with pursuing recovery under the home equity loan that is allowed by contract and seeking foreclosure in an adversary proceeding. The bankruptcy court erred in not granting such fees found the district court in the case of *In re Erickson*, 09-11933, 2012 WL 4434740 (W.D. Tex. Sept. 24, 2012), *aff'd*, 566 Fed. Appx. 281 (5th Cir. 2014). Where the district court reversed the bankruptcy court's order not granting *in rem* legal fees in the final judgment in the adversary proceeding. The court found that the bankruptcy erred in denying the lender's motion in its entirety based on the unavailability of a personal judgment without consideration of an *in rem* judgment. *Id.*

The Texas Supreme Court in *Wells Fargo Bank, N.A. v. Murphy*, 458 S.W.3d 912 (Tex. 2015) held that a Texas state court had authority to award attorney fees to the lender under Tex. Civ. Prac. & Rem. Code §37.009. By challenging the loan under the Uniform Declaratory Judgment Act declaratory judgment statute the borrower then subjected itself to the possibility of payment of legal fees to the lender. The lender in that case successfully argued a distinction between recognizing liability on the loan as an "extension of credit" under article XVI, § 50(a)(6) of the Texas Constitution and liability for the borrower's conduct in pursuing litigation under the Texas Declaratory Judgment Act that permits the award of legal fees as is equitable and just. Since the borrowers availed themselves of the court to invalidate a lien it makes sense that they reaped the consequences of that action. The *Murphy* decision is a real blow to debtors wishing to challenge home equity loans for spurious reasons in state court.

Debtors will want to pursue declaratory judgment claims in bankruptcy court or federal court because a declaratory judgment action in state court under the Texas Civil Practices and Remedies Code will be converted to a Federal Declaratory Judgment Act claim where no legal fees are available under 28 U.S.C. §2201. The Fifth Circuit in *Utica Lloyd's of Texas v. Mitchell*, 138 F.3d 208, 210 (5th Cir. 1998) held that that the "Texas DJA is neither substantive nor controlling." *Id.* at 697; *In re Pride Companies, L.P.*, 285 B.R. 366, 370 (Bankr. N.D. Tex. 2002).

13. No Violations or Issues of Fact Raised. If the home equity loan may have no violations then the lienholder prevails. *In re Edwards*, 00-5055-RBK, 2001 WL 708827, at *3 (Bankr. W.D. Tex. Feb. 27, 2001); *In re Zeman*, ADV. 09-5079-C, 2010 WL 4807087, at *1 (Bankr. W.D. Tex. Nov. 22, 2010); *In re Wimberly*, 355 B.R. 596, 598 (Bankr. S.D. Tex. 2006), aff'd, CIV A H-06-4098, 2007 WL 2537584 (S.D. Tex. Aug. 31, 2007) or the motion for summary judgment raised issues of fact. *In re Reno*, 04-15828-FRM-7, 2008 WL 4178191, at *6 (Bankr. W.D. Tex. Sept. 4, 2008).

VI. DISCHARGEABILITY

If a borrower has committed fraud against the lender then sometimes the lender may file an action to declare the debt non-dischargeable under 11 U.S.C. § 523 that contains a list of possible actions. The creditor should be aware of the deadlines to file such a complaint that will be included in the notice of the bankruptcy proceeding.

A. Deadline to File Complaint. In the case of *In re Lovelace*, 443 B.R. 494, 500 (Bankr. W.D. Tex. 2011) the bankruptcy court noted that no complaint objecting to the dischargeability of debt or discharge was filed by the lender in that case that involved the validity of the home equity lien against the property. There the debtor received the funds from the proceeds for a home equity loan and the lien was filed of record. After filing Chapter 7 the court found that the lien was invalid because it was a secondary home equity lien against the property. If the court had found that the borrower committed fraud then it could have found personal liability against the debtor.

B. Lender's Non-Dischargeability Complaint Denied. The case of *In re Shankles*, 2013 WL 5348879, at *1 (Bankr. E.D. Tex. Sept. 23, 2013) involved a home equity loan closed in July 2007 taken out on agricultural property where the debtor intended to remove the agricultural designation prior to the loan closing. The title company that closed the loan did not make certain that the designation was removed and the loan was permitted to close. In 2011 the lender began foreclosure proceedings in state court. The debtor gave notice of a possible violation in September 2011 that the loan violated the home equity laws in her responses to the in rem proceedings. The debtor filed for Chapter 11 in October 2011 and removed the *in rem* proceedings in state court to the bankruptcy court. The lender did not respond to the allegations made in the in rem proceedings within sixty days. The lender moved to lift the automatic stay to allow the state court proceedings to proceed. The court granted adequate protection by payment of the taxes and insurance into a deposit account but denied lifting the stay. The bankruptcy case was later converted to Chapter 7.

Then in January 2012 the lender filed a complaint to determine non-dischargeability of debt based on actual fraud and false pretenses under 11 U.S.C. § 523(a)(2)(A) and the use of a materially false financial statement in connection with a home equity loan under 11 U.S.C. § 523(a)(2)(B). The complaint's reference to the affidavit was a reference to the closing affidavit where the borrower stated that the property was not agricultural use. The dischargeability complaint did not allege fraud involving the home equity loan based on Tex. Const. Art. 16, §50(a)(6)(C). The lender's complaint involved the debtor's representation that it was involved in litigation in probate court over the validity of the deed transferring the property into her name where she had forged her husband's name to his will and administered his estate by conveying the real property to herself that she secured the home equity lien. The probate litigation voided title in her name but preserved the home equity lien and reconveyed the same property to her. The bankruptcy court in an earlier opinion capped her homestead exemption at $146,500 since the reconveyance of the property to her in 2009 was within 1,215 days of the bankruptcy filing. *In re Shankles*, 11-43075, 2013 WL 5348879 (Bankr. E.D. Tex. Sept. 23, 2013). However, the

lender's home equity lien had not been invalidated and the debtor had not taken any action to invalidate the lien prior to the lender's complaint under Section 523 other than to allege a violation in her response to the state court in rem proceedings.

The debtor responded to the dischargeability complaint by filing a counterclaim that the home equity lien was invalid because it was taken against property designated as agricultural and that she could assert its objection defensively more than four years after the closing based on Section 16.069(a) of the Texas Civil Practices and Remedies Code. The Chapter 7 trustee filed an objection to the bank's proof of claim and intervened in the adversary proceeding. The Chapter 7 trustee chose not to seek a refund of payments made against the loan because that claim was barred by the four year statute of limitations. The court consolidated the in rem proceedings removed to state court, the objection to claims and the adversary proceeding into one proceeding.

The bankruptcy court found that the debtor's future intent to remove the agricultural exemption, even if false, failed to satisfy the requirements of fraud under 11 U.S. C. § 523(a)(2)(A). But the court did not address whether she should have been barred from making an assertion contrary to her affidavit if she had the opportunity to verify the contents of the affidavit. This basis was cited by the bankruptcy court in the case of *In re Erickson v. Wells Fargo Nat. Ass'n*, 09-11933-CAG, 2011 WL 1599657, at *5 (Bankr. W.D. Tex. Apr. 27, 2011) where the court estopped the debtor from attempting to change his homestead affidavit. The bankruptcy court was also cited to the case of *Sosa v. Long Beach Mortg. Co.*, 03-06-00326-CV, 2007 WL 1711788, at *3 (Tex. App.—Austin June 12, 2007, no pet.) where the court estopped a debtor from attempting to change the designation of the property after making the designation publicly available. The bankruptcy court declined to address the either *Erickson* or *Sosa* in her *Shankles* opinion.

The court held that the lien was taken on agricultural property which was known at the time of the loan and there was no reliance on the debtor's affidavit that the property was not agricultural. The court held that the lien was incurable as a matter of law and that no action was taken within sixty days after the notice was made to cure the violation.

This case shows the danger of the home equity lender choosing to use the bankruptcy forum to determine the validity of its lien and taking aggressive action in the bankruptcy court based on a home equity lien with a constitutional defect – even if notice of the violation and the action to invalidate the lien is made more than four years after the closing. Not only could the lender lose its lien it could potentially be responsible for loan payments made by the debtor against the loan. The bank's lien had not been forfeited by the court and the debtor had no personal liability on the debt. The bank had not been damaged because its lien was still valid. Its complaint for fraud against the debtor permitted the debtor to invalidate the lien because the bankruptcy court permitted constitutional violations to be asserted more than four years after the closing. Had the lender taken no action whatsoever -- never moved to lift the stay, filed a proof of claim or filed a complaint for non-dischargeability of debt under Section 523 of the Bankruptcy Code and waited for the debtor's discharge to be granted then its lien would have

passed through the estate unaffected and it could have enforced its lien in state court and the debtor's attempt to raise a constitutional violation would be barred by the four year statute of limitations. *Jones v. Bank of New York Mellon,* 2015 WL 300495, at *10 (S.D. Tex. Jan. 22, 2015), *reconsideration denied,* CIV.A. H-13-2414, 2015 WL 1737402 (S.D. Tex. Apr. 16, 2015); *Scott v. JP Morgan Chase Bank, N.A.*, 4:13-CV-3211, 2014 WL 4167980, at *7 (S.D. Tex. Aug. 19, 2014); *Taylor v. U.S. Bank Nat. Ass'n.*, 2014 WL 1703936, at *3 (S.D. Tex. Apr. 29, 2014).

A creditor seeking to deny the dischargeability of debt based on a home equity loan should only do so when there is proof that they have been damaged by the debtor's fraud. In *Shankles* the debtor was untruthful but her actions but her actions did not cause damage to the bank resulting in the loss of its lien.

VII. FINAL JUDGMENT

Judicial Foreclosure. If the home equity lien is upheld some creditors are choosing to have a final judgment entered by the bankruptcy court that affirms the lien and orders foreclosure through the state court procedures under the Texas Rules of Civil Procedure.

The Fifth Circuit in *In re Erickson,* 566 Fed. Appx. 281, 283-84 (5th Cir. 2014) found no error in the district court permitting a judicial foreclosure of the home equity lien even though there was no contractual provision in the deed of trust allowing for the procedure. The court found that the judicial foreclosure and the ability of a trustee to foreclose under the power of sale in a deed of trust are separate and distinct remedies, either of which the trustee may elect to pursue. *Thurman v. Fed. Deposit Ins. Corp.,* 889 F.2d 1441, 1445 (5th Cir.1989); *Kaspar v. Keller,* 466 S.W.2d 326, 328 (Tex.Civ.App.-Waco 1971); *Am. Nat. Ins. Co. v. Schenck,* 85 S.W.2d 833, 839 (Tex.Civ.App.-Amarillo 1935).

Other courts have followed suit that a home equity lender can elect between a judicial foreclosure and non-judicial foreclosure. *Huston v. U.S. Bank Nat'l Ass'n,* 988 F.Supp.2d 732 (S.D.Tex.2013); *Soin v. JPMorgan Chase Bank, N.A.*, CIV.A. H-14-1861, 2014 WL 4386003, at *3 (S.D. Tex. Sept. 4, 2014).

The court in *Steptoe v. JPMorgan Chase Bank, N.A.*, 01-14-00813-CV, 2015 WL 1263128, at *3 (Tex. App.—Houston [1st Dist.] Mar. 19, 2015, no. pet. h.) followed the *Erickson* decision and held that when a security instrument in a home-equity loan contains a power of sale provision then the lender has a choice of remedies and can file a counterclaim for judicial foreclosure in a suit initiated by the borrower.

VIII. APPEALS

A. Notice of Appeal. The deadline to file an appeal from the bankruptcy court to the district court is 14 day after the order from which the appeal is taken. 28 U.S.C. § 158(c)(2)(appeal must be taken within time provided by Fed. R. Bank. P. 8002); Fed. R. Bankr. P. 8002(a)(1) (Notice of appeal must be filed within 14 days of entry of judgment, order or

decree); *Smith v Gartley, (In re Berman – Smith),* 737 F. 3d 997, 1003 (5th Cir. 2013)(Time limit specified in Fed. R. Bankr. P. 8002 is jurisdictional).

Under Bankruptcy Rule 8002(d)(2), a bankruptcy court may not extend the time to file a notice of appeal if the judgment, order, or decree appealed from: (A) grants relief from an automatic stay under § 362, 922, 1201, or 1301 of the Code. In the case of *In re Erickson,* 566 Fed. Appx. 281, 282-83 (5th Cir. 2014), the bankruptcy court imposed the automatic stay during the adversary proceeding over the validity of the home equity lien. During the pending adversary proceeding the debtor was issued the discharge and the bankruptcy case was closed. These latter events served to lift the automatic stay. The bankruptcy court issued a final judgment in the adversary proceeding granting relief from the automatic stay to allow the judicial foreclosure of the home equity lien. The debtor failed to timely appeal. The lender argued that under Bankruptcy Rule 8002(d)(2) the bankruptcy court could not extend the time to file a notice of appeal since the final judgment granted relief from the automatic stay. The bankruptcy court extended the time to file an appeal under Bankruptcy Rule 105. The district court affirmed.

The Fifth Circuit in *In re Erickson*, 566 Fed. Appx. 281, 282-83 (5th Cir. 2014) held that the bankruptcy court erred in extending the deadline to appeal based on 11 U.S.C. §105.[9] The Fifth Circuit found other grounds to uphold the late filing more than fourteen days and found that the failure to file the appeal to the district court on time "was the result of excusable neglect." When the debtor failed to timely appeal to the Fifth Circuit the court found that the time to appeal was timely and extended to 150 days because the district court did not issue a final judgment with its opinion.[10]

B. Supercedeas Bond. A judgment debtor may suspend enforcement of a judgment by good and sufficient supercedeas bond. Tex. R. App. P. 24.1. When the judgment is for the recovery of an interest in real property, the trial court determines the type and amount of security the debtor must post and the amount of that security must be at least the value of the property interest's rent or revenue. Tex. R. App. P. 24.2(a)(2)(A). In *Wickliffe v. Tooley*, 05-15-00696-CV, 2015 WL 5013691, at *1-2 (Tex. App.—Dallas Aug. 25, 2015, no. pet. h.) the court held that under Tex. R. App. P. 24.2(a)(2)(A), the property's overall value is not a relevant factor in setting the bond. Rather, the only relevant factor is the value of the property interest's *rent or revenue*. The court set the bond at $5,400 based on rental value of $350 to $500 a month over twelve months. The court found that trial court abused its discretion in setting the bond at $75,000. The court found that the trial court did not abuse its discretion in requiring a corporate surety bond because no complaint was made at the trial court about that ruling.

[9] "[I]f the bankruptcy court found that it had discretion to extend the time to appeal under 11 U.S.C. § 105 in the face of an effective order lifting the automatic stay, and thus to abridge Federal Rules of Bankruptcy Procedure 8002 and 9006 expressly to the contrary, it was wrong."[9] *In re Erickson*, 566 Fed. Appx. 281, 283 (5th Cir. 2014).

[10] The court held that the appeal was timely under Federal Rule of Civil Procedure 58, Federal Rule of Appellate Procedure 4(a)(7), and Federal Rule of Bankruptcy Procedure 7058 because the district court did not enter judgment on a separate document. In such circumstances, the court found that the filing of a notice of appeal up to 150 days after the final "order" entered without a separate document was timely.

The trial court must lower the amount of security required by statute if posting a bond, deposit, or security in the amount required is likely to cause the judgment debtor substantial economic harm. Tex. R. App. P. 24.2(b). A debtor can file an affidavit that they have no assets and the creditor can contest the affidavit. Tex. R. App. P. 24.2(c)(2). If the lender cannot controvert the affidavit then the debtor's affidavit will stand. *In re Erickson*, 09-11933, 2012 WL 4434740, at *13 (W.D. Tex. Sept. 24, 2012), *aff'd*, 566 Fed. Appx. 281 (5th Cir. 2014)(debtor moved to stay enforcement of judgment under Fed. R. Civ. P. 62(f) claiming $1,000 in assets; district court approved supercedeas bond of $500 as it did not exceed 50% of the of debtor's assets).