No. _______________

In the Supreme Court of the United States

CHARLES J. HAWKINS,
*Petitioner,*
v.

JP MORGAN CHASE BANK, N.A.,
*Respondent.*

*On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit*

# PETITION FOR A WRIT OF CERTIORARI

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## QUESTION PRESENTED

The Texas Constitution says one thing. The Fifth Circuit says another. There are no cases on point. Many Texans stand to lose their homes as a result. The precise issue was already under expedited review in a state multidistrict appeal bound for the Texas Supreme Court. Yet the Fifth Circuit refused to either certify the question to the Texas Supreme Court (as it did contemporaneously in another case involving the same provisions of the Texas Constitution) or else place the case in abeyance.

When the Court of Appeals took away important state constitutional rights from Texans and refused to defer to the Texas courts, did it misapply *Erie*?

## PARTIES TO THE PROCEEDINGS

Petitioner Charles J. Hawkins, an individual, was an appellant in the court below. Respondent JP Morgan Chase Bank, N.A. was the appellee.

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## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is unpublished but is available at 2015 WL 3505353. Pet. App. 1a. The underlying order of the United States District Court for the Western District of Texas is likewise unpublished but is available at 2015 WL 3505353. Pet. App. 11a.

## JURISDICTION

This Court has jurisdiction under 28 U.S.C. § 1254(1). The judgment of the Fifth Circuit was entered June 4, 2015.

## TEXAS CONSTITUTIONAL PROVISIONS AND OFFICIAL AGENCY INTERPRETATIONS

**Tex. Const. art. XVI, § 50(a)(6)(L):**

> The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for:
>
> (6) an extension of credit that:
>
> (L) is scheduled to be repaid:
>
> (i) in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment ...

**Tex. Const. art. XVI, § 50(a)(6)(u):**

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

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

**7 Tex. Admin. Code § 153.1(1):**

Balloon--an installment that is more than an amount equal to twice the average of all installments scheduled before that installment.

**7 Tex. Admin. Code § 153.11(3):**

For a closed-end equity loan to have substantially equal successive periodic installments, some amount of principal must be reduced with each installment. This requirement prohibits balloon payments.

**7 Tex. Admin. Code § 153.16:**

. . .

(2) An equity loan must amortize and contribute to amortization of principal.

. . .

(4) The scheduled installment amounts of a variable rate equity loan must be:

> (A) substantially equal between each interest rate adjustment; and
>
> (B) sufficient to cover at least the amount of interest scheduled to accrue

between each payment date and a portion of the principal.

(5) An equity loan agreement may contain an adjustable rate of interest that provides a maximum fixed rate of interest pursuant to a schedule of steps or tiered rates or provides a lower initial interest rate through the use of a discounted rate at the beginning of the loan.

## INTRODUCTION

The Texas Constitution bars balloons and payment volatility in the specific case of home equity mortgage loans. Tex. Const. art. XVI, § 50(a)(6)(L) ("Section 50(a)(6)"); 7 Tex. Admin. Code §§ 153.1(1) (2015), 153.11 (2008), 153.16 (2004). The big banks ignored that prohibition, using the lure of federal foreclosure prevention programs to put thousands of Texans into volatile payment schemes with balloons and payment spikes. *See also Starkey et al. v. Bank of America, N.A.*, No. 4:12-CV-02084 (S.D. Tex. 2012) (identical to this case). No one disputes that such schemes cannot be included in the loan on the day the loan is made; the issue is whether they can be inserted the day after, by amendment. As it stands now, Texans with loans that were amended after closing will be obliged to make balloon payments years or decades from now despite the fact that those borrowers have a state-constitutional right to "substantially equal" payments for the duration of their loans. Because the Texas mortgage market is dominated by national entities like Chase, who remove virtually every diversity mortgage case to

federal court, the Fifth Circuit's misuse of *Erie* has given the big banks a bypass around the requirements of the Texas Constitution. *See Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938).

No Texas appellate court has ever interpreted the Texas Constitution to allow home equity loans to have volatile payment schemes, which are in effect ticking foreclosure time bombs because they create payment shocks. The only decided case remotely on point is a Fifth Circuit case that stresses the profound importance of "substantially equal" payments for the entire life of the loan. *Cerda v. 2004-EQR1 L.L.C.*, 612 F.3d 781, 789 (5th Cir. 2010).

That said, the precise issue whether the ban on volatile payment schedules extends past the closing date of what is typically a 30-year mortgage is currently under expedited review in an intermediate Texas appeals court, in the form of a class action within a statewide MDL proceeding. Pet. App. 54a (MDL order); *see Graze et al. v. Nationstar Mortg., LLC*, No. 03-15-00329-CV (Tex. App. - Austin 2015) ("Nationstar MDL")[1]; Tex. R. Jud. Admin. 13.9(c) (mandating expedited appellate review of MDL orders and no appellate-district transfers of such cases). The Fifth Circuit, however, instead of certifying the issue to the Texas Supreme Court as it has done in other important, difficult cases, or else staying its hand while the Nationstar MDL appeal

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[1] *Events and documents accessed at:* http://www.search.txcourts.gov/Case.aspx?cn=03-15-00329-CV&coa=coa03.

works its inevitable way up to the Texas Supreme Court, as Mr. Hawkins requested below, relied on one irrelevant 2014 Texas Supreme Court decision to legalize volatile payment schedules. *See Sims v. Carrington Mortg. Servs., L.L.C.*, 440 S.W.3d 10, 12 (Tex. 2014) (Pet. App. 32a).

The *Sims* decision emphatically does not overrule the Texas Constitutional ban on volatile mortgage payments. The Fifth Circuit simply read the case wrong. If anything, the decision reaffirms the importance of the ban since the borrowers' loan was restructured precisely to give them permanently lower payments that remained fixed through maturity. Yet because mortgage servicing is now solely the province of big national banks, the Fifth Circuit's profound misreading of exactly one Texas Supreme Court case legalizes an abusive lending practice that the big lenders perpetrated on thousands of Texans. These people stand to lose their homes years or decades from now when large payment obligations suddenly come due -- just what the Texas Constitution was designed to prevent. The Fifth Circuit's misapplication of *Erie* gives the big banks a federal safe-haven for abusive lending practices until the Texas Supreme acts. In the meantime, Texans like Mr. Hawkins, denied a state forum to redress their grievances, are losing their state-constitutional rights and their homesteads.

## STATEMENT OF THE CASE

### A. Tex. Const. art. XVI, § 50(a)(6) generally

Owing to Texas's history as a debtor's haven, foreclosure on homesteads is regulated by the Texas Constitution. *See* Pet. App. 50a (Tex. Const. art. XVI, § 50 (interpretive comments)). Texas refused to legalize home equity loans until 1997 because they involve collateralizing the homestead for the sake of the things (cars, boats, coats) borrowers buy with such loans. Texas, in finally opening up its market, did what it could to minimize the temptations and dangers. *Id.* The 1997 Constitutional amendment placed onerous restrictions on every aspect of such loans, from their initial solicitation to the physical return of the paper note upon cancellation. *See generally* Ann Graham, *Where Agencies, the Courts, and the Legislature Collide: Ten Years of Interpreting the Texas Constitutional Provisions for Home Equity Lending*, 9 Tex. Tech. Admin. L. J. 69 (2007); Charles C. Boettcher, *Taking Texas Home Equity for a Walk, But Keeping it on a Short Leash!*, 30 Tex. Tech. L. Rev. 197 (1999).

In Section 50(a)(6) parlance, these loans are called "extensions of credit," a phrase strictly synonymous with "home equity loan." The restrictions are many and onerous, and the penalty for lender noncompliance is forfeiture of the loan unless timely cured according to a specific protocol. *See* Tex. Const. art. XVI, § 50(a)(6)(Q)(x). Owing to how the various restrictions work in practice, Texas home equity loans typically become the primary (first-lien) mortgage, supplanting all prior loans.

Texas home equity loans, strikingly, also act as a one-way ratchet: once a home has been collateralized by a home equity loan, every subsequent loan collateralized by that homestead must also be a home equity loan, subject every time to the gauntlet of requirements for such loans. *See* Tex. Const. art. XVI, § 50(f). Indeed, after 2009, distressed borrowers found themselves stuck with loans they could not refinance because the borrowers would have to *pay cash money into the refinance* to get the loan-to-value ratio back down to the mandated 80% maximum. *See* 2013 Tex. House Comm. Hearing Video at mins. 33:00-37:00 (finance comm. chair comments regarding proposed amendment to soften 80% loan-to-value requirement).[2] Section 50(a)(6) is a paternalistic law that in individual cases leads to hardship for the sake of the broader policy goal of minimizing the number of foreclosures. *See* Boettcher *supra*, at 261. Balloons and teaser payments are illegal because they afford the borrower low payments initially followed by a punch to the face later -- the opposite of protection from foreclosure. *See* Graham, *supra*, at 84.

**B. Subsection 50(a)(6)(L) specifically**

Texas home equity mortgages cannot have volatile payment schedules. They must be "scheduled to be repaid . . . in substantially equal . . .

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[2] *Official video and materials accessed at* http://www.house.state.tx.us/video-audio/committee-broadcasts/committee-archives/player/?session=83&committee=270&ram=13050609270

installments." Tex. Const. art. XVI, § 50(a)(6)(L). Breaking that down, the payments must be:

- *scheduled* -- meaning the upfront establishment of a fully-amortizing payment scheme, *see* 7 Tex. Admin. Code § 153.11;
- *repaid* with each installment -- meaning some principal must be included with every payment, *id.*; 7 Tex. Admin. Code § 153.16(2); and
- *substantially equal* in payment amount -- any changes must be gradual so that a borrower doesn't face payment shocks or surprises along the road to paying off the loan and freeing the homestead from debt, *id.*

As a logical result of these several requirements, so-called "teaser" periods of interest-only payments are illegal, as are the resulting payment spikes that result therefrom, and, more obviously, balloons. *See generally Cerda*, 612 F.3d at 790-92.

None of the above is controversial. But what the Fifth Circuit has done in misapplying *Erie* is declare, for the benefit of Chase and other Texas-diverse big banks, that the prohibition on volatile payment schemes evaporates the day after the loan is made. Thus, so long as the loan papers as of the date of closing don't schedule a balloon or interest-only payments, Section 50(a)(6) has been satisfied, and the parties are thereafter free to ditch the original, substantially-equal payment scheme. It's so easy, it's

as if the prohibition on volatile payment schemes never existed.

It turns out that some of the Section 50(a)(6) requirements do apply solely at origination. *See*, *e.g.*, Tex. Const. art. XVI, § 50(a)(6)(B) ("on the date the extension of credit is made"). But Section 50(a)(6)(L) and others are conspicuously perpetual and non-waivable. *See*, *e.g.*, Tex. Const. art. XVI, § 50(a)(6)(D) (judicial foreclosure required); Tex. Const. art. XVI, § 50(a)(6)(F) (not a line of credit); Tex. Const. art. XVI, § 50(a)(6)(K) (only one home equity loan at a time). If it were otherwise, these latter prohibitions would be toothless. The ban on balloons, for instance, is a joke if the loan can be modified after origination to lower the monthly payment drastically but recapture everything with a large balloon due at maturity, as occurred with Mrs. Brooks in the remanded portion of this case. The ban on interest-only payments would be pointless if an unsophisticated borrower in distress could bargain payment equality away in order to get lower payments for a time followed by a payment spike later, as happened with Mr. Hawkins. Borrowers accept teaser payments because they think their ship will come in or the bubble will never burst, but Section 50(a)(6) casts a jaded eye at loans with scheduled payment shocks.

**B. The Hawkins and Brooks loans**

Mr. Hawkins took out a home equity loan in 2005 and defaulted during the recession. Chase both restructured and modified his loan in a single agreement. Pet. App. 13a. The restructuring added $15,873 in past-due amounts back into the note, but

it didn't preserve the original note's substantially-equal payment scheme. The separate *modification* established a new repayment scheme with five years of interest-only payments of $1,348 followed by a $500 spike in the payments thereafter. Mrs. Brooks's home equity loan was likewise restructured, thereby adding $45,591 back into the note, but her modified payment schedule that reamortized the principal gave her very low payments for twenty-odd years followed by a whopping $146,000 balloon at maturity. Pet. App. 13a.

**C. Proceedings below**

After Chase insisted to Mr. Hawkins that the restructuring aspect of his loan had been illegal and that Chase couldn't go back and fix it -- meaning Hawkins was locked into the $500 payment spike down the road -- he, Mrs. Brooks, and another borrower filed a proposed class action asserting that the both the restructurings that plowed more money into the note and the modified payment schemes that created payment shocks were illegal. The district court dismissed Hawkins for failure to state a claim, but it agreed with Mrs. Brooks that her balloon violated Section 50(a)(6)(L). Pet. App. 25a-26a. All plaintiffs appealed.

Another case implicating solely the issue of adding past-due sums back into Texas home equity loans reached the Fifth Circuit ahead of this case. The Fifth Circuit certified that issue to the Texas Supreme Court and then placed this case in abeyance. *See Sims v. Carrington Mortgage Servs., L.L.C.*, 538 F. App'x 537, 547 (5th Cir. 2013). A

decision for the borrowers in *Sims* would have rendered all but superfluous the narrower claim of illegal payment schedules present in this case.

The Texas Supreme Court ultimately approved of what it dubbed "restructurings" that add past-due sums back into the note so long as such restructurings preserve the substantial equality of payments. Pet. App. 32a. That mooted the broader claim asserted by Hawkins, Brooks and Cusick. But when Hawkins' and Brooks's case was taken up again after abeyance (Cusick had only a restructuring), the Fifth Circuit concluded that the *Sims* decision also legalized balloons and interest-only payments that violate substantial payment equality, despite the fact that such modifications to the original note's payment scheme had not been at issue in *Sims*. Pet. App. 1a.

Hawkins and Brooks sought rehearing and either certification to the Texas Supreme Court or else abeyance pending a decision in the state Nationstar MDL case already briefed on an expedited appeal. Pet. App. 54a (MDL order); *Graze*, No. 03-15-00329-CV (Tex. App. - Austin 2015). The Fifth Circuit, however, dismissed Hawkins' claims (Pet. App. 5a-6a) and remanded Brooks's for unrelated reasons (Pet. App. 6a-8a). In the meantime, in an identical proposed class action pending in federal district court in Houston against Bank of America, the district court, at the request of borrowers with the same fact patterns as Mr. Hawkins and Mrs. Brooks, stayed those proceedings pending the outcome in the Nationstar MDL appeal. Pet. App. 29a.

**D. The Texas Supreme Court *Sims* decision**

In *Sims*, the Texas Supreme Court concluded that Section 50(a)(6) allows sums past due under the original loan to be added back into the same loan, assuming that the payments remain substantially equal as a result. Pet. App. 34a, 44a ("Section 50(a)(6) does not forbid a revision of the initial repayment schedule that merely adjusts the regular installment amount"). The Court, adopting the term "restructuring" to describe the process of merely recategorizing money, differentiated a "restructuring" from a true "modification," which actually changes the terms of the original note in some way. The restructuring in *Sims* increased the borrower's principal balance but simultaneously reduced the loan interest rate, giving the borrower a slightly lower payment *from that point forward, all the way to maturity*. The issue was never presented of a modified payment scheme involving balloons or interest-only payments, though the Texas Supreme Court did go out of its way to point out that the substantial payment equality established by the original note had, in fact, been preserved (that is, not "modified") in the restructuring. Pet. App. 34a, 44a.

The *Sims* holding is that a restructuring that capitalizes past-due sums authorized by the original loan does not constitute a new extension of credit. Pet. App. 45a. That is, moving money from the *arrears* category to the *principal* category is not a new loan, but is instead a mere "restructuring" of the existing loan. That is important to lenders because it means that they are not required to go through the many, difficult hoops of Section 50(a)(6)(A)-(Q) each

time they recategorize arrears as principal. That is all *Sims* says, and it has nothing to do with the validity of balloons or interest-only payments.

The Fifth Circuit, however, twisted the logic of *Sims* to say that *any post-closing change to the loan* that does not constitute a new loan (that is, a new "extension of credit") can violate *any provision* of Section 50(a)(6). Pet. App. 5a-6a. Thus, if a restructuring also includes a modification of the original note's substantially-equal payment scheme, that separate *modification* of a particular loan term is rendered immune from Section 50(a)(6), no matter how flagrant the violation may be, and irrespective of whether the provision in question is conspicuously perpetual and non-waivable by its very nature.

**E. The Nationstar MDL**

Nationstar is the sole large servicer headquartered in Texas, and it happens that Nationstar, successor-in-interest to a large portfolio of sub-prime Texas home equity loans made before 2009, routinely modified those loans after 2009 to include interest-only periods followed by very large payment spikes -- spikes so large as to constitute "balloons" within the technical definition contained in the official agency interpretation of Section 50(a)(6)(L). Pet. App. 54a. Undersigned counsel also serves as lead counsel in both the Nationstar MDL and the identical *Starkey v. Bank of America* class action in Houston federal court. With many thousands of loans believed to be at issue in the several cases, the state MDL has been hurried to the extent possible to take advantage of the requirement

that appeals of MDL cases be afforded expedited review plus immunity from inter-district transfer.

## REASONS FOR GRANTING THE PETITION

The twin aims of the *Erie* rule are discouragement of forum-shopping and avoidance of inequitable administration of the laws. *Hanna v. Plumer*, 380 U.S. 460, 468, 85 S. Ct. 1136, 14 L. Ed. 2d 8 (1965). "It would be unfair for the character of result of a litigation materially to differ because the suit had been brought in a federal court." *Id.* at 467.

The Fifth Circuit's *Erie* determination legalizes a flagrant abuse of Texas Constitutional lending laws to favor national banks who can choose between the state and federal forums. That imperils the homestead of every affected Texan with who can't defeat diversity -- meaning most Texas home equity borrowers. Thousands of these borrowers face catastrophe in the years ahead when they can't meet a payment spike or balloon that will come due. For many of these people, the payment will come due at maturity, just when the Texas Constitution affords them the right to pay the loan off with one final, regular installment. For the big banks to win this kind of pass, there must be something clear and compelling in the decided cases to justify it, but there is not. The Fifth Circuit has simply misread -- fundamentally and profoundly -- one Texas Supreme Court case, and in so doing tilted the playing field to favor Chase and other national banks who have the luxury of removing nearly every case to federal court.

In 1997, when Section 50(a)(6) was adopted by popular vote in Texas, the mortgage industry looked very different than it does today. The 21st Century saw the rise of mass mortgage securitization and the related consolidation of mortgage servicing into a few national entities such as Chase and Bank of America. As a result, the Texas federal courts sitting in diversity came to decide most cases arising under the mortgage provisions of the Texas Constitution. That should put the onus on the Fifth Circuit to tread lightly in cases of doubt, in deference to state judicial processes. Yet the Fifth Circuit has been anything but consistent in the deference it affords to Texas courts in Section 50(a)(6) cases.

In one notable instance where the Fifth Circuit waded deep into Section 50(a)(6) waters, it disturbed the state-federal balance of judicial power. In 2013, the Fifth Circuit declared that a residual statute of limitations in a session law (as opposed to a constitutional provision) trumped specific wording in Section 50 that indicated that limitations does not apply to Section 50(a)(6) claims. (Section 50(a)(6) also has its own cure process for lender violations, and the cure provisions apply for the life of the loan.) *See Priester v. JP Morgan Chase Bank, N.A.*, 708 F.3d 667, 673 (5th Cir. 2013), *cert. denied* 134 S. Ct. 196, 187 L. Ed. 2d 256 (2013). Along the way, the court reasoned that ordinary borrowers who aren't provided with the lengthy, prescribed Section 50(a)(6) disclosures prior to closing are themselves at fault for not knowing that they didn't get the disclosures, the requirement for whose provision is set out *in the disclosures*. *Id.* at 677. That paved the way for the court to declare that borrowers ought to

know what they don't know at the time they put their homesteads up as collateral, and that four years later, they lose the right to sue over what they only learned long after the closing at which they were not given a list of their rights.

It has taken two years of concerted effort by Texas borrowers to dodge diversity removal and propel that important issue up to the Texas Supreme Court, a delay that has led to the ratification of striking Section 50(a)(6) violations by the mere passage of time. *See Wood v. HSBC Bank U.S.A., N.A.*, No. 14-0714 (Tex. 2014) (briefing nearly complete).[3] These include situations where borrowers had two home equity loans on the same property, a scenario so patently illegal that the borrowers could not extricate themselves from the loans because title companies refused to insure a curative consolidating loan. *See, e.g.*, *McDonough v. JPMorgan Chase Bank, N.A.*, No. 3:12-CV-189, 2013 WL 1966930, at *1 (S.D. Tex. 2013); *see* Graham, *supra*, at 79. That is one instance where Fifth Circuit's *Erie* determination in an area of uniquely Texas Supreme Court authority has given the national banks a get-out-of-jail-free card for every claim that has expired owing to limitations. If the Texas Supreme Court ultimately disagrees with *Sims*, the Fifth Circuit's *Erie* determination in *Priester* will have harmed untold numbers of Texans whose vital claims died a premature death in federal court.

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[3] *Accessed at:* http://www.search.txcourts.gov/Case.aspx?cn=14-0714&coa=cossup.

In other instances, including earlier proceedings in this case, the Fifth Circuit has wisely deferred to the Texas Supreme Court. It did so soon after Section 50(a)(6) was adopted. *See, e.g., Doody v. Ameriquest Mortgage Co.*, 242 F.3d 286, 290 (5th Cir. 2001). It did so concerning whether adding past-due sums to the loan is a new loan or just a "restructuring" of the old loan. *See Sims,* 538 F. App'x at 547. It did so very recently, while this case was pending, concerning whether the requirement of return of the cancelled note actually means what it says. *Garofolo v. Ocwen Loan Servicing, L.L.C.*, No. 14-51156, 2015 WL 3561295, at *5 (5th Cir. June 9, 2015).

The Fifth Circuit did not certify the questions presented in the 2011 case that explored Section 50(a)(6)(L)'s requirement of substantially-equal payments, but the dissenting judge who argued for certifying questions in that case sat on both subsequent panels that did certify important Section 50(a)(6) questions. *Cerda*, 612 F.3d at 797 (Haynes, J. dissent). The *Cerda* court's discussion of Section 50(a)(6)(L) is not controversial in merely amplifying on what Section 50(a)(6)(L) and the official agency interpretations say, but the dissenting judge's views on the wisdom of deciding Section 50(a)(6) issues have obviously gained traction.

The Fifth Circuit should not have decided this case on the merits, but having done so, its analysis is too cursory and opaque given the thousands of ticking foreclosure time bombs effectively legalized thereby. The upshot of the Fifth Circuit's decision is that a practice that logically has to be illegal for the

life of the loan can be rendered legal the day after closing -- the balloon due at maturity, for instance, which could not have been in the loan documents at closing, can be inserted into those documents as a "modification" the day after. And even if the Texas Supreme Court ultimately does accept that nettlesome proposition, it is still ill-advised for the federal courts to have done so first. *Sims* did not do it, and the Texas Constitution does not do it. Mr. Hawkins should be given the news by his home-state high court.

## CONCLUSION

On behalf of potentially thousands of Texans on whose behalf Hawkins brought this case, and who face mortgage payment shocks in the years and decades ahead, Hawkins asks that the petition for a writ of certiorari be granted and that the issue in this case be certified to the Texas Supreme Court or else that this case be placed in abeyance while the Texas appeals courts decide the central issue in the pending, identical Nationstar MDL appeal.

Respectfully submitted,

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United States Court
of Appeals
Fifth Circuit
**FILED**
June 4, 2015
Lyle W. Cayce
Clerk

**IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT**

No. 13-50086

CHARLES J. HAWKINS, on behalf of himself and all others similarly situated; WILLIAM J. CUSICK, on behalf of himself and all others similarly situated; MICHELLE E. CUSICK, on behalf of herself and all others similarly situated; MARIA C. BROOKS,
Plaintiffs - Appellants

v.

JP MORGAN CHASE BANK, N.A.,
Defendant - Appellee

Appeal from the United States District Court
for the Western District of Texas
USDC No. 1:12-CV-892

ON PETITION FOR REHEARING

Before STEWART, Chief Judge, and SOUTHWICK and COSTA, Circuit Judges.

PER CURIAM:[*]

IT IS ORDERED that the petition for panel rehearing is GRANTED and the opinion previously filed in this case, *Hawkins v. JP Morgan Chase Bank, N.A.*, No. 13-50086, 597 F. App'x 287, 2015 WL 1142804, is WITHDRAWN. The following opinion is substituted therefor:

This case involves Texas home equity loan restructurings that capitalized past-due interest, fees, taxes, and escrow into the principal of Appellants' home equity loans. Appellants allege the restructurings were actually extensions of credit, which would require compliance with Article XVI, Section 50(a)(6) of the Texas Constitution. The Texas Supreme Court recently answered this question, holding that transactions of this sort are loan modifications that do not require compliance with Section 50(a)(6), unless the restructuring "involve[s] the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note." *Sims v. Carrington Mortg. Servs., L.L.C.*, 440 S.W.3d 10, 17 (Tex. 2014). Because it is unclear on our record whether Appellant Maria C. Brooks's restructuring involved an increase in the obligations created by the original note via a balloon payment, we VACATE the judgment of the district court and REMAND as to her claim. Because the remaining restructurings did not involve satisfaction and replacement of the

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* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

original notes, any increase in obligations under the original notes, or any advancement of new funds, we AFFIRM the dismissal of those claims.

I

Maria C. Brooks (Brooks), Charles J. Hawkins (Hawkins), and William J. Cusick and Michelle E. Cusick (the Cusicks) on behalf of themselves and all others similarly situated (collectively, Appellants) brought suit in federal district court against JPMorgan Chase Bank, N.A. (JPMC) alleging various violations of Article XVI, Section 50(a)(6) of the Texas Constitution (Section 50(a)(6)). JPMC was servicing Appellants' loans, each of which originated with third-party lenders. The crux of Appellants' claims is that their transactions with JPMC were refinances of their home equity loans that required compliance with various provisions of Section 50(a)(6), instead of modifications that would not require Section 50(a)(6) compliance as JPMC contends.

Hawkins obtained a $320,000 home equity loan from Town & Country Credit Corporation in 2005. Hawkins defaulted on this loan some time before February 18, 2009. Hawkins and JPMC entered into an agreement to modify the loan in a manner that would capitalize past-due interest, property taxes, and insurance into the principal of the loan in the amount of $15,873.49, and the term of the loan was extended to April 1, 2035. The modification also allowed interest-only payments during the first five years following the modification. At the conclusion of this five-year period, JPMC would re- amortize the loan.

The Cusicks obtained a $268,000 home equity loan from CTX Mortgage Company, LLC in 2005. The Cusicks defaulted on this loan before April 1, 2009. The Cusicks and JPMC entered into an agreement to modify the loan that would increase the amount payable under the loan to $291,834.39. The increase represented a capitalization of past-due interest and escrow on the loan and did not alter the maturity date of the loan.

Brooks obtained a $190,000 home equity loan from Long Beach Mortgage Company in 2004. Brooks defaulted on this loan some time before March 1, 2012. Brooks and JPMC agreed to modify the loan under the Home Affordable Modification Program. Unpaid interest and escrow were to be capitalized into the principal of the loan in an amount more than $45,590.91, and the modification allowed for a balloon payment of $146,102.76 due at the end of the loan term on June 1, 2034.

JPMC brought a motion to dismiss for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6), which the district court granted. Appellants filed this appeal.

II

"We review de novo a district court order granting a Rule 12(b)(6) motion to dismiss for failure to state a claim and may affirm on any basis supported by the record." Asadi v. G.E. Energy (USA), L.L.C., 720 F.3d 620, 622 (5th Cir. 2013) (citing Torch Liquidating Trust ex rel. Bridge Assocs. v. Stockstill, 561 F.3d 377, 384 (5th Cir. 2009)). To survive a Rule 12(b)(6) motion, a complaint must set out "enough facts to state a claim to relief that is

plausible on its face." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007).

After this appeal was filed, the Texas Supreme Court answered questions certified by this court in a similar case presenting similar claims, Sims v. Carrington Mortg. Servs., L.L.C., 538 F. App'x 537, 547 (5th Cir. 2013). The Texas Supreme Court held that:

> the restructuring of a home equity loan that . . . involves capitalization of past-due amounts owed under the terms of the initial loan and a lowering of the interest rate and the amount of installment payments, but does not involve the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note, is not a new extension of credit that must meet the requirements of Section 50.

Sims, 440 S.W.3d at 17. The Hawkins and Cusick transactions each involved capitalization of past-due amounts under the loan without satisfying or replacing the original note, advancing new funds, or increasing the obligations created by the original note. Thus, the restructurings of these loans were modifications, which do not require compliance with Section 50(a)(6). Id. Therefore, we affirm the dismissal of Hawkins's and Cusicks' claims.

It is unclear from the record, however, whether Brooks's transaction involves an "increase in the obligations created by the original note." Id. at 17. The total payments due after the restructuring

under Brooks's payment schedule equal $247,132.60. Following this schedule, the loan restructuring documents also included a provision stating: "Notwithstanding the foregoing schedule, I agree that unless sooner paid, I will have a final balloon payment in the amount of $146,102.76 due and payable on the New Maturity Date." The district court found this provision to be a balloon payment—an apparent violation of Section 50(a)(6)(L)(i), which requires extensions of credit to be repaid "in substantially equal successive periodic installments."[1]

In Sims, the Texas Supreme Court held that a restructuring capitalizing past-due amounts owed under the initial loan is not an extension of credit requiring Section 50 compliance if the modification does not involve, among other things, "an increase in the obligations created by the original note." 440 S.W.3d at 17. On our record, it is uncertain whether Brooks's modification in fact represents an increase in the obligation created by her original home equity loan. On one hand, it is possible that the final payment does not increase the obligations under the original loan because many of Brooks's monthly payments are not much more than the accumulated interest. On the other hand, it is possible that the modified payment schedule accounts for the entire loan, recapitalization, and interest for the life of the loan, in which case the final payment, if owed in

[1] The Texas Administrative Code, interpreting Section 50(a)(6)(L)(i), states that "[t]his requirement prohibits balloon payments." 7 Tex. Admin. Code § 153.11(3).

addition to the scheduled amounts, may represent an increase in the original obligation.

Although the district court stated that Brooks's restructuring was an apparent violation of Section 50, it relied on a savings clause in JPMC's standard security agreement that allows JPMC to reform loan documents that violate Section 50 by providing written notice to the borrower after JPMC receives notice of the violation. Brooks did not allege she had provided any written notice to JPMC other than via her First Amended Complaint in this case. The district court found the complaint insufficient to count as notice to However, a Texas Court of Appeals recently held, in Wells Fargo Bank, N.A. v. Leath, 425 S.W.3d 525, 532 (Tex. App.—Dallas 2014, pet. denied), that a pleading in a lawsuit can constitute notice that triggers a 60-day lender cure period under Section 50(a)(6)(Q)(x). In Leath, the court held that an answer to a bank's application for foreclosure constituted sufficient notice of a constitutional violation where the answer stated that the loan violated the Texas Constitution by exceeding 80 percent of the value of the property. Id. at 532−33. The Texas Supreme Court denied the petition in Leath.

Because it is unclear on our record whether Brooks's modification represented an increase in the obligation created by her original loan, we VACATE and REMAND the dismissal of Brooks's claim for a determination of whether her modification violated Section 50. On remand, the district court should consider whether, in light of Sims, Brooks's modification violates Section 50(a)(6)(L)(i) and

whether, in light of Leath, Brooks's First Amended Complaint constituted sufficient notice to JPMC. As to the dismissal of Hawkins's and the Cusicks' claims, we AFFIRM.

United States Court
of Appeals
Fifth Circuit
**FILED**
June 4, 2015
Lyle W. Cayce
Clerk

**IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT**

No. 13-50086

CHARLES J. HAWKINS, on behalf of himself and all others similarly situated; WILLIAM J. CUSICK, on behalf of himself and all others similarly situated; MICHELLE E. CUSICK, on behalf of herself and all others similarly situated; MARIA C. BROOKS,
Plaintiffs - Appellants
v.

JP MORGAN CHASE BANK, N.A.,
Defendant - Appellee

Appeal from the United States District Court
for the Western District of Texas
USDC No. 1:12-CV-892

ON PETITION FOR REHEARING

Before STEWART, Chief Judge, and SOUTHWICK and COSTA, Circuit Judges.

J U D G M E N T

This cause was considered on the record on appeal and the briefs on file.

It is ordered and adjudged that the judgment of the District Court is affirmed in part and vacated in part, and the cause is remanded to the District Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that defendant-appellee pay to plaintiffs-appellants the costs on appeal to be taxed by the Clerk of this Court.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

Charles J. HAWKINS, William J. Cusick, Michelle E. Cusick, and Maria C. Brooks, on behalf of themselves and all other similarly situated parties, Plaintiffs,

v.

JPMORGAN CHASE BANK, N.A., Defendant.

CIVIL ACTION NO. 1:12-cv-892

**ORDER**

SAM SPARKS, District Judge.

BE IT REMEMBERED on this day the Court reviewed the file in the above-styled cause, and specifically Defendant JPMorgan Chase Bank, N.A. (JPMC)'s Motion to Dismiss [# 12], Plaintiffs Charles J. Hawkins, William J. Cusick, Michelle E. Cusick, and Marie C. Brooks's Response [# 15], and JPMC's Reply [# 16]. Having reviewed the documents, the governing law, and the file as a whole, the Court now enters the following opinion and orders GRANTING the motion to dismiss.

**Background**

This budding class action calls into question the home equity lending practices of Defendant JPMC. Plaintiffs are borrowers who defaulted on their home

equity loans and subsequently sought modifications[1] from the loan servicer, JPMC. In order to avoid foreclosure, JPMC and Plaintiffs entered into loan modifications. Although each modification was unique, the common thread was an increase in the principal amount of the loans due to the capitalization of past-due interest and past-due escrow [2] on the original loans. Plaintiffs argue JPMC's actions violated the Texas Constitution, and as a result their liens—and those of "at least thousands of class members"—are void as of the date of the modifications. In short, everyone gets a free house.[3]

The Cusicks obtained a $268,000 home equity loan from CTX Mortgage Company, LLC in 2005. At some time prior to April 2009, the Cusicks defaulted on their loan. To avoid foreclosure, the Cusicks and JPMC entered into a loan modification agreement. The agreement increased the amount payable under the loan to $291,834.39, based on past-due interest and past-due escrow on the original loan, and did not alter the maturity date of the loan. Plaintiffs allege this modification violated the Texas Constitution because a home equity loan's principal "is fixed as of the date the home equity loan was first made and

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[1] The parties dispute whether the actual arrangements were "modifications" or "refinances." JPMC also argues the modifications were never finalized, but assumes they were for purposes of the motion to dismiss.

[2] The past-due escrow amounts include payments for items such as property taxes and insurance.

[3] *But see SEC v. Cross Fin. Servs., Inc.,* 908 F.Supp. 718, 720 (C.D.Cal.1995) ("This case illustrates the adage 'if it sounds too good to be true, it probably is.' ").

may only decline thereafter with every payment made until it is paid off or refinanced with a new extension of credit," subject to certain regulatory formalities not followed by JPMC in this case. First Am. Compl. [# 8] ¶ 69.

Hawkins (and his ex-wife) obtained a $320,000 home equity loan from Town & Country Credit Corp. in 2005. At some time prior to February 2009, Hawkins defaulted on the loan. To avoid foreclosure, Hawkins and JPMC entered into a loan modification agreement. The agreement added $15,873.49 to the loan principal, based on past-due interest and past-due escrow. Hawkins also alleges the modification allowed for interest-only payments for a period of five years following the modification.

Brooks obtained a $190,000 home equity loan from Long Beach Mortgage Company in 2004. At some time prior to March 2012, Brooks defaulted on the loan. To avoid foreclosure, Brooks and JPMC entered into a loan modification agreement. The agreement added more than $45,590.91 to the loan principal, based on past-due interest and past-due escrow. Brooks also alleges the modification recited a $146,102.76 balloon payment due at the end of the loan term.

Plaintiffs allege all three "modifications" were actually new extensions of credit (i.e., refinances), and were therefore subject to various requirements under the Texas Constitution, many of which were not met by JPMC. *See* TEX. CONST. art. XVI, § 50(a)(6) (A)(Q). Plaintiffs Hawkins and Brooks further allege their modifications resulted in interest-only and balloon-payment notes, which are

prohibited. *See id.,* § 50(a)(6)(L). JPMC now moves to dismiss, arguing the modifications were, in fact, modifications, and therefore fully compliant with the Texas Constitution.

## Analysis

### I. Motion to Dismiss—Rule 12(b)(6)—Legal Standard

Federal Rule of Civil Procedure 8(a)(2) requires a complaint to contain "a short and plain statement of the claim showing that the pleader is entitled to relief." FED. R. CIV. P. 8(a)(2). A motion under Federal Rule of Civil Procedure 12(b)(6) asks a court to dismiss a complaint for "failure to state a claim upon which relief can be granted." FED. R. CIV. P. 12(b)(6). The plaintiff must plead sufficient facts to state a claim for relief that is facially plausible. *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009); *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal,* 566 U.S. at 678. Although a plaintiff's factual allegations need not establish that the defendant is probably liable, they must establish more than a "sheer possibility" that a defendant has acted unlawfully. *Id.* Determining plausibility is a "context-specific task," and must be performed in light of a court's "judicial experience and common sense." *Id.* at 679.

In deciding a motion to dismiss under Rule 12(b)(6), a court generally accepts as true all factual

allegations contained within the complaint. *Leatherman v. Tarrant Cnty. Narcotics Intelligence & Coordination Unit,* 507 U.S. 163, 164, 113 S.Ct. 1160, 122 L.Ed.2d 517 (1993). However, a court is not bound to accept legal conclusions couched as factual allegations. *Papasan v. Allain,* 478 U.S. 265, 286, 106 S.Ct. 2932, 92 L.Ed.2d 209 (1986). Although all reasonable inferences will be resolved in favor of the plaintiff, the plaintiff must plead "specific facts, not mere conclusory allegations." *Tuchman v. DSC Commc'ns Corp.,* 14 F.3d 1061, 1067 (5th Cir.1994). In deciding a motion to dismiss, courts may consider the complaint, as well as other sources such as documents incorporated into the complaint by reference, and matters of which a court may take judicial notice. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 322, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007).

## II. Application

Before addressing the specific arguments raised by the motion to dismiss, the Court will briefly summarize the relevant law and recent decisions in similar cases.

### A. Home Equity Lending under the Texas Constitution

In 1997, the Texas Constitution was amended, and "Texas became the last state in the nation to permit home-equity loans." *LaSalle Bank Nat'l Ass'n v. White,* 246 S.W.3d 616, 618 (Tex.2007). "Although home-equity lending is now constitutionally permissible, article [XVI], section 50(a)(6) of the Texas Constitution still places a number of limitations on such lending." *Id.* Section 50's

labyrinthine provisions are nearly impossible to navigate, and impose the draconian penalty of total forfeiture upon a noncompliant lender (unless the lender cures within sixty days after being notified by the borrower). *See* TEX. CONST. art. XVI, § 50(a)(6)(Q)(x).

Most relevant to this suit are section 50's provisions concerning modifications and refinances. Plaintiffs argue their modifications were actually "refinances" (termed "extensions of credit") under section 50(f) because they "added or advanced" interest and escrow sums into new loan principal, effectively satisfying and replacing the original note. First Am. Compl. [# 8] ¶¶ 70–71. Refinances are subject to various requirements outlined in section 50(a)(6) (A)-(Q), most notably: (1) the lender must provide the borrower with various disclosures, TEX. CONST. art. XVI, § 50(g); (2) there must be a closing at "the office of the lender, an attorney at law, or a title company," *id.* § 50(a)(6)(N); and (3) the lender and borrower must sign a written acknowledgment of the fair market value of the property on the date the refinance is made, *id.* § 50(a)(6)(Q)(ix). Section 50 also governs repayment of extensions of credit, requiring the debt be repaid "in substantially equal successive periodic installments ... each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment." *Id.* § 50(a)(6)(L).

In addition to the constitutional provisions themselves, there are also regulations interpreting section 50. "Originally, no Texas administrative agency was empowered with rule-making authority

over the [constitutional] amendments [adding section 50]." *Cerda v.2004–EQRl LLC,* 612 F.3d 781, 786 (5th Cir.2010). In spite of this apparent regulatory vacuum, four Texas agencies quickly authored an advisory commentary. *Id.* The Texas Supreme Court subsequently recognized the commentary as persuasive authority. *Id.* (citing *Stringer v. Cendant Mortg. Corp.,* 23 S.W.3d 353, 357 (Tex.2000)). Additional constitutional amendments in 2003 "authorize[d] the legislature to delegate the authority to issue interpretation of the home equity lending provisions," and official regulations have since been codified. *Tex. Bankers Ass'n v. Ass'n. of Cmty. Orgs. for Reform Now (ACORN),* 303 S.W.3d 404, 40708 (Tex.App.-Austin 2010, pet. granted); *see also* 7 TEX. ADMIN. CODE §§ 153.1–153.96.

**B. Recent Cases**

The parties note two recent cases which are particularly instructive because they involve almost identical allegations against different banks. Judge McBryde, at our sister court in Fort Worth, dismissed with prejudice similar claims, finding the alleged refinances were actually modifications, and therefore no constitutional violations occurred. *Sims v. Carrington Mortg. Servs., LLC,* No. 4:12–CV–087–A, 2012 WL 3636884, at *3–6, *10 (N.D.Tex. Aug.23, 2012). This Court finds *Sims* particularly instructive because the Court confronted the exact legal theory primarily advanced here, and found dismissal was warranted. *Id.* at *6 ("Although plaintiffs advance a number of interesting theories to support their claims, they have provided the court no legal

authority that would persuade the court that plaintiffs have stated a plausible claim that capitalizing past-due interest and adding that amount to the principal of a home equity loan violated the Texas Constitution.").

The second case of note is currently pending in this Court before Judge Yeakel. *Hawkins v. Wells Fargo Bank, N.A.,* No. 1:11–cv–00877–LY (W.D. Tex. Jul 6, 2012) (order denying motion to dismiss). In *Hawkins,* Wells Fargo moved to dismiss similar claims brought against it, and the motion was referred to Magistrate Judge Andrew W. Austin. At the time, "[n]o court ha[d] addressed the issue presented," and Magistrate Judge Austin recommended denying the motion to dismiss, based primarily on "factual questions" concerning the status of the loan agreement as a modification or refinance. *Hawkins,* No. 1:11–cv–00877–LY, slip op. at 6–7 (W.D. Tex. June 21, 2012) (Report and Recommendation). In particular, Magistrate Judge Austin declined to look at the actual loan documents at the 12(b)(6) stage. *Id.* at 7. Judge Yeakel accepted the Report and Recommendation and denied the motion to dismiss. *Hawkins,* No. 1:11–cv–00877–LY, slip op. at 1–2 (W.D.Tex. July 6, 2012) (order adopting report and recommendation, denying motion to dismiss). Though Plaintiffs naturally make much of the survival of the *Hawkins* claims, this Court places little weight on what was essentially a decision to defer adjudication on the merits, especially because this Court is free to consider the relevant loan documents in this case, as they are attached to or incorporated into the First Amended Complaint by reference. *See Tellabs,* 551 U.S. at 322.

**C. Plaintiffs' Loans were Modified, not Refinanced**

The critical inquiry in this case, as in *Sims* and *Hawkins,* is whether Plaintiffs' loan agreements were modifications or refinances. Also like *Sims,* the Court is convinced the agreements in this case were modifications, not refinances. *See* 2012 WL 3636884, at *4–6.

The regulations define a modification as follows:

> A modification of a home equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced. A home equity loan and a subsequent modification will be considered a single transaction. The home equity requirements of Section 50(a)(6) will be applied to the original loan and the subsequent modification as a single transaction.

7 TEX. ADMIN. CODE § 153.14(2); *see also* 29 TEX. REG. 10257, 10259 (2004) (to be codified at 7 TEX. ADMIN. CODE §§ 153 .91, .92, .94–96) ("A refinance creates a new loan whereas a modification amends the original loan.").

Plaintiffs' loan modifications meet the regulatory definition of a modification: one or more terms were modified, but the notes were not satisfied and replaced. The modification agreements themselves expressly state as much. The Cusicks' modification, signed by them, states:

> Nothing in this Agreement shall be understood or construed to be a satisfied or release in whole or in part of the Loan Documents. Except as otherwise specifically provided in this Agreement, the Loan Documents will remain unchanged, and the Borrower and Lender will be bound by, and comply with, all of the terms and provisions thereof, as amended by this Agreement.

First Am. Compl. [# 8–2], Ex. B, ¶ 7.

Similarly, Hawkins's modification, signed by him, states:

> ALL OTHER TERMS REMAIN UNCHANGED. Nothing in this Modification shall be understood or construed to be a satisfaction or release in whole or in part of the Loan Agreement. Except as expressly provided in this Modification, the Loan Agreement will remain unchanged and Borrower and Lender will be bound by, and comply with, all of the terms and provisions of the Loan Agreement, as amended by this Modification.

*Id.* [# 8–3], Ex. C, ¶ 7.

Finally, Brooks's modification, signed by her, states:

> [N]othing in this Agreement shall be understood or construed to be a satisfaction or release in whole or in part of the obligations contained in the Loan Documents; and that except as otherwise specifically provided in, and as expressly modified by, this Agreement, the Lender and I will be bound by, and comply with, all of the terms and conditions of the Loan Documents.

Mot. to Dismiss [# 12–4], Ex. D, ¶ 4(F).[4]

The modification documents clearly express the parties' intent to *modify* the loans. All three documents specifically indicate they *do not* satisfy and replace the existing loans. Accordingly, the Court finds Plaintiffs have modified, rather than refinanced, their loans. *See Sims,* 2012 WL 3636884, at *5 ("The court finds that the plain language of the 2009 and 2011 documents shows no intention by the parties to satisfy and replace the original note, causing the 2009 and 2011 transactions to fall within the definition or description of a 'modification' in 7 Tex. Admin. Code § 153.14(2).").

Plaintiffs argue the modifications must be considered refinances in spite of the language in the agreements themselves because they constituted an "advance of additional funds," an action "not

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[4] Brooks's modification agreement was only partially attached to the First Amended Complaint. However, because the document is referenced and is central to Plaintiffs claims, the Court will consider the entire document, attached to the motion to dismiss.

permitted by a modification of an equity loan." 7 TEX. ADMIN. CODE § 153.14(2)(B). The *Sims* court considered and rejected this argument as well, noting "a common-sense reading of the term 'additional funds' would appear to contemplate money provided by the lender to the borrower over and above the amount already loaned, that the borrower could use for other purposes at his or her discretion.... Rolling their past-due interest into the principal in 2009 and 2011 gave plaintiffs no extra cash to do with as they wished." 2012 WL 3636884, at *5.

This Court agrees with the "common-sense reading" advanced in *Sims.* In this case, JPMC did not loan Plaintiffs additional funds and simply give them the option of using those funds to become current on their mortgages. Instead, JPMC agreed to modify the terms of the original loan, as indicated by the paperwork the parties signed. The amount owed by Plaintiffs did not increase under the modifications, which also suggests no additional funds were advanced.[5] This understanding is also consistent with the regulatory treatment of "the original loan and the subsequent modification as a single transaction." 7 TEX. ADMIN. CODE § 153.14(2).

The authorities relied upon by Plaintiffs are not persuasive. First, Plaintiffs argue JPMC essentially "used the wrong form," and therefore the refinance

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5 Of course, the amount Plaintiffs owed eventually increased, as the higher principal continued to accrue interest after the modification. But the modification itself did not immediately increase the amount due to JPMC.

should be treated as a modification. *Adams v. Ameriquest Mortg. Co. (In re Adams),* 307 B.R. 549, 55253 (Bankr.N.D.Tex.2004). But *In re Adams* is distinguishable because both parties there agreed the transaction at issue was actually a refinance, the parties simply disputed whether it was a refinance of a home equity loan. *Id.* Moreover, the court specifically found both parties intended the loan at issue to be a refinance of a home equity loan. *Id.* at 553. This case is not one where the bank seeks to avoid the application of section 50(a)(6) at all, but rather one where the parties clearly understood they were modifying a home equity loan—a loan which had already complied with the strictures of section 50(a)(6).

Second, Plaintiffs argue *In re Lovelace* is "an informative parallel" to this case. *Lovelace v. USAA Fed. Savs. Bank (In re Lovelace),* 443 B.R. 494 (Bankr.W.D.Tex.2011). In *In re Lovelace,* the homeowners sought to acquire a second home equity loan from the defendant, despite already having a home equity loan from another bank. *Id.* at 496. The court held the defendant's lien was void because the Texas Constitution only permits a single home equity loan to exist on a given property. *Id.* at 500. Unlike *In re Lovelace,* this case does not present two competing banks, or even two competing home equity loans. Instead, this case presents a single lender which modified its home equity loan (the only home equity loan on the property) through a proper contractual arrangement with the borrowers. Additionally, *In re Lovelace* undermines Plaintiffs' "advance of funds" argument above, as the second home equity loan was classified as an extension of

credit (i.e., an advance of funds) because funds were deposited in the borrowers' bank account for use at their discretion, not simply added on to existing principal. *Id* at 496.

**D. Specific Provision Violations**

Having concluded Plaintiffs' loan modifications were, as advertised, modifications rather than refinances, the Court now turns to Plaintiffs' specific allegations under the Texas Constitution. As noted above, the addition of past-due interest to the principal balance of the loans does not constitute an advance of funds, and therefore provides Plaintiffs no basis for recovery under section 50. JPMC was also not required to reissue the section 50(g) disclosures after the modification. *Sims,* 2012 WL 3636884, at *10 (holding "sections 50(f) and (g) are inapplicable" to modifications). Nor was JPMC required to hold a second closing event, or execute a second written acknowledgment of the fair market value of the property, as the original loan and modification are treated as a single transaction. *See* 7 TEX. ADMIN. CODE § 153.14(2). It simply makes no sense to require the parties to repeat all the formalities of an initial home equity loan whenever they seek to modify the terms of the loan already formally executed.

Assuming Plaintiffs assert JPMC also violated section 50(a)(6) (B), this claim also fails. Section 50(a)(6)(B) prohibits a home equity loan from exceeding eighty percent of the fair market value of the homestead "on the date the extension of credit is made." TEX. CONST. art. XVI, § 50(a)(6)(B). As the *Sims* court held, "a straightforward consideration of

the text of section 50 and the administrative regulations all lead to but one reasonable conclusion: the phrase 'on the date the extension of credit is made' refers to the date of the original home equity-loan and not to each subsequent modification." 2012 WL 3636884, at *7. JPMC's obligation is to ensure the home equity loan, when originally made, represents a permissible loan-to-value ratio. Because Plaintiffs do not allege their original loans exceeded eighty percent of the fair market value of their homes at the time the loans were made, they fail to state a violation of section 50(a)(6)(B).

Hawkins' temporary interest-only mortgage payment does not violate section 50(a)(6)(L). That section requires installment payments to "equal[ ] or exceed [ ] the amount of accrued interest as of the date of the scheduled installment." TEX. CONST. art. XVI, § 50(a)(6)(L)(I). Hawkins' loan allowed for a temporary five-year term of interest-only payments, after which the loan payments would readjust to add back in principal reduction over the remaining life of the loan, resulting in an eventual payoff under the schedule. The temporary interest-only payments "equal[ed]" the amount of accrued interest as of the date of the scheduled installment, and therefore complied with the plain language of section 50(a)(6)(L). Additionally, the regulations suggest this provision was primarily intended to "prohibit[ ] balloon payments." 7 TEX. ADMIN. CODE § 153.11(3).

Finally, Plaintiff Brooks argues her loan included an impermissible balloon payment in violation of section 50(a)(6)(L). Brooks' modification

agreement plainly states: "Notwithstanding the foregoing schedule, I agree that unless sooner paid, I will have a final balloon payment in the amount of $146,102.76 due and payable on the New Maturity Date." Mot. to Dismiss [# 12–4], Ex. D, ¶ 3(C). Section 50(a)(6)(L)'s requirement of "substantially equal successive periodic installments" "prohibits balloon payments." TEX. CONST. art. XVI, § 50(a)(6)(L); 7 TEX. ADMIN. CODE § 153.11(3). Brooks's balloon payment thus appears to be a clear violation of section 50(a)(6)(L), and JPMC does not address the legality of the balloon payment in its Response.

There is one catch, however. JPMC's standard security agreement contains a "savings clause," which allows JPMC to reform loan documents that violate section 50 by providing written notice to the borrower. JPMC must also receive notice of the alleged violation. Plaintiff Brooks does not allege JPMC was ever given notice of the impermissible balloon payment in her loan documents. Additionally, the allegation appears for the first time in the First Amended Complaint, filed December 7, 2012, which is the first document possibly providing such notice to JPMC. Absent allegations JPMC was provided with notice of the impermissible balloon payment, given an opportunity to cure the defect through its savings clause, and refused to do so, Plaintiffs fail to state a claim for violation of section 50(a)(6)(L).

## Conclusion

Plaintiffs' complaint fails because its core premise—the modifications willingly entered into by

Plaintiffs were actually refinances in disguise—is wrong. The bulk of Plaintiffs' claims fail because the provisions of section 50 JPMC allegedly violated do not apply to modifications. With respect to the provisions that do apply, those concerning interest-only and balloon payments, Plaintiffs also fail to state a claim based on the facts alleged in the First Amended Complaint. Although Plaintiffs offer a detailed and sweeping interpretation of section 50, no case cited by Plaintiffs actually supports the theory they put forward. This is unsurprising given the seemingly inequitable result Plaintiffs seek.[6] The Court must therefore dismiss this case for failing to state any claim upon which relief can be granted. Additionally, because Plaintiffs have already amended their complaint once, and their claims rest on erroneous legal theories, the Court sees no reason to grant leave to amend again at this time.

Accordingly,

IT IS ORDERED that Defendant JPMorgan Chase Bank, N.A.'s Motion to Dismiss [# 12] is GRANTED;

IT IS FINALLY ORDERED that Plaintiffs' claims are DISMISSED WITHOUT PREJUDICE.

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[6] Though the phrase is sometimes used too cavalierly, this lawsuit truly is an example of the phrase "no good deed goes unpunished." Plaintiffs, on the verge of losing their homes, sought modifications from the bank. The bank agreed to modify the loans, avoiding foreclosure and keeping roofs over Plaintiffs' heads. Plaintiffs respond by suing the bank and demanding a free home because of the modifications they requested and agreed to. Though Plaintiffs' eyes are blind to the alternate meaning of *equity* in the term "home equity loan," the law in Texas is not.

SIGNED this the *28th* day of January 2013.

/s/ Sam Sparks
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

Charles J. HAWKINS, William J. Cusick, Michelle E. Cusick, and Maria C. Brooks, on behalf of themselves and all other similarly situated parties, Plaintiffs,

v.

JPMORGAN CHASE BANK, N.A., Defendant.

CIVIL ACTION NO. 1:12-cv-892

**ORDER OF DISMISSAL**

BE IT REMEMBERED on this day the Court entered an order in the above-styled cause, granting Defendant's motion to dismiss and DISMISSING WITHOUT PREJUDICE all claims in this case. Thereafter, the Court enters the following:

IT IS ORDERED, ADJUDGED, and DECREED that the above-styled cause is DISMISSED WITHOUT PREJUDICE. All costs are taxed against the plaintiffs, for which let execution issue.

SIGNED this the 28th day of January, 2013.

/s/ Sam Sparks
SAM SPARKS,
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Brigitte Starkey, David Starkey, Nancy C. Calderon, and Phillip R. Calderon on behalf of themselves and all others similarly situated,

*Plaintiffs*,

v.

Bank of America, National Association,

*Defendant*.

CIVIL ACTION NO. 4:12-CV-2084

ORDER GRANTING UNOPPOSED MOTION TO CONTINUE STAY

On this day, came to be considered the Unopposed Motion to Continue Stay (Dkt. No. 61) filed by plaintiffs Antoinette Dickson, Brigitte Starkey, David Starkey, Nancy C. Calderon, and Phillip R. Calderon. The Court, having considered the motion, the pleadings on file, and the arguments in support of the motion, is of the opinion that the motion should be GRANTED.

Accordingly, it is ORDERED that the motion is hereby GRANTED. This action is stayed until the earliest of: (1) a final opinion by the Third Court of Appeals or, if taken to the Texas Supreme Court, then by the Texas Supreme Court, on the Tex. Const. art. XVI, § 50(a)(6)(L) claims in Graze et al. v. Nationstar Mortgage, LLC; (2) motion of a party on

30 days' notice to the other showing good cause why the stay should be lifted.

It is so ORDERED.

SIGNED on this 31st day of July, 2015.

/s/ Kenneth M. Hoyt
United States District Judge

No. 13–0638
Supreme Court of Texas.

Frankie SIMS, on Behalf of Himself and all Others Similarly Situated; and Patsy Sims, on Behalf of Herself and all Others Similarly Situated,
Appellants,

v.

CARRINGTON MORTGAGE SERVICES, L.L.C.,
Appellee.

**Opinion**

Chief Justice HECHT delivered the opinion of the Court.

To avoid foreclosure, homeowners and lenders often try to restructure underwater home mortgage loans that are in default by capitalizing past-due amounts as principal, lowering the interest rate, and reducing monthly payments, thereby easing the burden on the homeowners. But home equity loans are subject to the requirements of Article XVI, Section 50 of the Texas Constitution. The United States Court of Appeals for the Fifth Circuit has asked whether those requirements apply to such loan restructuring.[1]We answer that as long as the original note is not satisfied and replaced, and there is no additional extension of credit, as we define it,

[1] 538 Fed.Appx. 537 (5th Cir.2013) (per curiam); *see* TEX. CONST. art. V, § 3–c(a) ("The supreme court [has] jurisdiction to answer questions of state law certified from a federal appellate court.").

the restructuring is valid and need not meet the constitutional requirements for a new loan.

**I**

Frankie and Patsy Sims obtained a 30–year home equity loan in 2003. In 2009, the Simses, behind on their payments, reached what was entitled a "Loan Modification Agreement" with Carrington Mortgage Services, L.L.C. The agreements involved capitalizing past-due interest and other charges, including fees and unpaid taxes and insurance premiums, and reducing the interest rate and monthly payments. Two years later, the Simses were again behind, and this time CMS sought foreclosure. The Simses resisted, asserting that the 2009 restructuring violated constitutional requirements for home equity loans. The parties then reached a second "Loan Modification Agreement", further reducing the interest rate and payments. The following chart summarizes the loan data at the outset and after the two restructurings:

| | Principal | Amt. Cap'd | New Prin. | Rate | Payment | Appraisal |
|---|---|---|---|---|---|---|
| 2003 Loan | $76,000.00 | __ | __ | 9% | $611.51 | $96,000 |
| 2009 Mod. | $72,145.50 | $2,200.00 | $74,345.50 | 6.5% | $511.16 | $72,300 |
| 2011 Mod. | $72,655.61 | $7,368.44 | $80,023.95 | 4.75% | $492.34 | $73,000 |

The original note required the Simses to pay principal, interest, and late charges.[2] The security agreement echoed that requirement and added an obligation for the Simses to make payments for "Escrow Items", such as taxes, assessments, and insurance premiums.[3] The security agreement also authorized the lender to "do and pay for whatever is reasonable or appropriate" to protect its interest in the property and its rights under the agreement and provided that any amount the lender disbursed to that end "shall become additional debt of Borrower secured by this Security Instrument." The 2009 and 2011 "Loan Modification Agreements" provided that all the Simses' obligations and all the loan documents remained unchanged.[4]

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[2] The note signed by the Simses stated: "In return for a loan that I have received, I promise to pay U.S. $76,000.00 (this amount is called 'principal'), plus interest, to the order of the Lender." The note also provided for a 5% late charge on overdue principal and interest.

[3] The security instrument stated: "Borrower shall pay to Lender on the day Periodic Payments are due under the Note, until the Note is paid in full, a sum (the 'Funds') to provide for payment of amounts due for: (a) taxes and assessments and other items which can attain priority over this Security Instrument as a lien or encumbrance on the Property; ... and (c) premiums for any and all insurance required by Lender under Section 5. These items are called 'Escrow Items.' "

[4] The 2009 agreement stated: "All covenants, agreements, stipulations, and conditions in your Note and Mortgage will remain in full force and effect, except as modified herein, and none of your obligations or liabilities under your Note and Mortgage will be diminished or released by any provisions hereof, nor will this Agreement in any way impair, diminish, or affect [the] rights under or remedies on your Note and Mortgage."

Two months after the 2011 agreement, the Simses brought this class action against CMS in the United States District Court, alleging that CMS's loan modifications for them and other similarly situated borrowers violated Article XVI, Section 50 of the Texas Constitution. Before considering certification, the court dismissed the case under Federal Rule of Civil Procedure 12(b)(6) for failure to state a cause of action, [5] and the Simses appealed. After oral argument, the Fifth Circuit certified the following four questions to us:

> 1. After an initial extension of credit, if a home equity lender enters into a new agreement with the borrower that capitalizes past-due interest, fees, property taxes, or insurance premiums into the principal of the loan but neither satisfies nor replaces the original note, is the transaction a modification or a refinance for purposes of Section 50 of Article XVI of the Texas Constitution?
>
> If the transaction is a modification rather than a refinance, the following questions also arise:
>
> 2. Does the capitalization of past-due interest,

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Similarly, the 2011 Agreement stated: "[A]ll terms and provisions of the Loan Documents, except as expressly modified by this Agreement, remain in full force and effect; nothing in this Agreement shall be understood or construed to be a satisfaction or release in whole or in part of the obligations contained in the Loan Documents; and [ ] except as otherwise specifically provided in, and expressly modified by, this Agreement, the Lender and you will be bound by, and will comply with, all of the terms and conditions of the Loan Documents."

[5] 889 F.Supp.2d 883, 884 (N.D.Tex.2012).

fees, property taxes, or insurance premiums constitute an impermissible "advance of additional funds" under Section 153.14(2)(B) of the Texas Administrative Code?

3. Must such a modification comply with the requirements of Section 50(a)(6), including subsection (B), which mandates that a home equity loan have a maximum loan-to-value ratio of 80%?

4. Do repeated modifications like those in this case convert a home equity loan into an open-end account that must comply with Section 50(t)?

## II

As we have more fully explained in prior decisions, because of Texas' strong, historic protection of the homestead, home equity loans are regulated, not by statute as one might suppose, but by the "elaborate, detailed provisions" of Article XVI, Section 50 of the Texas Constitution.[6] To provide guidance to lenders, the Finance Commission and the Credit Union Commission have been authorized by the Constitution and by statute to interpret these provisions, subject to judicial review,[7] and the Commissions have done so in Chapter 153 of the

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[6] *Fin. Comm'n of Tex. v. Norwood,* 418 S.W.3d 566, 571 (Tex.2013); *see also LaSalle Bank Nat'l Ass'n v. White,* 246 S.W.3d 616, 618 (Tex.2007) (per curiam) ("Texas became the last state in the nation to permit home-equity loans when constitutional amendments voted on by referendum took effect in 1997.").

[7] *Norwood,* 418 S.W.3d at 573; TEX. CONST. art. XVI, § 50(u).

Texas Administrative Code.[8] "A lender's compliance with an agency interpretation of Section 50, even a wrong interpretation, is compliance with Section 50 itself."[9] Thus, in answering the certified questions, we look to the constitutional text and the Commissions' interpretations. However, those interpretations "can do no more than interpret the constitutional text, just as a court would."[10]The issue is not whether a lending practice or policy is advisable, something the Commissions would decide in exercising their regulatory functions; the issue is what the Constitution requires.[11]

**A**

The certified questions assume a distinction between a loan modification and a refinancing that, if understood in financial circles,[12] is not clear in the

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[8] 7 TEX. ADMIN. CODE §§ 153.1–.96

[9] *Norwood,* 418 S.W.3d at 573.

[10] *Id.* at 585.

[11] *Id.*

[12] CMS points to the Federal Reserve Board's definition of a "refinancing" requiring new Truth In Lending Act disclosures under Regulation Z when refinancing is undertaken by the original creditor, or a holder or servicer of the original obligation. Under this definition, a refinancing is "a new transaction requiring new disclosures" that "occurs when an existing obligation that was subject to [federal 'closed end credit' disclosure requirements] is satisfied and replaced by a new obligation". 12 C.F.R. § 226.20(a); 12 C.F.R. pt. 226, supp. 1, cmt. 20(a) (Official Staff Interpretations). Some transactions, however, will not be treated as a refinancing under this section, including "[a] change in the payment schedule or a change in collateral requirements as a result of the consumer's default or delinquency, unless the rate is increased, or the new amount financed exceeds the unpaid balance plus earned finance

text of Section 50. Neither concept is defined in Section 50. The word "refinance" is used eleven times in Section 50, and "refinancing" once.[13] In each instance, the reference seems to be to a redone transaction. A form of the word "modify" is used in three places in Section 50. In one, lenders are authorized to "modify" previously provided documentation at closing in exigent circumstances.[14] In the other two, lenders can correct noncompliance with Section 50 by sending a borrower "notice modifying any ... amount, percentage, term, or other provision prohibited by this section",[15] or, if noncompliance cannot be cured under the other provisions, by offering the borrower a $1,000 credit and "the right to refinance the extension of credit" for the remaining term at no cost "with any modifications necessary to comply" or that the

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charge and premiums for continuation insurance...." *Id.* § 226.20(a)(4). The Federal National Mortgage Association, in an amicus brief, references the same regulation but does not otherwise attempt to define a distinction between refinancings and modifications. An amicus brief by the Independent Bankers Association of Texas, the Texas Bankers Association, and the Texas Mortgage Bankers Association refers to the distinction but does not attempt to define it. Other federal entities, like HUD and FDIC, have their own glossaries referring to and defining general terms like "modification," "mortgage modification," "refinancing," and "debt restructuring," but these agencies, to fulfill their specific missions, also define and apply more specific classifications or limitations.

[13] TEX. CONST. art. XVI, § 50(a)(4), (a)(6)(M)(iii), (a)(6)(Q)(vii), (a)(6)(Q)(x)(f), (a)(8); § 50(e) and (f).

[14] *Id.* § 50(a)(6)(M)(ii).

[15] *Id.* § 50(a)(6)(Q)(x)(c).

parties agree will comply.[16] In these two instances, if not also in the first, a modification could substantially alter the loan; indeed, in the last situation, modifications can shape the refinancing.[17]

The modification-refinancing distinction is one drawn by the Commissions in interpreting Section 50(a)(6)(M)(iii). The effect of that provision is to prohibit a second home equity loan within a year of the first, with certain exceptions. As interpreted by the Commissions, the provision prohibits a "refinancing" like a "new equity loan" but not a "modification".[18] According to the Commissions, a

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[16] *Id.* § 50(a)(6)(Q)(x)(f).

[17] Section 153.96(b) of the Commissions' interpretations contemplates that in order to comply with constitutional requirements, "the lender ... and borrower may ... modify the equity loan without completing the requirements of a refinance". 7 TEX. ADMIN. CODEE § 153.96(b)(2)(A).

[18] " § 153.14. One Year Prohibition: Section 50(a)(6)(M)(iii)

"An equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property.

"(1) Section 50(a)(6)(M)(iii) prohibits an owner who has obtained an equity loan from:

"(A) refinancing the equity loan before one year has elapsed since the loan's closing date; or

"(B) obtaining a new equity loan on the same homestead property before one year has elapsed since the previous equity loan's closing date, regardless of whether the previous equity loan has been paid in full.

"(2) Section 50(a)(6)(M)(iii) does not prohibit modification of an equity loan before one year has elapsed since the loan's closing date. A modification of a home equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced. A home equity loan and a subsequent modification will be considered a single transaction. The home equity requirements of Section 50(a)(6) will be

modification does not involve satisfaction or replacement of the original note, an "advance of additional funds", or new terms that would not have been permitted for the original "extension of credit".[19] Further, the original loan and a subsequent modification are treated as a single transaction, including for purposes of the 3% fee cap.[20]

But Section 50(a)(6)(M)(iii) of the Constitution does not mention refinancing or modification. It states:

> (a) The homestead ... is ... protected from forced sale[ ] for the payment of all debts except for: ...
>
> (6) *an extension of credit* that: ...
>
> (M) is closed not before: ...
>
> (iii) the first anniversary of the closing date of

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applied to the original loan and the subsequent modification as a single transaction.

"(A) A modification of an equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law. An example of a modification that is not required to be in writing is the modification required under the Soldiers' and Sailors' Civil Relief Act.

"(B) The advance of additional funds to a borrower is not permitted by modification of an equity loan.

"(C) A modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit.

"(D) The 3% fee cap required by Section 50(a)(6)(E) applies to the original home equity loan and any subsequent modification as a single transaction."

7. TEX. ADMIN. CODE § 153.14 (emphasis added).

[19] *Id.* § 153.14(2).

[20] *Id.* § 153.14(2)(D).

> any other extension of credit described by Subsection (a)(6) of this section secured by the same homestead property [with certain exceptions]....[21]

The applicability of this particular provision, as well as all of Section 50(a)(6), which governs home equity loans, depends not on whether the transaction is a modification or a refinance but on whether it is an "extension of credit". If the restructuring of a home equity loan does not involve a new extension of credit, the requirements of Section 50(a)(6) do not apply. Thus, we restate the first certified question as follows:

> 1. After an initial extension of credit, if a home equity lender enters into a new agreement with the borrower that capitalizes past-due interest, fees, property taxes, or insurance premiums into the principal of the loan but neither satisfies nor replaces the original note, is the transaction *a new extension of credit* for purposes of section 50 of Article XVI of the Texas Constitution?

**B**

Neither the Constitution nor the Commissions' interpretations define an "extension of credit", but its meaning is clear. Credit is simply the ability to assume a debt repayable over time, and an extension

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[21] TEX. CONST. art. XVI, § 50(a)(6)(M)(iii) (emphasis added).

of credit affords the right to do so in a particular situation.[22]

The Simses argue that any increase in the principal amount of a loan is a new extension of credit within the meaning of Section 50(a)(6), in effect equating the loan principal with an extension of credit. The Constitution contradicts the Simses' argument. Section 50(a)(6)(E) refers to principal as a component of an extension of credit, capping fees at "three percent of the original principal amount *of* the extension of credit".[23] The extension of credit for purposes of Section 50(a)(6) consists not merely of the creation of a principal debt but includes all the terms of the loan transaction. Terms requiring the borrower to pay taxes, insurance premiums, and other such expenses when due protect the lender's security and are as much a part of the extension of credit as terms requiring timely payments of principal and interest. The Simses argue that in restructuring a loan to capitalize past-due amounts, the lender is actually advancing additional funds to itself (past-due interest) or others (past-due taxes and insurance) to pay those amounts for the

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[22] *See, e.g.,* TEX. FIN.CODE § 31.002(a)(34) (" 'Loans and extensions of credit' means direct or indirect advances of money ... to a person that are conditioned on the obligation of the person to repay...."); *id.* § 181.002(a)(28) (same); *id.* § 350.001(a) ("credit means the right granted to a debtor to defer payment of debt or to incur debt and defer its payment"); *id.* § 393.001(4) (" 'extension of consumer credit' means the right to defer payment"); *see also* 7 TEX. ADMIN. CODE § 12.3(a)(2) (defining "[l]oans or extensions of credit" for purposes of TEX. FIN.CODE § 34.201 as including various transactions involving an advance of funds to be repaid over time).

[23] TEX. CONST. art. XVI, § 50(a)(6)(E) (emphasis added).

borrower, and that this constitutes a new extension of credit. But the borrower's obligation for such amounts, and the lender's right to pay them to protect its security, were all terms of the original extension of credit. The Simses argue that requiring interest on capitalized, past-due amounts is really a new loan, but it is simply a mechanism for deferring payment of obligations already owed in a way that allows the borrower to retain his home.

The Simses argue that a loan that can be restructured to change the amount of the periodic payments does not meet the requirement of Section 50(a)(6)(L)(i) that loans be "scheduled to be repaid ... in substantially equal successive period installments".[24] But the required schedule is not one that, when initially set, can never be altered. After all, whenever a payment is missed, the schedule is altered. Further, Section 50(g) gives the borrower the right to prepay the loan,[25] which would alter the initial schedule. Section 50(a)(6) does not forbid a revision of the initial repayment schedule that merely adjusts the regular installment amount.

CMS argues that restructuring a loan does not involve a new extension of credit so long as the borrower's note is not satisfied or replaced and no new money is extended. We agree that these two conditions are necessary, but we cannot say with assurance that they are sufficient. For example, a restructuring to make the homestead lien security for another indebtedness, such as the borrower's consumer or credit card debt, would certainly be a

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[24] *Id.* § 50(a)(6)(L)(i).
[25] TEX. CONST. art. XVI, § 50(g).

new extension of credit. The test should be whether the secured obligations are those incurred under the terms of the original loan.

The Simses object that this test provides no effective limit on the size or frequency of additions to principal. But the terms of the original loan supply the limit. The Simses' argument is that any change in principal is a new extension of credit, but as we have shown, their position is inconsistent with Section 50.

The Simses argue that it matters not that, as in their own situation, restructuring lowers the interest rate and the amount of installment payments, and makes it possible for borrowers to keep their homes and meet their obligations. Lenders have two options other than foreclosing on loans in default: further forbearance and forgiveness. Nevertheless, the Simses' argument encourages lenders to foreclose, which is certainly at odds with the fundamental purpose of Section 50: to protect the homestead.

To the first certified question, we answer: the restructuring of a home equity loan that, as in the context from which the question arises, involves capitalization of past-due amounts owed under the terms of the initial loan and a lowering of the interest rate and the amount of installment payments, but does not involve the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note, is not a new extension of credit that must meet the requirements of Section 50.

**C**

Our reasons for answering the first question as we have largely dictate our answers to the other three certified questions.

Is the capitalization of past-due interest, taxes, insurance premiums, and fees an "advance of additional funds" under the Commissions' interpretations of Section 50?[26]

No, if those amounts were among the obligations assumed by the borrower under the terms of the original loan. And more importantly, such capitalization is not a new extension of credit under Section 50(a)(6).

Must a restructuring like the Simses' comply with Section 50(a)(6)? No, because it does not involve a new extension of credit, for the reasons we have explained. The Simses argue that any restructuring must satisfy Section 50(a)(6)(B), which requires a home equity loan to be

> of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead *on the date the extension of credit is made....*[27]

The Simses' argument incorrectly assumes that the

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[26] 7 TEX. ADMIN. CODE § 153.14.
[27] TEX. CONST. art. XVI, § 50(a)(6)(B) (emphasis added).

restructuring is a new extension of credit.[28]

Finally, would repeated restructuring convert a home equity loan into an open-end account subject to Section 50(t)? Section 50(t) applies to a home equity line of credit—"a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which ... the owner requests advances, repays money, and reborrows money". The repeat transactions are clearly contemplated from the outset. *See also* TEX. FIN.CODE § 301.002(a)(14)(A) ("In this subtitle ... 'Open-end account' ... means an account under a written contract between a creditor and an obligor in connection with which: (i) the creditor reasonably contemplates repeated transactions and the obligor is authorized to make purchases or borrow money; (ii) an interest or time price differential may be charged from time to time on an outstanding unpaid balance; and (iii) the amount of credit that may be extended during the term of the account is generally made available to the extent that any outstanding balance is repaid....").

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[28] The Circuit noted that if the highlighted phrase modified the word "value" and not the word "exceed", the provision would never allow the loan principal, during the life of the loan, to exceed the amount that was the value of the property when the loan was closed. 538 Fed.Appx. 537, 545–546 (5th Cir.2013) (per curiam). This could happen if the loan-to-value ratio was very close to the limit at the time the loan closed, and when the loan was restructured, the amount capitalized caused the total principal indebtedness to exceed the limit. But nothing in Section 50 suggests that a loan's compliance is to be determined at any time other than when it is made.

This description does not remotely resemble a loan with a stated principal that is to be repaid as scheduled from the outset but must be restructured to avoid foreclosure.

Fundamentally, the requirements of Article XIV, Section 50 of the Texas Constitution for extensions of credit secured by the homestead are designed to protect the homestead, not endanger it. The Constitution does not prohibit the restructuring of a home equity loan that already meets its requirements in order to avoid foreclosure while maintaining the terms of the original extension of credit. We answer the certified questions accordingly.

## TEX. CONST. ART. XVI, § 50 INTERPRETIVE COMMENTARY

The homestead exemption was a Texas creation. It was the logical development of the evolution of the changing social attitude toward debtors whereby first the person, then the personal property, and finally the real estate of the debtor were freed from the control of the creditor through the abolition of imprisonment for debt, the extension of chattel exemptions, and the adoption of the homestead exemption.

While Texas was governed by Spanish colonial law and, subsequent thereto, the law of Mexico, it became familiarized with chattel exemptions for such items as family clothing, the minimum of furniture for the family abode, and the implements of the breadwinner, none of which could be used for forced application to the payment of debts. In an agricultural community, it was no great step to extend the concept underlying these chattel exemptions to the family home and land.

The earliest homestead exemption law was the Statute of January 26, 1839 (Laws of the Republic of Texas, First Session of the Third Congress, 1839, pp. 125-126). Beyond statements to its intent and purpose, the idea of homestead exemption elicited slight notice, scarcely any comment, and no discernible opposition. Its passage was hurried through the legislature on the last day of its session with the legislators apparently unaware of the important precedent the law would establish or of the far-reaching effect it was to have.

The direct cause of the law was the United States Panic of 1837 and the ensuing depression during which numerous families lost homes and farms through foreclosures, and in the Republic of Texas business became stagnate, money scarce, and credit unobtainable. Most Texans were in debt, and the young nation was in economic peril. The homestead exemption was looked upon as a necessary measure to offset the economic danger to Texans and Texas. It had a three-fold purpose: (1) to preserve the integrity of the family as the basic element of social organization, and, incidentally, to encourage colonization for in a frontier society each pioneer family was of definite value to the community; (2) to provide the debtor with a home for his family and some means to support them and to recoup his economic losses so as to prevent the family from becoming a burdensome charge upon the public; (3) to retain in pioneers the feeling of freedom and sense of independence which was deemed necessary to the continued existence of democratic institutions.

Although the Constitution of the Republic contained no provisions with reference to homestead exemptions, Texans quickly learned that homestead exemptions could not be left to the mercy of the legislators. The Fourth Congress of the Republic, in an act concerning executions (Act of February 5, 1840, sections 4 and 24, Laws of Republic of Texas, Session of Fourth Congress, pp. 93-98), annulled the law of 1839, although no explanation for this action can be found in the journals of that congress. The next legislature, however, repealed the action of the Fourth Congress and re-enacted the

original homestead exemption law. (Act of December 22, 1840, Laws of Republic of Texas, Session of Fifth Congress, pp. 61-62). Consequently, the convention which drew up the Constitution of 1845, designed to provide for the government of the State of Texas after annexation by the United States, determined to safeguard the homestead by putting it beyond the reach of legislators as well as creditors by incorporating an exemption provision in the constitution.

Article VII, Section 22, of the Constitution of 1845 declared:

> The Legislature shall have power to protect by law from forced sale, a certain portion of the property of all heads of families. The homestead of a family not to exceed two hundred acres of land, (not included in a town or city,) or any town or city lot or lots, in value not to exceed two thousand dollars, shall not be subject to forced sale, for any debts hereafter contracted, nor shall the owner, if a married man, be at liberty to alienate the same, unless by consent of the wife, in such manner as the Legislature may hereafter point out.

There was little opposition in the convention to the homestead exemption as such, although it was adopted by a vote of only 42 to 14. The opposition specifically went on record as approving of the principle but objected to the wording of the measure on various grounds--the limitation on the size of the homestead was felt to be too small or too large; or objection was voiced to the provision preventing the husband from alienating the homestead without the wife's consent.

The Constitutions of 1861 and 1866 carried forward those homestead provisions. The Constitution of 1869 provided for the exemption of a rural homestead not exceeding 200 acres or an urban homestead not in excess of $5,000 evaluation without reference to improvements. The present constitution included the 1869 provisions with the added provision that a place of business might be included in an urban homestead and that certain property of an unmarried adult might be exempt as a homestead.

At the convention of 1875 opposition again arose to the provision preventing the husband from alienating the homestead without the wife's consent. But eloquent pleas were made picturing the sad effect of drunken and worthless husbands bringing their wives to want and poverty, and the provision was retained.

MDL No. 13-0427

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IN RE NATIONSTAR MORTGAGE, LLC TEXAS HOME EQUITY LOAN MODIFICATION LITIGATION

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On Review by The Multidistrict Litigation Panel

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Chief Justice Stone delivered the unanimous opinion of the MDL Panel.

Rule 13 authorizes this panel to transfer "related" cases from different trial courts to a single pretrial judge if the transfer will: (1) serve the convenience of the parties and witnesses; and (2) promote the just and efficient conduct of the litigation. TEX. R. JUD. ADMIN. 13.3. Seven home equity borrowers have asked this panel to transfer six lawsuits pending in five different counties against a single defendant, Nationstar Mortgage, LLC, to an MDL pretrial court. For the reasons stated below, we grant the motion.

**BACKGROUND: HOME EQUITY LOANS AND THE TEXAS CONSTITUTION**

Texas has a long history of carefully protecting family homesteads from foreclosure "by limiting the types of liens that can be placed upon homestead property." *LaSalle Bank Nat'l Ass'n v. White*, 246 S.W.3d 616, 618 (Tex. 2007). "Texas became the last state in the nation to permit home-equity loans when constitutional amendments voted on by referendum took effect in 1997." *Id.* These loans

allow homeowners "to use the equity in their home as collateral to refinance the terms of prior debt and secure additional loans at rates more favorable than those for consumer loans." *Id.* "Although home-equity lending is now constitutionally permissible, article XIV, section 50(a)(6) of the Texas Constitution still places a number of limitations on such lending." *Id.*

The home equity borrowers in the six pending lawsuits were in default on their loans when Nationstar offered a loan modification that would prevent foreclosure. Nationstar used the same, short loan modification form in each transaction. The home equity borrowers have sued Nationstar contending that the loan modifications violated the limitations contained in article XIV, section 50(a)(6). Primarily, the lawsuits focus on allegations that the loan modifications: (1) exceeded the 80% loan-to-value ratio limitation contained in section 50(a)(6)(B); and (2) permitted interest-only payments or contained a balloon payment in violation of section 50(a)(6)(L)'s limitation on the scheduling of payments.

**ARE THE CASES RELATED?**

Under rule 13.2(f) cases are "related" if they involve "one or more common questions of fact." See TEX. R. JUD. ADMIN. 13.2(f). "While the rule requires common questions of fact, strict identity of issues and parties in the cases is not required and cases containing case-specific issues such as damages may still be transferred under Rule 13." *In re Delta Lloyds Ins. Co. of Houston*, 339 S.W.3d 384, 386 (Tex. M.D.L. Panel 2008). "The claims in each of

the [six] pending cases are based on [alleged] standard practices and procedures followed by" Nationstar in its business of modifying home equity loans. *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litigation*, 286 S.W.3d 669, 672 (Tex. M.D.L. Panel 2007). The plaintiffs contend that Nationstar's standard policies and procedures were applied in each case to an identical loan modification form that each of the home equity borrowers was required to submit. Thus, the plaintiffs allege that Nationstar's "general business practice" and standard procedures used to modify home equity loans violate the Texas Constitution. *See In re State Farm Lloyds Hurricane Ike Litigation*, 392 S.W.3d 353, 354-55 (Tex. M.D.L. Panel 2012) (holding cases were related where plaintiffs alleged defendant had a "general business practice" of adjusting claims that unfairly tilted the process in its favor).

Nationstar responds that the cases are highly individualized because the terms of each of the loans being modified were different. This argument is similar to the argument made and rejected in *Ocwen Loan Servicing*, 286 S.W.3d at 672 (granting consolidation despite argument that servicing of each plaintiffs' mortgage loan was subject to "unique facts"). Although we continue to acknowledge that "every case is different," *In re Hurricane Rita Evacuation Bus Fire*, 216 S.W.3d 70, 72 (Tex. M.D.L. Panel 2006), discovery in these cases "will be aimed at disclosing the nature of [Nationstar's] common practices and procedures." *Ocwen Loan Servicing*, 286 S.W.3d at 672. Nationstar further responds that the plaintiffs' allegations "are not congruent with each other." However, "[a] rule 13 transfer of cases

does not require that the cases be congruent or anything close to it." *In re Hurricane Rita Evacuation Bus Fire*, 216 S.W.3d at 72. Because the plaintiffs focus on Nationstar's standard practices and procedures, we hold that the six cases are related.

**WOULD TRANSFER FURTHER CONVENIENCE AND EFFICIENCY?**

"In deciding whether transfer to a pretrial court will further the general MDL goals of convenience, efficiency, and justice, our more specific inquiry is whether transfer would: (1) eliminate duplicative and repetitive discovery, (2) minimize conflicting demands on witnesses, (3) prevent inconsistent decisions on common issues, and (4) reduce unnecessary travel." *In re State Farm Lloyds Hurricane Ike Litigation*, 392 S.W.3d at 355-56. "A fifth objective of the

MDL process is to allocate finite judicial resources intelligently by minimizing the occasions when different judges decide the same or similar issues again and again." *Id.* at 356. "When one trial judge has decided an issue that is common to a set of related cases, the legal system cannot afford to let other trial judges spend time deciding the issue again." *Id.*

As previously noted, consolidation will eliminate the duplicative and repetitive discovery that would be promulgated with regard to Nationstar's general business practices in modifying home equity loans to Texas borrowers. Most of this discovery as to Nationstar's standard practices will likely involve only a few corporate representatives or

employees of Nationstar. Rule 13's concern for the convenience of witnesses encompasses employee witnesses. *See In re Hurricane Rita Evacuation Bus Fire*, 216 S.W.3d at 72. Consolidation will also ensure that issues relating to the application of article XIV, section 50(a)(6) of the Texas Constitution are decided the same way by allowing the pretrial judge to make consistent rulings. See Ocwen Loan Servicing, 286 S.W.3d at 672-73 (noting "similar legal issues will arise as to whether [the] standard practices and procedures give rise to liability under the commonly alleged theories").

Finally, consolidating these cases is an intelligent allocation of finite judicial resources and will prevent different trial judges from having to decide the same issues. *In re State Farm Lloyds Hurricane Ike Litigation*, 392 S.W.3d at 355-56.

**CONCLUSION**

Because the plaintiffs have shown that the six cases are related within the meaning of rule 13 and that transferring them to one pretrial court would serve the convenience of the parties and witnesses, the motion to transfer is granted. The pre-trial judge will be appointed by separate order.

PRESIDING JUDGE PEEPLES, CHIEF JUSTICE MCCLURE, AND JUSTICE BROWN, join.

JUSTICE LANG-MIERS, not participating.

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CATHERINE STONE,
CHIEF JUSTICE
OPINION DELIVERED:
AUGUST 16, 2013