

# Texas Supreme Court Confirms that Liberal Application of Equitable Subrogation Isn't Going Anywhere



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**T**exas home equity lending law recently received a bit of clarity from the Supreme Court in its recent decision of *Zepeda v. Federal Home Loan Mortgage Corporation*. For a little bit of background, Texas has some of the strongest homestead protection laws in the country. As a result, home equity loans (which include cash-out refinances and home equity lines of credit) were not recognized in Texas as valid liens on homestead property until 1997. Further, even after home equity liens were allowed, the lender must strictly comply with a long list of requirements set forth in the Texas Constitution to have a valid lien. If a

home equity lien is found to be constitutionally non-compliant, the borrower has the right to notify the lender of the defect, which the lender must cure within sixty days. If the lender does not cure the defect within the sixty day timeframe, the lien is void and the lender may also be required to repay the borrower all of the principal and interest it received during the life of the loan.

In order to ease the draconian penalties a lender may suffer from of a constitutionally non-compliant home equity lien, the Texas courts have liberally applied the doctrine of equitable subrogation. Under this doctrine, a lender whose lien is found to be invalid will still retain a lien equal to any amounts it paid to discharge other liens secured by the property. The lender is said to “stand in the shoes” of the prior lender’s lien interest. In 2007, the Texas Supreme Court in *LaSalle Bank v. White*, extended this doctrine and expressly rejected the argument that the 1997 amendment to the Texas Constitution that allowed for home equity liens

abrogated a lender's equitable subrogation rights. 246 S.W.3d 616, 620 (Tex. 2007).

In *Zepeda*, the home equity mortgage borrower, Sylvia Zepeda ("Zepeda"), notified the lender, Federal Home Loan Mortgage Corporation ("Freddie Mac"), that its home equity lien was non-compliant with the Texas Constitution's requirement that a lender sign a specific document titled an acknowledgment of fair-market-value. After the sixty-day cure period passed without Freddie Mac taking any action to cure, Zepeda filed suit to quiet title on the property. Both Zepeda and Freddie Mac filed motions for summary judgment. Zepeda argued that Freddie Mac did not have a valid lien as a result of its failure to cure the constitutional defect. Freddie Mac argued that it was entitled to equitable subrogation because its loan was used to discharge the original purchase-money lien. The trial court granted Zepeda's motion for summary judgment and denied Freddie Mac's motion. In doing so, it found that Freddie Mac was not entitled to either equitable or common law subrogation because, by failing to cure the actin, it had acted negligently.

Freddie Mac appealed to the Fifth Circuit which certified the following question to the Texas Supreme Court:

"If the party seeking equitable subrogation could have satisfied the elements of § 50(a)(6)(Q)(ix) [to cure the home equity lien] but failed to do so, does that failure to preclude it from invoking equitable subrogation?"

The Texas Supreme Court's answer to the certified question was unequivocally "no." The Court noted that the doctrine of equitable subrogation has existed alongside the Texas Constitution's homestead protection provisions since at least 1890 and—as it had explained in *LaSalle v. White*, the recent amendments allowing home equity liens did not disturb the doctrine. The Court also explained that "the lender's right to subrogation is 'fixed' when the prior, valid lien is discharged." Thus, the Court found that the lender's actions in *Zepeda* of failing to cure a non-compliant home equity lien had no adverse effect on its equitable subrogation rights.

In *Zepeda*, Texas Supreme Court left no doubt that doctrine of equitable subrogation will continue to be liberally applied. Texas home equity lenders should also feel reassured that their equitable subrogation rights will not be undermined though its actions that occur after it discharges a prior, valid lien.

