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Attorneys At Law

2905 Corporate Circle

Flower Mound, TX 75028

Phone: 972-353-4174

Fax: 972-221-9316

Partners

Shawn P. Black¹

Ryan Black²

Daniel S. Engle³

Steven Kubik

Senior Lawyers

Margaret A. Noles

Sydney Davis

Associates

Kyle Beckwith

Joshua Verkerk

Of Counsel

David M. Tritter

Calvin C. Mann, Jr.

Thomas E. Black, Jr.

Gregory S. Graham⁴

Retired Partner(s)

Calvin C. Mann, Jr.

Thomas E. Black, Jr.

Gregory S. Graham⁴

To: Clients and Friends

From: Daniel S. Engle

Subject: Texas Appellate Court Affirms Attorney's Fees on Equitable Subrogation Claim on Home Equity Litigation

On March 21, 2024, the Court of Appeals, Corpus Christi-Edinburg, in an unpublished opinion, ruled that a trial court had the authority and did not abuse its discretion in awarding attorney's fees on a successful counterclaim for equitable subrogation in a Texas home equity lien validity dispute.

The case *Earley v. Nationstar Mortgage, LLC et. al.*, 2024 WL 1202906 (TX Court of Appeals, Corpus Christi-Edinburg) dealt with a dispute in which homestead owners, the Earleys, challenged a 2005 home equity loan that was secured by property containing an agricultural designation, which was a violation of the home equity provisions in Article XVI, Section 50(a)(6) at the time. The 2005 loan was for \$303,200 on forty acres and refinanced a prior 1997 "home equity" loan on twenty acres (the owners had bought an adjoining twenty acres in 2000 to add to the original twenty) for \$191,650. The Earleys received \$125,698.89 at closing.

In 2015, the Earleys notified Nationstar Mortgage, LLC that the 2005 loan did not comply with the Texas Constitution due to a portion of the collateral property being designated for agricultural use—a violation of then-Article XVI, Section 50(a)(6)(I) (this particular provision was repealed 2018 and lenders may now make home equity loans secured by agricultural property). In January 2016, the Earleys notified Nationstar that they were entitled to a refund of principal and interest. In June 2016, the Earleys filed suit against Nationstar and presumed noteholder U.S. Bank N.A. as trustee for Banc of America Funding 2008-FT1 Trust, Mortgage Pass-Through Certificates, Series 2008-FT1 (collectively "defendants") alleging a quiet-title action and breach-of-contract claim. Defendants asserted equitable subrogation to the prior 1997 lien and statute of limitations defenses. The defendants also filed a counterclaim seeking a declaratory judgment that they were equitably subrogated to the 1997 "home equity" lien¹. Both sides filed for summary judgment.

The trial court resolved the summary judgment motions by: 1) finding that the 2005 lien was invalid, 2) finding that the Earleys take nothing on their other claims, including the breach-of-contract action, 3) finding that the Defendants were equitably subrogated to the 1997 lien, and 4) awarding the Defendants attorney's fees concerning the declaratory judgment for equitable subrogation. The Earleys appealed the findings against them, including arguing for clarification on the trial court's equitable subrogation declaration to answer questions on whether the defendants were equitably subrogated to all forty acres or just the twenty acres secured by the 1997 lien and the amount secured by equitable subrogation—that is, should the Earleys be credited for the amounts paid on the 2005 loan. The defendants did not appear the finding that the 2005 lien was invalid.

The appellate court upheld the trial court's findings. In accordance with established case law concerning home equity lending, it held that the breach-of-contract dispute accrued in 2005 when the closing occurred. Therefore, the Earleys were time-barred due to the four-year statute of limitations for breach-of-contract actions and could not sue for a forfeiture of principal and interest. The appellate court also rejected an argument from the Earleys to supplement the appellate record.

¹ Also Licensed in Kentucky and New York

² Also Licensed in District of Columbia

³ Also Licensed in New York

⁴ Also Licensed in Georgia

On the questions regarding the scope of equitable subrogation, the appellate court held that the trial court fully resolved the defendants' equitable subrogation claim through the trial court's declaratory judgment. The appellate court held that issues such as the amount of collateral secured via equitable subrogation and whether the Earleys should be credited for payments under the 2005 loan were questions that were not yet material as those are issues that are only material to a foreclosure actions.

Finally, the appellate court upheld the trial court's awarding of attorney's fees on the equitable subrogation declaratory judgment action. Of note, under Texas law, the Uniform Declaratory Judgments Act, authorizes a Texas court to "award costs and reasonable and necessary attorney's fees as are equitable and just" on declaratory judgments (Texas Civil Practice and Remedies Code Section 37.009). This contrasts with suits to quiet title, which do not support an award of attorney's fees. The court noted that to support a finding of attorney fees, a counterclaim for a declaratory judgment must not simply be a denial of the plaintiff's claim. Instead, the declaratory judgment must be a claim for relief independent of the plaintiff's claim quiet title claim and must entail greater ramifications and seek some sort of affirmative relief. In its holding, the appellate court found that the defendants' counterclaim for an equitable subrogation declaratory judgment was a claim independent of the Earleys' quiet title claim and thus, the defendants were entitled to seek attorney's fees. The appellate court also found that the trial court did not err in its discretion in awarding the fees.

Overall, this decision is favorable for home equity noteholders and servicers as it supports the awarding of attorney's fees in home equity litigation circumstances in which equitable subrogation can be relied upon—that is, when the home equity loan refinanced an existing valid debt on homestead. However, any award of attorney's fees would be at the discretion of a trial court. And this decision was unpublished, so it is not binding precedent, but it may be used as persuasive authority.

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¹ There is a possibility that this 1997 lien was not valid either. Home equity loans on Texas homestead did not become legal until 1998 when Article XVI, Section 50(a)(6) of the Texas Constitution became effective. Apparently, the Earleys did not attempt to argue this 1997 lien was invalid, either because the 1997 collateral was not the Earleys' homestead when the loan was made or if the 1997 collateral was their homestead at the time, due to an oversight. If the 1997 lien was invalid, the defendants would not have been entitled to equitable subrogation. *See, e.g., Nationstar Mortgage, LLC v. Barefoot*, 654 S.W.3d 440, 464 (TX Court of Appeals, Houston 14th District) (2007 home equity lender not equitably subrogated to 2005 home equity lender whose loan it refinanced because 2005 lien was invalid).