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To: Clients and Friends

From: Shawn P. Black

Subject: Accrual of Equitable Subrogation. *PNC Mortgage v. Howard*, 2023 WL 3398580 (TX Supreme Court 2023).

Since at least 1890, Texas has recognized the common-law doctrine of equitable subrogation. *Texas Land & Loan Co. v. Blalock*, 76 Tex. 85, 13 S.W. 12, 13–14 (1890). In the context of mortgage lending, the doctrine of equitable subrogation provides that a "subsequent lender will succeed to the rights of prior lenders and become entitled to 'all rights of the prior creditors in relation to the debt.'" *Vogel v. Veneman*, 276 F.3d 729, 735 (5th Cir. 2002). This means that even if a refinance lender's lien is defective, the refinance lender still has a valid lien under equitable subrogation to the extent its refinance loan satisfied prior debt secured by the property. Texas courts have acknowledged that equitable subrogation benefits both lenders and homeowners. "Without equitable subrogation, lenders would be hesitant to refinance homestead property due to increased risk that they might be forced to forfeit their liens." *LaSalle Bank Nat. Ass'n v. White*, 246 S.W.3d 616, 620 (Tex. 2007). Even in instances where the requirements of the Texas Constitution are not met, Texas courts have allowed lenders to invoke the doctrine of equitable subrogation to obtain partial repayment of the loan. *See*, e.g., *Benchmark Bank v. Crowder*, 919 S.W.2d 657, 662 (Tex. 1996). And in 2020, the Supreme Court of Texas held that even a lender that failed to correct a curable constitutional defect under Tex. Const. art. XVI, § 50(a)(6) is entitled to equitable subrogation. *See Federal Home Loan Mortgage Corporation v. Zepeda*, 2020 WL 1975169 (Tex. Apr. 24, 2020). Our prior memoranda discussing *Zepeda* can be viewed at here and here .

Although Texas case law had recognized equitable subrogation, it was previously unclear as to exactly when an equitable subrogation claim accrued and thus, when an equitable subrogation claim would be time-barred by the applicable four-year statute of limitation governing foreclosure actions (*see* TEX. CIV. PRAC. & REM. CODE § 16.035(a)). On May 12, 2023, the Texas Supreme Court addressed a case in which the parties argued over the appropriate accrual date of an equitable subrogation action and whether the action was time-barred.

In *PNC Mortgage v. Howard* (2023 WL 3398580), a married couple (the Howards) took out two mortgages with First Franklin Financial Corporation to purchase a home in 2003. Two years later, they refinanced with the Bank of Indiana, using the proceeds of that loan to pay off the purchase-money loans. The Bank of Indiana then assigned its refinance note and deed of trust to PNC Mortgage (PNC). The Howards stopped making payments on the loan in 2008, and PNC accelerated the loan in 2009.

In the spring of 2010, the Bank of Indiana, despite having assigned its note to PNC, sent the Howards a notice of acceleration and conducted a nonjudicial foreclosure sale of the property. The Howards sued to set aside the foreclosure sale, naming both the Bank of Indiana and PNC as defendants. In 2014, the trial court granted the Howards' motion for partial summary judgment against the Bank of Indiana and rendered a judgment declaring the foreclosure sale void. It was not until January, 2015, that PNC made a claim against the Howards to foreclose its lien. By then, the four-year statute of limitation for a foreclosure action under the refinance Deed of Trust had expired as the Note had been accelerated in 2009.

Realizing the statute of limitation problem, PNC shifted strategies. In both a counterclaim to the Howards' wrongful-foreclosure suit and affirmatively in a separate lawsuit, PNC asserted a claim for foreclosure on the liens held by the Howards' original lender, First Franklin, which were transferred to PNC's predecessor in the refinance transaction through the doctrine of equitable subrogation. PNC argued that the limitations period on a refinance lender's subrogation claim should not accrue until the maturity date of the notes on the original debt that was later refinanced—in this case, the maturity date of the 2003 loans. Under this argument, PNC's foreclosure action would not be time-barred until four years after the maturity date of the 2003 loans and PNC could maintain a foreclose action under equitable subrogation.

The court rejected PNC's argument. It stated "[i]n the refinance transaction, the original note is paid. That note then ceases to exist; it no longer has a maturity date; and a new note between the borrower and the refinance lender is executed." (Howard at 4). It went on to explain: "[l]ike the original lender, a refinance lender has only one foreclosure claim, which accrues when the note made in the refinancing transaction is accelerated. If the lien created by the refinance transaction turns out to be invalid, then equitable subrogation substitutes the remedy of foreclosing on the original creditor's lien instead. Subrogation provides the refinance lender with an alternative remedy, not an additional claim." (Howard at 5). Therefore, the court held that any claim a lender has through equitable subrogation—due to paying off a previous debt secured by valid liens against the property—accrues when the lender accelerates its Note.

A footnote to the decision explained the court's reasoning: "[t]hough perhaps unlikely in the modern era of thirty-year mortgages, if an original note with a short term is refinanced into a longer-term note, under PNC's proposed rule, the refinance lender could lose any right to foreclose through subrogation before the borrower defaults on the refinanced note. PNC's rule would thus produce arbitrary results that could negatively impact the ability of some borrowers to refinance for a reason having nothing to do with the borrower's creditworthiness—the remaining term on the original note at the time of refinancing." (Howard, FN 32).

The court did not address the question of accrual of equitable subrogation if a Note wasn't accelerated but based on the court's logic, it should be presumed that in the absence of acceleration, any equitable subrogation claim would accrue at the Note's maturity date and be time-barred four years after the maturity date. It should also be reiterated that equitable subrogation is only valid to the extent of discharging prior debts secured by the property.

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