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December 28, 2009

To: Clients and Friends

From: David F. Dulock

Subject: Legislative Update, 81st Regular Session of the Texas Legislature, 2009 – Bills Effective on and after September 1, 2009

This is the third and last legislative update from the 81st Regular Session of the Texas Legislature, 2009, prepared by this firm and summarizes House and Senate Bills effective on September 1, 2009, that we consider are of interest to our clients.

1. **Mortgage Fraud:** House Bill 2840 amends Section 32.32 of the Penal Code to: (i) make it an offense to intentionally or knowingly make a materially false or misleading written statement in providing a real property appraisal for compensation; and, (ii) add the Texas Department of Housing and Community Affairs (TDHCA) to the list of agencies required to assist a Texas or federal prosecuting attorney or law enforcement agency in the investigation of an offense involving a mortgage loan. **Our Comment:** *Depending on the value of the property, Section 32.32 provides that the offense may range from a Class C misdemeanor up to and including a felony of the first degree.*

House Bill 2840 also amends the Government Code to: (i) add the TDHCA to the list of authorized governmental agencies to which a person is required to report information regarding fraudulent activity (*Section 402.031(a)(1)*); (ii) add a TDHCA representative to the residential mortgage fraud task force (*Section 402.032(c)*); and, (iii) include the TDHCA among those state agencies authorized to share information that is confidential or otherwise restricted by law and that relates to the possible commission of corporate fraud or mortgage fraud by a person licensed or otherwise regulated by any of those agencies (*Section 555.051(a)*).

2. **Recording a Property Owners' Association Management Certificate:** Senate Bill 1919 amends Section 209.004 of the Property Code to: (i) require the name and mailing address of the person managing a property owners' association or the name and mailing address of the association's designated representative to be included in the management certificate the association is required to record in the real property records; (ii) provide that, if a property owners' association fails to record a management certificate or an amended management certificate, the purchaser, lender, or title insurance company or its agent in a transaction involving property in the association is not liable to the association for any amount due to the association on the date of a transfer to a "bona fide purchaser" and for any debt to or claim of the association that accrued before the date of a transfer to a bona fide purchaser; (iii) provide that a lien of a property owners' association failing to file a management certificate or an amended management certificate, which lien is to secure an amount due to the association on the effective date of a transfer to a bona fide purchaser, is enforceable only for an amount incurred after the effective date of sale; and, (iv) define a "bona fide purchaser" to mean (x) a person acting in good faith who pays valuable consideration without notice or (y) a lender under a deed of trust. Senate Bill 1919 requires a property owners' association that exists on September 1, 2009, to file the information required by amended Section 209.004 not later than May 1, 2010.

3. **Redemption of Property after Foreclosure of Assessment Lien:** House Bill 3479 amends, in pertinent part, the Property Code by amending Sections 209.010 and 209.011 of the Texas Residential Property Owners Protection Act (Chapter 209) to extend certain rights of notice and redemption to a lienholder of record after foreclosure sale by a property owners' association, but prohibits the lienholder from redeeming the property before a certain date or if the property owner has previously redeemed. The notice of foreclosure sale and redemption right must be sent to the lienholder's address reflected on the recorded deed of trust. It also must be sent to the address of each assignee/transferee of the deed of trust who has provided written notice to the property owners' association by certified mail, return receipt requested, or U.S. mail, with signature confirmation. ***Our Comment:*** *Be advised that this new lienholder redemption right does not replace the loan closing requirement for a subordination agreement or a 60/90-day estoppel letter for the property owners' association lien.*

4. **Homestead in Qualifying Trust:** House Bill 3767 amends the Property Code by adding Section 41.0021 to provide, in pertinent part, that property occupied and used by a settlor or beneficiary as a principal residence in which the settlor or beneficiary owns a beneficial interest through a qualifying trust (*defined by Section 41.0021*) is to be considered the homestead of the settlor or beneficiary under the Texas Constitution and Property Code (*respectively, Section 50, Article XVI, and Section 41.001*). Section 41.0021 requires a married person who transfers property to the trustee of a qualifying trust to comply with requirements of law relating to the joinder of the person's spouse and authorizes a trustee to sell, convey, or encumber property transferred to the qualifying trust without the joinder of either spouse unless expressly prohibited by the instrument or court order creating the trust. Section 41.0021 provides that its provisions do not affect certain constitutional and statutory rights of a surviving spouse or surviving children under Section 52, Article XVI, of the Texas Constitution and Part 3, Chapter VIII, of the Probate Code. House Bill 3767 states that it applies only to a transfer of property to a qualifying trust that is effective on or after September 1, 2009, and any such transfer that is effective before said date is governed by prior law.

5. **Payment to Trustee after Public Sale of Foreclosed Property:** House Bill 655 amends Section 51.0075(f) of the Property Code to provide that the purchase price in a foreclosure sale of real property held by a trustee or substitute trustee is due and payable without delay on acceptance of the bid or within such reasonable time as may be agreed upon by the purchaser and the trustee or substitute trustee if the purchaser makes such request for additional time to deliver the purchase price. ***Our Comment:*** *Prior to this amendment, Section 51.0075(f) required that the purchase price be paid immediately on acceptance of the bid.*

6. **Lis Pendens – Notice and Expunction:** House Bill 396 amends Section 12.007 of the Property Code by adding subsection (d) to require a person who files a notice of lis pendens in accordance with Section 12.007 to serve a copy of the notice on each party to the pending lawsuit who has an interest in the real property affected by the notice not later than the third day after the date the person files the lis pendens notice. House Bill 396 further amends the Property Code by adding new Section 12.0071 that: (1) authorizes a party to a lawsuit in connection with which a notice of lis pendens has been filed to apply to the court to expunge the notice; and, (2) requires the court to order the notice of lis pendens expunged if the court determines at the expunction hearing that (i) the pleading on which the lis pendens notice is based does not state a real property claim, (ii) the lis pendens claimant fails to establish the probable validity of the real property claim, or (iii) the lis pendens claimant failed to serve a copy of the lis pendens notice on each party to the lawsuit that subsection 12.007(d) requires to be served with the notice.

7. **Construction Contract Trust Funds and Misapplication of Trust Funds:** House Bill 1513 amends Sections 162.001, 162.003, 162.004 and 162.031 of the Property Code relating to construction contract trust funds, as follows:

(a) Subsection 162.001(c) is amended to specify that a fee payable to a contractor is not considered trust funds if, in addition to the existing criteria in subsection (c), the fee is earned by the contractor as provided by the construction contract between the contractor and the property owner and is either paid to the contractor or is disbursed from a construction account required by Section 162.006. ***Our Comment:*** *Section 162.006 requires a contractor to maintain a construction account for a written construction contract for improving residential homestead that exceeds \$5000.*

(b) Subsection 162.001(d) is added to specify that trust funds paid to a creditor under Chapter 162 (which contains provisions relating to construction payments, loan receipts, and the misapplication of trust funds) are not property or an interest in property of a debtor who is a trustee of the trust funds.

(c) Section 162.003 is amended by adding subsection (b) to provide that a property owner is a beneficiary of trust funds in connection with a residential construction contract, including funds deposited into a construction account required by Section 162.006.

(d) Section 162.004 is amended by adding subsection (c) to provide that the provisions of Chapter 162 apply to a public or private contract for the improvement of specific real property in Texas, regardless of whether the contract is covered by a statutory or common law payment bond.

(e) Section 162.031 is amended by adding subsection (d) to provide that a trustee who commingles trust funds with other funds in the trustee's possession does not defeat the trust created under Chapter 162 for those trust funds.

8. **Continuation of Owner Title Insurance Coverage of Transferred Property:** House Bill 3768 amends Section 2703.101 of the Insurance Code to require the Insurance Commissioner, for an owner's title insurance policy issued to an individual covering residential real property, to adopt terms that provide for continuation of coverage (subject to rights and defenses against the original named insured) for the following recipients of title to the property: (i) a person who inherits the property on the named insured's death; (ii) the named insured's spouse who receives title upon divorce; (iii) the trustee of a trust established by the named insured and to whom title is transferred after the policy date; or (iv) the beneficiaries of the above trust upon the named insured's death. This change in title policy coverage applies only to an insurance policy or contract that is delivered, issued for delivery, or renewed on or after January 1, 2010.

9. **Release of Lien by Title Insurance Company Affidavit:** House Bill 3945 amends Section 12.017 of the Property Code, in pertinent part, as follows:

- (a) Subsection (a) is amended to revise the definition for "title insurance company" and to add the definition for "Authorized title insurance agent."
- (b) Subsection (b) is amended to add additional property for which an affidavit operating as a release of a mortgage may be executed and filed (*i.e.*, property, other than 1-to-4 family residence, if the original debt secured by the mortgage is less than \$1.5 million).

- (c) Subsection (c) is amended to (i) remove the existing 60-day period given the mortgagor to execute and deliver a release of mortgage before an affidavit that operates as a release may be executed and filed pursuant to Section 12.017; and, (ii) authorize an “Authorized title insurance agent” to execute and file the affidavit.
- (d) Subsection (d) is amended to remove the statements the affidavit must contain and, in their place, to add a form of the affidavit that complies with Section 12.071.
- (e) Subsection (f) is amended to (i) remove the requirement that the affiant attach to the affidavit certain documentary evidence that the mortgage has been paid off; (ii) provide for notice requirements to the mortgagee relating to the affidavit before it may be filed; and, (iii) authorize the mortgagee to file a separate controverting affidavit.
- (f) Subsection (g) is amended to additionally provide that for the affidavit to operate as a release of the described mortgage the affidavit must not be controverted by a separate affidavit filed by the mortgagee.
- (g) Subsection (i) is amended to remove the existing provision that provides that a person who knowingly causes a false affidavit to be filed liable to a party injured by the affidavit for the greater of actual damages or \$5,000, and replaces it with a provision that provides that a person who negligently causes a false affidavit to be filed liable to a party injured by the affidavit for actual damages. This damages provision is in addition to the existing provision providing for criminal penalties under Section 37.02, Penal Code, for knowingly causing a false affidavit to be filed.
- (h) Subsection (j) is added to authorize a title insurance company or authorized title insurance agent who files the affidavit, after payment of the mortgage, to use any recording fee collected for recording a release of the mortgage for the purpose of filing the affidavit.
- (i) Subsection (j) is added to provide that Section 12.017 does not affect any agreement or obligation of a mortgagee to execute and deliver a release of mortgage.

10. **Series Limited Liability Company/Assumed Name Certificate:** Senate Bill 1442 amends the Business Organizations Code to (among other amendments) add Subchapter M to Chapter 101 (*new Sections 101.601 through 101.621*) providing for the creation of a series limited liability company. Ben Idziak and Ali Hedayatifar of our firm have prepared the following comments regarding this new type of entity under Texas law.

Our Comment: *With this legislation, Texas has joined seven other states (Delaware, Nevada, Oklahoma, Iowa, Illinois, Tennessee, Utah and Wisconsin) permitting the formation of a series limited liability company (“series LLC”). Essentially, a series LLC is one or more subsidiary LLCs set up under one Parent LLC. For example, Parent LLC has three series LLCs: A, B, and C. As long as each series LLC “(1) has separate rights, powers, or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations; or (2) has a separate business purpose or investment objective” only the liabilities of series LLC-A can be enforced against the assets of series LLC-A, only the liabilities of series LLC-B can be enforced against the assets of series LLC-B, and only the liabilities of series LLC-C can be enforced against the assets of series LLC-C.*

The liabilities of one particular series LLC cannot be enforced against the assets of the other series LLCs or the Parent LLC.

For the above limitation on liability to apply: (1) the Parent LLC's certificate of formation must contain a notice of the limitation of liability with respect to the series LLC; (2) the Parent LLC's company agreement must contain a statement to the effect of the limitation on liability with respect to the series LLC; and, (3) the records maintained for a series LLC must account for the assets associated with the series LLC separately from the other assets of the Parent LLC or any other series LLC. The records requirement is met if records are maintained in a manner so that the assets of the series LLC can be reasonably identified by specific listing, category, type, quantity, or computational or allocational formula or procedure, including a percentage or share of any assets, or by any other method under which the identity of the assets can be objectively determined.

One of the unanswered questions debated in the states that allow series LLCs is whether courts will respect the inter-cell liability protection of series LLCs. While it is believed Texas courts will respect the inter-cell liability protection of series LLCs, this is yet to be determined.

Another unsettled question relating to series LLCs is how a series LLC will be treated under bankruptcy law (e.g., whether the internal liability shield will be effective in a bankruptcy context).

The most obvious benefit of a series LLC is that only one filing fee is incurred for the Parent LLC regardless of the number of series LLCs the Parent LLC has.

Under a [2008 Private Letter Ruling](#) the IRS held that each series LLC would be treated as a separate entity for tax purposes. (Number 200803004, Release Date: 1/18/2008)

A series LLC may be a useful tool for clients to do net branching and to manage multiple real properties through one Parent LLC. However, we do not recommend that a series LLC be used for this or any other purpose before legal counsel has examined and approved this new statute for the intended purpose.

Senate Bill 1442 (among other amendments) also amends: (i) Section 71.102 of the Business & Commerce Code to remove the requirement that a certificate for an assumed business or professional name include the address of the registrant's registered office in Texas and the name of its registered agent at that address; and, (ii) the provisions of Section 71.103 of the Business & Commerce Code that establish the places of filing such a certificate.

11. Use of Cell Phone Prohibited while Operating Vehicle in School Crossing Zone:

House Bill 55 amends, in pertinent part, Section 545.425 of the Transportation Code to prohibit the operator of a motor vehicle from using a wireless communication device within a school-crossing zone unless the vehicle is stopped or the wireless communication device is used with a hands-free device. A municipality, county, or other political subdivision that enforces the prohibition is required to post a sign at the entrance of each school-crossing zone to inform vehicle operators of the prohibition. It is an affirmative defense to prosecution for violating this prohibition that the wireless communication device was used to make an emergency call to an emergency response service, hospital, fire or police department, health clinic, medical doctor's office, or an individual to administer first aid treatment. Section 545.425 does not apply to an

operator of an authorized emergency vehicle using a wireless communication device while acting in an official capacity or a vehicle operator who is licensed by the Federal Communications Commission while operating a radio frequency device other than a wireless communication device. Section 545.425 preempts all inconsistent local ordinances, rules, or regulations relating to the use of a wireless communication device by a motor vehicle operator.

12. Protocol for Folding the State Flag of Texas: Senate Bill 1145 amends the Government Code by adding Section 3100.073 to provide specific instructions for the means by which the Texas flag should be folded and to specify that a folded Texas flag should be presented or displayed with all folded edges secured and with the blue stripe and a portion of the white star visible. ***Our Comment:** It is hard to believe that until the passage of Senate Bill 1145, we Texans did not have an official policy regarding the folding of our state flag, which, as we all know, is second in importance only to “Old Glory.”*

DISCLAIMERS

Unless otherwise stated in this legislative update, the above bills are effective on September 1, 2009. No attempt was made by this legislative update to summarize all the bills effective on or after September 1, 2009 that could affect mortgage lending or mortgage lenders or brokers. This legislative update is simply an attempt to advise our clients as to those bills effective on or after September 1, 2009, that we believe are of interest to our clients. The above summaries are not complete descriptions of these bills, and you are urged to review the entirety of any bill summarized above that you believe may affect your business. You may request copies of these bills from us, if you so desire.

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