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Texas Supreme Court Addresses Interpretations of Texas Constitution's Home Equity Provisions

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In January 2004, three weeks after the Finance Commission of Texas and the Credit Union Commission of Texas (the "Commissions") issued final interpretations of the home equity provisions in article XVI, section 50 of the Texas Constitution ("Section 50"), six homeowners brought suit, challenging several of the interpretations. In *Finance Commission of Texas v. Norwood*, ___ S.W.3d ___, 2013 WL 3119481 (Tex. June 21, 2013), the Texas Supreme Court addressed two jurisdictional and three substantive issues relating to those interpretations.

Commissions' Interpretations are Subject to Judicial Review

The Court held that Section 50(u) of the Texas Constitution does not deprive the Judiciary of the power to review the Commissions' interpretations. The Court also held that the Commissions' interpretations are given the same stature as the decisions of intermediate state and federal courts of appeals. Significantly, however, the Court held that the Commissions' interpretations are not entitled to any deference under Section 50(u) and are to be reviewed de novo, just as courts review all matters of law.

Home Equity Borrowers Have Standing to Challenge Commissions' Interpretations

The Court found that the homeowners had standing to challenge the Commissions' interpretations because the homeowners implicitly alleged a potential injury to their interest in obtaining a future home equity loan resulting from the Commissions' alleged misinterpretations. Although not addressed by the Court, the same rationale would probably provide a lender with standing to challenge the Commissions' interpretations because the interpretations could negatively impact the lender's interest in making future home equity loans.

Commissions' Interpretation of "Interest" Under Section 50(a)(6)(E) is Improper

In the first substantive issue, the Court considered whether the Commissions correctly gave the term "interest" under Section 50(a)(6)(E) of the Texas Constitution the same meaning as in Section 301.002(a)(4) of the Texas Finance Code, thereby removing discount points from the three-percent fee cap in Section 50(a)(6)(E). The Court held that the Commissions' interpretation was improper for two reasons. First, the Court found that the adoption of whatever definition of "interest" the Legislature might enact from time to time in a statute infringed on the Texas Constitution's separation of powers because it effectively gave the Legislature power to amend the Constitution without ratification by the voters. Second, the Court opined that while the Commissions' broad interpretation of "interest" provides consumers greater protection from usury, it lessens the protection provided by the fee cap in Section 50(a)(6)(E). The Court found that such an inverse relationship was not intended by the framers and ratifiers of Section 50(a)(6)(E). Ultimately the Court held that the term "interest" in Section 50(a)(6)(E) means "the amount determined by multiplying the loan principal by the interest rate." Under this definition, it appears that discount points are not considered "interest" and must be included in the calculation of the fee cap.

Mailing Consent and Closing Through an Attorney-in-fact are Prohibited

The Court also rejected the Commissions' interpretation of Section 50(a)(6)(N), which allowed homeowners to mail to the place of closing their consent to the placing of a lien on the homestead and to attend the closing through an attorney-in-fact. The Court found that such an interpretation permits coercion in obtaining the required consent and a power of attorney at the borrower's home, thereby defeating the purpose of Section 50(a)(6)(N).

Rebuttable Presumption of Receipt of Notice Upheld

Finally, the Court examined the Commissions' interpretation of Section 50(g), which provides a rebuttable presumption that notice is received, and therefore provided, three days after it is mailed. The Court found that the interpretation does not impair the constitutional requirement to provide the Section 50(g) notice; it merely relieves a lender from proving receipt unless receipt is challenged.

Practical Takeaways

Because of this decision, home equity lenders will no longer be able to exclude discount points from the calculation of the fee cap under Section 50(a)(6)(E). In addition, lenders may not have homeowners mail a consent to the place of closing or allow homeowners to attend a closing through their attorney-in-fact. Lastly, while lenders will still have a rebuttable presumption that a Section 50(g) notice is received within three days of mailing it, they should be prepared to prove actual receipt if the homeowner challenges receipt.

The Court's interpretation of "interest" under Section 50(a)(6)(E) may have an immediate impact on home equity loans in the pipeline. For instance, lenders may need to make immediate changes to pricing practices to account for the inclusion of discount points in the fee cap. Because such changes may take time, lenders may need to impose a temporary moratorium on home equity loan closings until such practices can be implemented and potentially affected loans identified. Alternatively, lenders may need to audit their home equity loan closings over the next few months to identify loans affected by the Court's ruling and then preemptively cure those loans by refunding any fees exceeding three-percent of the loan amount. Otherwise, lenders could face downstream liability for closing loans that do not comply with the Texas Constitution.

The Court's interpretation of Section 50(a)(6)(E) may also have long-term effects on home equity interest rates. Because lenders will not be able to discount rates by charging points upfront, interest rates on home equity loans could increase in many cases. Ironically, the Court's interpretation of Section 50(a)(6)(E) could put home equity borrowers at greater risk of default and foreclosure than if they were permitted to pay upfront points to obtain a lower rate.

There is, however, an important silver lining in the Court's opinion. The Court repeatedly emphasized that under the safe harbor provision in Section 50(u), compliance with an interpretation of the Commissions or of an appellate court that is in effect at the time of the compliance is compliance with the Constitution itself, even if the interpretation is later held to be incorrect. This blanket protection from liability with regard to loans closed before June 21, 2013, where the fee cap was exceeded as a result of discount points, potentially could be used by lenders to obtain favorable dispositive rulings in pending and future cases involving such loans.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

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