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MEMORANDUM

TO: Clients and Friends of the Firm

FROM: Sam J. Brown

DATE: June 25, 2013

SUBJECT: Cause No. 10-0121, The Supreme Court of Texas; The Finance Commission of Texas, The Credit Union Commission of Texas, and Texas Bankers Association, Petitioners v. Valerie Norwood, Elise Shows, Maryann Robles-Valdez, Bobby Martin, Pamela Cooper, and Carlos Rivas, Respondents

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On Friday, June 21, 2013, the Texas Supreme Court issued its long-awaited opinion in *Finance Commission of Texas, et al v. Norwood, et al* (commonly known as the "*ACORN*" case), reviewing certain home equity interpretations of the Joint Regulatory Commissions, the Texas Finance Commission and the Credit Union Commission (the "Commissions"). A copy of the Court's opinion may be found at:

http://www.supreme.courts.state.tx.us/historical/2013/jun/100121.pdf

The background and history of this case is the subject of two previous client memoranda: the first memoranda being dated May 10, 2006, and issued with respect to the Final Summary Judgment and Temporary Order entered by the 126th Judicial District Court of Travis County, Texas, a copy of which is posted to our website at www.loanlawyers.com; and the second memoranda being dated January 14, 2010 and issued with respect to the appellate decision issued by the Third Court of Appeals-Austin, a copy of which is attached to this memorandum.

In its opinion, the Texas Supreme Court held as follows:

1. **Use of Powers of Attorney.** The Texas Constitution, Section 50(a)(6)(N) provides that a Texas home equity loan may be "closed only at the offices of the lender, an attorney at law, or a title company," and closing is not merely the final action but includes the initial action of executing a power of attorney. Thus, the Supreme Court held "executing the required consent or a power of attorney are part of the closing process and must occur only at one of the locations allowed by the constitutional provision," i.e., at the offices of the lender, title company or an attorney at law.
2. **3% Fee Cap.** Section 50(a)(6)(E) of the Texas Constitution provides that a home equity borrower may not be required to pay, "in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the

extension of credit." To strengthen the 3% cap, the Supreme Court held that the definition of interest, for purposes of a 50(a)(6) loan, was "the amount equal to loan principal multiplied by the interest rate." In footnote 104, on page 32, it was stated: "This narrower definition of interest does not limit the amount a lender can charge for a loan; it limits only what part of the total charge can be paid in front-end fees rather than interest paid over time." As expressed below, such holding places in issue the charging of true discount points at closing on 50(a)(6) loans.

3. **Presumption of Delivery of 12-day Notice.** The Supreme Court affirmed the holding of the Third Court of Appeals and trial court permitting a lender to mail the consumer disclosure [Notice of Extension of Credit under Section 50(a)(6)(g)], including the rebuttable mailing and delivery presumption that notice is received three days after it is mailed.

CHANGES IN PRACTICES AND PROCEDURES

Based upon the holding of the Texas Supreme Court in *ACORN,* we would recommend the implementation of the following practices and procedures, if current practices and procedures are in conflict:

- **3% Fee Cap.** True discount points are not specifically addressed by the Supreme Court within its *ACORN* opinion, notwithstanding the fact that, in its brief to the Third Court of Appeals-Austin, ACORN did concede that "true discount" points charged by the lender in exchange for a lower rate of interest, should qualify as "interest" for exclusion from the 3% cap. Because the Supreme Court did not address true discount within its opinion and because of the very broad language of the Court within footnote 104, on page 32, as set forth above, for home equity loans closed on or after June 21, 2013, until and unless further clarification is received from the Texas Supreme Court, all lender's origination charges, including true discount points and excepting only pre-paid interest, collected at or before loan closing must be included within the 3% cap specified by 50(a)(6)(E).
- **Powers of Attorney.** Unless the lender can secure written verification, e.g., an affidavit of a non-interested, knowledgeable party, that a power of attorney was executed at the offices of the lender, an attorney at law, or a title company, for all home equity loans closed on or after June 21, 2013, powers of attorney should not be accepted. Caveat: Even if the place of execution of the power of attorney has been verified, as set forth above, lender is advised to secure the approval of the use of the power of attorney by the title agency serving as settlement agent.

Because of the safe harbor provisions of the official interpretations of the Commissions, loans closed prior to June 21, 2013 are not affected by the decision of the Texas Supreme Court in *ACORN.*

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MEMORANDUM

TO: Clients and Friends of the Firm

FROM: Sam J. Brown

DATE: January 14, 2010

SUBJECT: Cause No. 03-06-00273-CV, Third Court of Appeals, Third District, at Austin; Texas Bankers Association, Finance Commission of Texas, and Credit Union Commission of Texas v. Association of Community Organizations for Reform Now, et al; Finding 7 TAC §153.1 (11), 153.5(3), (4), (6), (8), (9), and (12)Constitutionally Invalid

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BACKGROUND: HISTORY OF THE ACORN DECISION

- Constitutionality of certain of the official interpretations of the Joint Regulatory Agencies, the Texas Finance Commission and Credit Union Commission (the "Commissions"), codified in 7 TAC Chapter 153 was challenged by suit filed January 29, 2004, in Cause No. GN400269 in the District Court of Travis County, Texas, 126th Judicial District, styled *Association of Community Organizations for Reform Now (ACORN), Valerie Norwood, Elise Shows, Maryann Robles-Valdez, Bobby Martin, Pamela Cooper, and Carlos Rivas, Plaintiffs, vs. Finance Commission of Texas and Credit Union Commission of Texas, Defendants.*

- Plaintiffs filed the action pursuant to Chapter 37, Texas Civil Practices and Remedies Code, pertaining to declaratory judgments, and more particularly §2001.038, Texas Government Code, which provides for determining the validity or applicability of a state agency's rule in an action for declaratory judgment if it is alleged that the rule or its threatened application interferes with or impairs a legal right or privilege of Plaintiffs. A request of the district court on motion of the Commissions to transfer the action to the Third Court of Appeals-Austin under procedures permitted by §2001.038(f) was denied by the appellate court without comment.

- Thereafter, on consideration of Plaintiffs' motion for summary judgment and Defendants' cross motion, Judge Scott H. Jenkins of the 53rd District Court informed counsel by letter dated October 7, 2005 of his intent to rule for Plaintiffs in part on their points challenging the validity of §§153.5 (Fee Cap Rule), 153.12 (Oral or Electronic Application Rule), 153.13 (*De Minimis* Fee Variance Exception to Disclosure Rule), 153.18(3) (Debt Consolidation Rule), 153.20 (Blank Spaces Rule), 153.22 (Document Copies Rule), and 153.84 (HELOC Convenience Check Rule). At its scheduled meeting on October 21, 2005, the Commissions took up the matter and resolved to recommend that the Attorney General of Texas timely move the district court for

reconsideration of its order and vigorously represent the interests of the Commissions throughout a full appellate process.

- The Finance Commission after the issuance of the district court's October 7, 2005 letter forewarning of its intent to find these interpretive rule constitutionally invalid separately proposed on March 3, 2006 the repeal and substitution for rules 7 TAC §§153.13, .18, .20 and .22 (31 Tex. Reg. 1393) in an apparent effort to undermine ACORN's complaint of unconstitutionality of those interpretive rules and to render much of the district court's order moot on appeal. The public comment period ended April 12, 2006 and the proposed substituted rules were adopted as final rules in June, 2006.

- On April 29, 2006, the judgment or order was signed by the district court in the form of the Final Summary Judgment and Temporary Stay Order, finding a number of the Commissions' interpretive rules constitutionally invalid, including specifically 7 TAC §§ 153.1(11), 153.5(3), (4), (6), (8), (9) and (12), 153.12(2) in part, 153.13(4), 153.18(3), 153.20, 153.22, and 153.84(1), and ordering that the judgment was stayed in all respects for thirty days, with the rules declared to be invalid by the judgment to remain in effect during that time regardless of whether the judgment was superseded by the posting of a bond, filing notice of appeal or other action of a party.

- On May 2, 2006, the Commissions filed its Amended Notice of Appeal from the final judgment of the district court that was signed April 29, 2006. In fact, on April 12, 2006, prior to the judgment being signed, the Commissions prematurely filed a Notice of Appeal to the Texas Court of Appeals, Third District, at Austin, which was deemed effective upon April 29, 2006, the date the judgment was signed. The Commissions' perfection of the appeal superseded the judgment of the trial court, and, during the appellate period, the interpretative rules declared invalid the trial court judgment remained in full force and effect.

SPECIFIC HOLDINGS OF THE THIRD COURT OF APPEALS IN *ACORN*

On January 8, 2010, the Third Court of Appeals-Austin issued its Opinion in *ACORN* holding as follows:

1. 7 TAC §153.1 (11), 153.5(3), (4), (6), (8), (9), and (12). The Court affirmed the trial court's decision and held that utilization of the definition of interest under the 153.1(11), or Texas usury law that define points or charges as interest [153.5(3)(4)], including charges to originate [153.5(6)], charges to evaluate [153.5(8)], charges to maintain [153.5(9)], and charges to service [153.(12)], would render the plain language of the 3% constitutional cap meaningless. Accordingly, the Court held these rules to be invalid thereby precluding the use of Texas usury law to interpret the Constitution's 3% cap with respect to fees that may be charged to originate, evaluate, maintain, record, insure, or service the extension of home equity credit.

   Comment: In its brief to the Court, ACORN did concede that true "discount points," charged by the lender in exchange for a lower rate, should qualify as interest for exclusion from the 3% cap; however, the Court declined to provide a substitute definition of interest or to definitively categorize "discount points," "origination points," or any other charges that might be imposed by a lender as "interest" or "fees" with respect to the 3% cap, but the Court within a footnote did state that the Commissions would be free to adopt another definition of interest that is consistent with the plain language of the Constitution. Exclusion of true discount points from the 3% cap, as interest, is supported by the decision in *Tarver v. Sebring Capital Credit Corporation*, 69 S.W.3rd 708 (Tex. App. – Waco 2002).

2. 7 TAC §153.12. The Court reversed the trial court's decision and held that oral loan applications are permissible in Texas home equity loan transaction. In its opinion, the Court stated that in 2007, certain home equity provisions of the Texas Constitution were amended that reflected legislative intent to allow oral applications, including Tex. Const. art. XVI, §50(a)(g), which deleted any reference to a written application within the Notice Concerning Extensions of Credit (to be provided by the lender to the owner prior to closing) and the "Statement of Legislative Intent" recorded in the Journal of the Texas House of Representatives upon passage of the joint resolution proposing the 2007 constitution amendments, in which the author of the resolution stated that "the homeowner may submit a written, electronic, or *oral* application." Accordingly, the court held the term "application" included oral applications as the constitution is currently written, thereby reversing the trial court's order to the extent it invalidated the "oral application" portion of 7 TAC 153.12(2).
3. 7 TAC §153.22. The Court reversed the trial court and held that the lender must provide to the owner only the copies of the loan application and any documents signed by the owner at loan closing. In 2007, Tex. Const. art. XVI, § 50(a)(6)(Q)(v) was amended to state, "[A]t the time of extension of credit is made, the owner of the homestead shall receive a copy of the final loan application and all executed documents signed by the owner at closing related to the extension of credit." The Commissions then amended 7 TAC 153.22 to state that: (i) at closing, the lender must provide the owner with a copy of the final loan application and all executed documents that are signed by the owner at closing in connection with the equity loan; … and (ii) the lender is not obligated to give the owner copies of documents that were signed by the owner prior to or after closing. The Court held that the 2007 constitutional amendment renders moot ACORN's argument that documents signed prior to closing must be provided at closing to the homeowner, as the relevant provision now requires the lender to provide only copies of the loan application and any documents "signed by the owner at closing." Thus, the Court reversed the trial court's judgment invalidating 7 TAC §153.22.
4. 7 TAC §153.84(1). At the trial court, ACORN successfully challenged 7 TAC 153.84 on the basis that "convenience checks" in HELOC transactions are similar devices to credit cards, debit cards, and preprinted solicitation checks prohibited by Tex. Const. art. XVI, §50(t)(3). However, pursuant to the 2007 constitutional amendment to Tex. Const. art. XVI, §50(t)(3), "preprinted checks unsolicited by the borrower," were prohibited. Additionally, the amendment to 7 TAC 153.84(1) is consistent with the constitutional prohibition, permitting "preprinted checks requested by the borrower," and the rule no longer expressly permits the use of "convenience checks," the primary focus of ACORN's challenge to the validity of the rule. The Court reversed the trial court to the extent it invalidated 7 TAC §153.84.
5. 7 TAC §153.15. The Court affirmed the trial court's judgment upholding 7 TAC §153.15, thereby validating the use of powers of attorney by borrowers in home equity loan transactions.
6. 7 TAC §153.51. The Court affirmed the trial court's judgment upholding 7 TAC §153.51(1), which permits the mailing by the lender to the owner of the consumer disclosure [Notice of Extension of Credit under Tex. Const. art. XVI, §50(g)], including the rebuttable mailing and delivery presumption under such rule of a period of three calendar days, not including Sundays and federal holidays. The Court also upheld 7 TAC §153.51(3) which permits the lender to rely on an established system of verifiable procedures for evidence of compliance with such rule.

PRACTICAL CONSIDERATIONS

In March, 2006, to resolve complaints of unconstitutionality by ACORN, the Commissions proposed both the repeal and substitution of interpretative rules 7 TAC §§153.13, 153.18, 153.20, and 153.22. In June, 2006, the Commissions adopted such rules and rendered moot the portions of the *ACORN* decision of the trial court pertaining to such rules. Accordingly, such issues were not addressed by

the Third Court of Appeals-Austin in the *ACORN* Opinion. The current practice, procedures and advice of this firm is consistent with the substituted interpretative rules 7 TAC §§153.13, 153.18, 153.20, and 153.22.

We anticipate that the Commissions will in the near future propose and adopt revisions to its interpretive rules that have been invalidated by the Third Court of Appeals-Austin in *ACORN*, specifically 7 TAC §§153.1(11), 153.5(3), (4), (6), (8), (9), and (12), for the purpose of establishing a definition of interest to be used in calculation of the constitutional 3% cap for Texas home equity loans pursuant to Tex. Const. art. XVI, §50(a)(6)(E). The current practice, procedures and advice of this firm is consistent with the holding by the Third Court of Appeals-Austin with respect to invalidating 7 TAC §§153.1(11), 153.5(3), (4), (6), (8), (9), and (12), i.e., other than per diem interest and true loan discount (in which the fees paid are in reduction of the interest rate), lenders must include within the 3% cap all other points and fees paid to originate, evaluate, maintain, record, insure or service the loan.

Based upon the trial court's decision in *ACORN*, most lending institutions have refrained from processing oral loan applications upon Texas home equity loans; however, as set forth above, based upon certain 2007 amendments to the Texas Constitution authorizing oral loan applications upon such transactions, the Third Court of Appeals-Austin has reversed such finding, thereby validating oral loan application procedures upon Texas home equity loans.

Please contact us if you have any questions or comments regarding these matters.