



Texas Supreme Court Issues Ruling in *Federal Home Loan Mortgage Corporation v. Zepeda*

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On April 24, 2020, the Texas Supreme Court issued an important ruling on the availability of subrogation for invalid home equity loans in *Federal Home Loan Mortgage Corporation v. Zepeda*, No. 19-0712, 2020 WL 1975169 (Tex. Apr. 24, 2020). TLTA is grateful that the Court's decision aligns with the [amicus letter we submitted](#) encouraging the Court to uphold the centuries-old subrogation doctrine.

Sylvia Zepeda purchased her home in 2007 with a loan from CIT Group. In 2011, she refinanced that purchase money loan with a home equity loan from Embrace Home Loans. As part of the home equity transaction, Embrace paid off the balance of the purchase money loan and CIT Group released its lien against the property. In 2015, Zepeda sent a letter to Embrace, claiming that her home equity loan did not comply with the requirements of the Texas Constitution because Embrace had not signed the fair market value acknowledgment. Embrace responded by sending another copy of the FMV acknowledgment but again failed to sign it. Embrace later sold the loan to Freddie Mac, and Zepeda sent a similar letter complaining of the FMV acknowledgment to Freddie Mac. Freddie Mac did not respond to the letter, and Zepeda sued to invalidate the home equity lien and quiet title. Freddie Mac countered that even if the lien was invalid for failure to strictly comply with the Texas Constitution, it was still subrogated to CIT Group's 2007 purchase money lien because Embrace paid off the balance of that prior, valid lien. When the United States District Court for the Southern District of Texas ruled in favor of Zepeda, Freddie Mac appealed to the Fifth Circuit Court of Appeals. The Fifth Circuit examined whether subrogation was available where the complained-of defect was due to the fault of the lender, and it certified the following question to the Texas Supreme Court:

“Is a lender entitled to equitable subrogation, where it failed to correct a curable constitutional defect in the loan documents under § 50 of the Texas Constitution?”

The Court responded with an unequivocal “YES.” In doing so, the Court explained that a lender’s right to subrogation is “fixed” when the prior, valid lien is discharged, and thus the lender’s post-closing conduct is irrelevant to the availability of equitable subrogation in this context. The Court emphasized that the Constitutional home equity loan provisions “do[] not destroy the well-established principle of equitable subrogation” and the amendment of those provisions over the years has not “abrogate[d] lenders’ equitable subrogation rights under the common law.” It also rejected Zepeda’s public policy argument that the mere availability of subrogation erodes lenders’ incentives to make constitutionally-compliant loans and cure any deficiencies. According to the Court, “[c]ommon law subrogation has coexisted with this constitutional scheme for more than a century” and “revisiting the wisdom of subrogation in this case is unwarranted.” Notably, however, the Supreme Court declined to address Freddie Mac’s contention that it was contractually subrogated to CIT Group’s lien, after both the District Court and Fifth Circuit ruled against it on that theory.

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