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An important Financial Services update from the law firm of Jackson Walker.

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Texas Case Law Update - Judge Dismisses Putative Class Action Over Home Equity Modifications

By **Gordon M. Shapiro** & **Brian A. Kilpatrick**

In an ongoing effort to update our financial institution clients about developments in Texas jurisprudence that may impact them, we bring to your attention a recent decision of particular importance to mortgage and home equity lenders in Texas, *Hawkins v. JPMorgan Chase Bank, N.A.*, No. A–12–CA–892–SS, 2013 WL 443954 (W.D. Tex. Jan. 29, 2013). Dallas trial associate **Michael F. West** contributed to this e-Alert.

United States District Judge Sam Sparks dismisses class action complaint against JPMorgan Chase, and holds that home equity loan modifications did not violate the Texas Constitution, agreeing with and extending United States District Judge John McBryde's similar holding in 2012 in *Sims v. Carrington Mortgage Services, LLC*.

In *Hawkins*, Jackson Walker trial partners Gordon M. Shapiro, Brian A. Kilpatrick and **James Matthew Dow**, with assistance from **James L. Pledger** and Michael F. West, represented JPMorgan Chase Bank, N.A. in a putative class action filed in the Western District of Texas, Austin Division, seeking to invalidate "at least thousands of class members' " home equity loans, on the alleged grounds that the modifications violated various provisions in the Texas Constitution.

Hawkins is one of several putative class action lawsuits pending in Texas alleging that financial institutions are violating the Texas Constitution by modifying home equity loans in such a way as to capitalize past-due interest and advanced escrow into higher, modified principal amounts, and by not jumping through certain other procedural hoops. The plaintiffs in these cases, all of whom were in default and facing foreclosure, generally pursued the modifications with the lenders, oftentimes pursuant to federal programs such as the **Making Home Affordable** initiative. The financial institutions, such as JPMorgan Chase in *Hawkins*, agreed to the modifications instead of pursuing their contractual and constitutional right to foreclose. Plaintiffs alleged that the financial institutions rolled past-due interest and/or escrow funds that had been advanced into a modified principal balance, thereby allowing the borrowers to pay back the past-due sums over time, as opposed to all at once. Plaintiffs argued that the Texas Constitution prohibited capitalizing these past-due amounts into a new higher principal, and that by agreeing to these modified terms (and others), the financial institutions, including JPMorgan Chase in *Hawkins*, violated the Texas Constitution. The remedy, argued plaintiffs, was a complete forfeiture of the loans. "In short," Judge Sparks noted, plaintiffs argue that "everyone gets a free house." *Id.* at *1.

Judge Sparks rejected plaintiffs' arguments, noting that the lawsuit exemplified the phrase "no good deed goes unpunished." *Id.* at *8

n.6. The Court agreed with the argument advanced by the Jackson Walker team in a motion to dismiss for failure to state a claim, and held that the transactions were proper modifications, not improper refinances, because (1) they showed no intent to satisfy and replace the original home equity loan, and (2) the capitalizing of past-due interest and advanced escrow into a modified principal amount is not a constitutionally prohibited "advancement of additional funds." *Id.* at *5. Judge Sparks also held that the constitutional disclosures that must ordinarily be provided with an "advancement of additional funds" need not be given in a modification for the same reasons. *Id.* at *6. Further, the Court held that the 80% loan-to-value cap found in the Texas Constitution does not apply to modifications because the value is only measured "on the date the extension of credit is made" and not on a subsequent modification date. *Id.* at *7. The Court relied, in part, on a decision by "our sister court in Fort Worth, [which] dismissed with prejudice similar claims, finding the alleged refinances were actually modifications, and therefore no constitutional violations occurred." *Id.* at *3 (*citing Sims v. Carrington Mortg. Servs., LLC*, No. 4:12–CV–087–A, 2012 WL 3636884, at *3–6, *10 (N.D. Tex. Aug. 23, 2012) (appeal pending, 5th Cir. Case No. 12-10978)).

Judge Sparks also found that a modification allowing temporary, interest-only payments for five years, which was then re-amortized for the remainder of the loan term, was permissible under the plain language of the Texas Constitution, which only required monthly payments to "equal [ ] or exceed [ ] the amount of accrued interest as of the date of the scheduled installment." *Id.* The Court noted that according to the regulations, the purpose of this constitutional provision was to prevent balloon payments, and the modification at issue in the case did not contain a balloon. *Id.*

Finally, with respect to another modification which did contain a balloon payment at the end of the modified term, Judge Sparks nevertheless dismissed the claim because the primary loan documents contained a "savings clause," which would allow JPMorgan Chase to reform the loan to cure any alleged constitutional violation, and plaintiffs failed to show that they had given JPMorgan Chase proper notice of the alleged violation before filing suit, so as to give the bank an opportunity to cure. *Id.*

In the end, the Court found that the plain language of the Texas Constitution barred plaintiffs' requested relief as did the policy behind it. Inasmuch as plaintiffs had previously amended their complaint, the Court dismissed plaintiffs' class action complaint without leave to amend. Plaintiffs appealed the judgment to the Fifth Circuit Court of Appeals.

If you have any questions regarding this e-Alert, please contact **Gordon M. Shapiro** at 214.953.6059 or **gshapiro@jw.com** or **Brian A. Kilpatrick** at 214.953.5933 or **bkilpatrick@jw.com**.

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