

# **JUDICIAL FORECLOSURE**

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## TABLE OF CONTENTS

I.	Defective or Ambiguous Instruments.....	3
II.	Defective Title.....	4
	A. Defect in Ownership .....	5
	B. Defect in Legal Description .....	7
	C. Interests Unaffected by Judicial Foreclosure.....	7
III.	Miscellaneous Considerations.....	9
	A. Judicial Foreclosure of Property in Receivership.....	9
	B. Pendency of Divorce .....	10
	C. Statute of Limitations Affecting Right to Foreclose .....	10
IV.	Pre-Foreclosure Tips that May Prevent Unnecessary Cost/Liability .....	10
	A. Other Lienholders.....	10
	B. Tax Liens.....	11
	C. EPA Considerations.....	11
V.	The Basics of Judicial Foreclosure .....	12
	A. Jurisdiction and Venue.....	12
	B. Pleading Requirements.....	12
	C. The Judgment.....	13
	D. The Writ and Sale .....	14
	E. Post Sale Matters.....	15
VI.	Home Equity and Reverse Mortgage Foreclosures .....	15
	A. Home Equity Foreclosures .....	16
	B. The Application.....	17
	C. Service .....	18
	D. The Notice.....	19
	E. Default or Answer.....	19
	F. The Order .....	19
	G. Abatement and Dismissal.....	20
	H. Reverse Mortgage Foreclosures.....	20

## Judicial Foreclosure

Judicial foreclosure can be an option that a lien holder chooses to exercise despite the fact they may be entitled to a non-judicial foreclosure, which is a faster and less expensive method of foreclosing real property liens. For example, a holder of a first lien deed of trust that provides for non-judicial foreclosure also has the option to file a lawsuit and request a judicial foreclosure. While filing suit for a judgment on the debt and foreclosure of real property does constitute an election of remedies,<sup>1</sup> the election does not bar a non-judicial foreclosure proceeding until a judgment has been rendered for judicial foreclosure.<sup>2</sup> Consequently, a lien holder can dismiss its judicial foreclosure proceeding before obtaining a judgment if the lien holder desires to seek non-judicial foreclosure of real property,<sup>3</sup> but a lien holder cannot concurrently pursue non-judicial foreclosure and a judicial foreclosure of the same property.<sup>4</sup> Why would you choose the more expensive option of judicial foreclosure over a less expensive and faster non-judicial foreclosure? Generally there are three categories of reasons to choose a judicial foreclosure over a non-judicial foreclosure, these reasons are: (1) defective instruments; (2) defective title; and (3) litigious borrowers. Judicial foreclosures all but eliminate claims litigious borrowers can make against lien holders for wrongful foreclosure.

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<sup>1</sup> *Coffman v. Brammer*, 50 S.W.2d 913 (Tex. Civ. App. – Amarillo 1932, no writ).

<sup>2</sup> *Gandy v. Cameron State Bank*, 2 S.W.2d 971 (Tex. Civ. App. – Austin 1927, writ ref'd).

<sup>3</sup> *See Patterson v. Shell Petroleum Corp.*, 143 S.W.2d 208 (Tex. Civ. App. – Amarillo 1940, writ dismiss'd).

<sup>4</sup> *In re Phillips*, 124 B.R. 712, 717 (Bankr. W.D. Tex. 1991).

## **I. Defective or Ambiguous Instruments**

“Defective instruments” refers to the instruments that form the basis of the obligations that the debtor has with regard to the property, which include, but are not limited to: (a) the debt instrument that forms the basis of the lien; (b) the lien that secures the debt to the property; and (c) other instruments that set forth the obligations of the debtor to the lender and/or the property. For example, if the promissory note or other debt instrument is ambiguous as to how interest is calculated, when the payment is due, and/or whether the debt can be accelerated if a payment is missed, it may be impossible to conduct a non-judicial foreclosure without exposing the lender to a wrongful foreclosure suit. An example of a defective lien is a deed of trust that fails to include delineate the trustee’s and/or substitute trustee’s method of conducting a non-judicial foreclosure sale in a “power of sale” clause, or a deed of trust that appoints a trustee to conduct the foreclosure sale without providing the beneficiary with the right to appoint a successor trustee and the trustee who was initially appointed becomes disabled or dies. Without a lien that specifically enables the beneficiary (the Lender) to conduct a non-judicial foreclosure sale, it would be wise to conduct a judicial foreclosure sale to prevent a wrongful foreclosure suit. Lastly, any instrument that provides additional obligations on the part of the borrower (e.g. a construction loan agreement) wherein a default triggers the Lender’s right to foreclose may lead to a wrongful foreclosure suit if the “event of default” is not clear. For instance, if the instrument requires the borrower to keep the property in “good” condition or not engage in “waste” of the property and the failure of the borrower to adhere to these requirements is an event of default, if the default is not

clear then it may be wise to enlist the Court's ability to make a judicial determination that the borrower has violated this obligation within the context of a judicial foreclosure proceeding.

Because the Texas Supreme Court has held there must be a defect in the procedure used to effectuate the foreclosure in order to successfully assert a claim for wrongful foreclosure,<sup>5</sup> defective instruments and/or ambiguous instruments expose lenders to risk if a non-judicial foreclosure sale is conducted based on defective instruments. In order to eliminate this risk to the fullest extent possible, a judicial foreclosure proceeding in a District Court should be coupled with a request that the District Court reform any defective instrument thereby eliminating a wrongful foreclosure claim based upon the defective instrument.<sup>6</sup>

## **II. Defective Title.**

Defective title in this paper will be broadly construed to include: (a) actual defects in the title of the property, (b) defective legal descriptions, (c) and interests that are unaffected by the foreclosure of your lien. Actual defects in the title of the property generally refer to defects in and/or disputes related to ownership of the property. It should be noted that the Court of Appeals in Waco has stated that the only issues that should be heard in an action for judicial foreclosure are those that affect the equity of redemption and the only parties to the action should be the mortgagor, mortgagee, and

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<sup>5</sup> *American Savings & Loan Ass'n v. Musick*, 531 S.W.2d 581, 587 (Tex. 1975). See also *Savers Federal Savings & Loan Ass'n v. Reetz*, 888 F.2d 1497 (5th Cir. 1989) and *Olney Savings & Loan v. Farmers Market*, 764 S.W.2d 869 (Tex. Ct. App. – El Paso 1989, writ ref'd).

<sup>6</sup> See *Caprock Investment Corp. v. Montgomery First Corp.*, 2005 WL 3118787 (Tex. App. – Fort Worth, 2005) (not designated for publication) (Lender sought reformation of deeds of trust as well as judicial foreclosure of the deeds of trust).

any party that has acquired rights or interest subsequent to the mortgagor and/or mortgagee.<sup>7</sup> In the context where the only cause of action that is brought in a lawsuit is the judicial foreclosure of property, the Waco Court is absolutely correct, as the judgment will only be binding on the parties to the suit and their privies.<sup>8</sup> However, it may be necessary for the lien holder to add additional causes of action in order to insure that its foreclosure will be affective in transferring clear title to a purchaser at the foreclosure sale and/or subsequent purchaser. Instances where judicial foreclosures must be coupled with other causes of action to achieve this result are discussed below.

**A. Defect in Ownership.** A defect in the ownership of the property is usually caused by a break in the chain of title. One of the most common breaks in the chain of title occurs when the owner of the property dies intestate. In *Washington v. Cole*, a former lien holder brought suit to judicially foreclose a vendor's lien against the alleged heir of the former purchaser of the property in an effort to deliver clear title to the property to a subsequent purchaser after the subsequent purchaser brought suit to quit title.<sup>9</sup> Although the cited opinion does not elaborate as to whether the vendor's lien was a defective instrument, it is fairly clear that the owner of the property (Mr. Cole) did not extinguish the rights of the former purchaser (Mrs. Ruth) before attempting to sell the property to the subsequent purchaser (Mr. and Mrs. Taylor). In response to Mr. & Mrs. Taylor's lawsuit against Mr. Cole to quiet title, Mr. Cole sought a judicial foreclosure of the property against Mrs. Ruth's heir (Mr. Washington) in order to extinguish Mr. and

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<sup>7</sup> *J. V. Wood & Bros. v. Brooks*, 5 S.W.2d 203, 204 (Tex. Civ. App. – Waco 1928, no writ).

<sup>8</sup> *Citizens Nat. Bank in Abilene v. Cattlemen's Production Credit Ass'n*, 617 S.W.2d 731, 737 (Tex. Civ. App. – Waco 1981, no writ).

<sup>9</sup> *Washington v. Cole*, 2007 WL 3293734, (Tex. App. – Houston [1st Dist.], 2007)(not designated for publication).

Mrs. Taylor's breach of warranty against Mr. Cole. Mr. Washington brought various causes of action against Mr. Cole including, but not limited to, civil conspiracy, fraud, negligent misrepresentation, and unfair trade practices. Mr. Cole probably could have avoided being sued by Mr. and Mrs. Taylor had he foreclosed the vendor lien against Mrs. Ruth before attempting to sell the property to Mr. and Mrs. Taylor. Had Mr. Cole foreclosed his vendor's lien, Mrs. Ruth's (and subsequently, Mr. Washington's) interest in the property would have been cut-off, and Mr. Cole could have provided a clear title to Mr. and Mrs. Taylor. It should go without saying that before securing a lien against real property a lender should determine whether its borrower has clear title to the property to be encumbered by the lien. A title policy or an abstractor's certificate serve as protective measures to insure that the borrower actually has the right to encumber the property he and/or she intends to encumber with the lender's lien. Not all defects in title are the result of natural causes like death.

In *Kyle v. Countrywide Home Loans, Inc.*, Countrywide brought suit against Jack B. Kyle and Janice M. Kyle for judicial foreclosure of the deed of trust against the Kyles' home, and to expunge fraudulently filed property records that were allegedly filed by the Kyles in an attempt to extinguish Countrywide's lien against the property. In *Andrews v. Kislak Nat. Bank*, the borrower actually clouded the title of her own property by filing false liens against the property that she occupied.<sup>10</sup> Thankfully, neither the Kyles nor Ms. Andrews were successful in their attempts to fraudulently create defects in the title to

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<sup>10</sup> *Andrews v. Kislak Nat. Bank*, 2001 WL 301599 (Tex. App. – Dallas, 2001)(not designated for publication).

their own properties, and both lenders were allowed to foreclose their liens against their properties.

**B. Defect in Legal Description.** Defects in legal description can cause the lien encumbering the property to either: (a) encumber the wrong property, (b) encumber an insufficient amount of the property, and/or (c) a combination of both (a) and (b). A defect in the legal description of a lien instrument cannot be cured by an action for judicial foreclosure, however, if there is a defect in the legal description of the lien instrument the issue should be addressed during the judicial foreclosure proceedings. Whether the defect occurred in an instrument that is in the chain of title prior to the lien or in the instrument creating the lien, Courts have the ability to reform instruments to give the intended legal effect intended by the parties.<sup>11</sup> However, the knowledge and intent of the parties nor a plat made from extrinsic evidence will not give validity to an instrument.<sup>12</sup> The Court will consider whether the description of the property, whether in the instrument itself or by reference to some other existing writing, is sufficient to identify the land with reasonable certainty.<sup>13</sup> If the lien inaccurately describes the property that it encumbers, the lien holder should seek to have the Court reform the lien so as to correctly identify the encumbered property so that the legal affect of the foreclosure of the lien clearly relates to the encumbered property.

**C. Interests Unaffected by a Judicial Foreclosure.** Generally there are two categories of interests in real property that will be unaffected by a judicial foreclosure, they are: (a) interests that cannot be affected by judicial foreclosure without notice, and

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<sup>11</sup> *Dixon v. Amoco Production Co.*, 150 S.W.3d 191, 195 (Tex. App. – Tyler 2004, rehearing denied).

<sup>12</sup> *Morrow v. Shotwell*, 477 S.W.2d 538, 540 (Tex. 1972).

<sup>13</sup> *Id.* at 539



(b) interests that cannot be affected by judicial foreclosure at all. The first class of interests are those interests that can be affected by a judicial foreclosure if they are made parties to the judicial foreclosure proceeding. Clearly a judicial foreclosure proceeding should include the mortgagor and the mortgagee, but who else should the mortgagee consider including in the suit? Junior lien holders should be included in the judicial foreclosure if the liens are to be discharged by the foreclosure of a senior lien upon the judicial foreclosure of the property.<sup>14</sup> A trustee-settlor is a necessary party to judicial foreclosure proceeding in which the property is held by a trust while the beneficiaries are not if the dispute involves no conflict between the trustee-settlor and the beneficiaries.<sup>15</sup> Foreclosures on portions of partnership interests require all the partners and their spouses to be joined in the judicial foreclosure proceeding.<sup>16</sup> The IRS is a necessary party to a judicial foreclosure if a federal tax lien has been filed against the property, and if the IRS is not included as a party then the tax lien remains on the property after the judicial foreclosure sale is conducted.<sup>17</sup> It is noteworthy that the IRS has a right to make a claim against the proceeds of the judicial foreclosure sale with the same priority its lien was entitled to at any time before the proceeds from the sale of the property is ordered in any case where the United States was not made a party.<sup>18</sup> The safe standard to apply is if you intend to have an affect on an interest in real property, then you will have to provide that individual/entity notice or the judicial foreclosure of your lien will not have any legal

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<sup>14</sup> *Colonial Savings & Loan Ass'n v. Texboro Cabinet Corp.*, 401 S.W.2d 357, 360 (Tex. Civ. App. – Fort Worth 1966, no writ).

<sup>15</sup> *Starcrest Trust v. Berry*, 926 S.W.2d 343, 355 (Tex. App. – Austin 1996, no writ)(citing *Hedley Feedlot, Inc. v. Weatherly Trust*, 855 S.W.2d 826, 833 (Tex. App. – Amarillo 1993, no writ).

<sup>16</sup> *Rips v. Ungerman*, 137 S.W.2d 87, 92 (Tex. Civ. App. – Fort Worth 1940, writ dism'd).

<sup>17</sup> 26 U.S.C. § 7425(a)(1).

<sup>18</sup> 26 U.S.C. § 7425(a).

effect on the individual/entity that you did not include in the judicial foreclosure proceedings.

Liens that are senior to the lien being foreclosed through a judicial foreclosure are not affected by the judicial foreclosure, and the judicial foreclosure will transfer the property subject to the senior lien.<sup>19</sup> Governmental entities in Texas have a special tax lien for ad valorem taxes assessed on real property, and these liens are superior to almost all preexisting liens, notwithstanding when the other lien arose.<sup>20</sup> Constitutional mechanic's liens and statutory mechanic's liens on property that can be removed without material injury to the land, preexisting improvements, and the materials themselves are superior to a recorded deed of trust lien even if the deed of trust was filed and recorded prior to the property being installed.<sup>21 22</sup>

### **III. Miscellaneous Considerations.**

**A. Foreclosure of Property in Receivership.** If the debtor's assets (whether an individual or corporation) have been placed into receivership, then before attempting to foreclose the lien interest you must have the court in which the receivership is pending either (a) release the property from the receivership so that it may be foreclosed, or (b) if the court is a District Court request that the Court enter an order directing the property be foreclosed.<sup>23</sup>

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<sup>19</sup> *Lewis v. Williams*, 294 S.W.2d 131, 132 (Tex. Civ. App. – Texarkana 1956, no writ).

<sup>20</sup> Tex. Tax Code Ann. § 32.05(b) (Vernon 2005).

<sup>21</sup> *F.D.I.C. v. Bodin Concrete Co.*, 869 S.W.2d 372, 382 (Tex. App. – Dallas 1993, rehearing denied)(constitutional mechanic's liens on removable property without damage to land, preexisting improvements, and the materials themselves are superior to deed of trust lien).

<sup>22</sup> *Dorsett Brothers Concrete Supply, Inc. v. Safeco Title Ins. Co.*, 880 S.W.2d 417, 423 (Tex. App. – Houston [14th Dist.] 1993, writ denied).

<sup>23</sup> *Texas American Bank/West Side v. Haven*, 728 S.W.2d 102, 104 (Tex. App. – Fort Worth 1987, writ dismissed)(citing *First Southern Properties, Inc. v. Vallone*, 533 S.W.2d 339 (Tex. 1976)).

**B. Pendency of Divorce.** “The pendency of a divorce proceeding does not diminish or limit a creditor’s right to proceed against either or both spouses for payment of community debts incurred prior to the divorce decree.”<sup>24</sup> Consequently, the fact that the debtor may be in domestic relations-litigation should not delay a judicial foreclosure of real property. Divorce decrees do not have any impact on the obligations of the debtors or the rights of the lien holder, even if one spouse is awarded the property.

**C. Statute of Limitations Affecting Right to Foreclose.** There are two statutes that relate to the statute of limitations to bring a foreclosure action, one statute indirectly addresses the matter and the other statute deals directly with the issue. Both statutes indicate that there is a four-year period in which a lien holder has to bring an action to foreclose its lien. Some attorneys assert that there is a four year statute of limitations on a suit to enforce a debt then the statute of limitations to enforce a lien that secures a debt is also four years.<sup>25</sup> While accurate, the Texas Civil Practice and Remedies Code specifically sets forth a four year limitation period for a lien holder to bring an action to enforce his/her lien once the cause of action arises.<sup>26</sup>

#### **IV. Pre-Foreclosure Tips that May Prevent Unnecessary Cost/Liability.**

**A. Other Lien Holders.** Before beginning the judicial (or non-judicial for that matter) foreclosure process, it is good practice to do a little research on the property you are about to foreclose on. One of the first steps a lien holder should take before

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<sup>24</sup> *Mussina v. Morton*, 657 S.W.2d 871, 874 (Tex. App. – Houston [1st Dist.] 1983, rehearing denied)(citing *Stewart Title Co. v. Huddleston*, 598 S.W.2d 321 (Tex. Civ. App. – San Antonio 1980, aff’d per curiam, 608 S.W.2d 611 (Tex. 1980)).

<sup>25</sup> Tex. Civ. Prac. & Rem. Code § 16.004(a)(3) (Vernon 1986).

<sup>26</sup> Tex. Civ. Prac. & Rem. Code § 16.035 (Vernon 1986).

foreclosing its interest in the property is to request an abstractor's certificate that delineates liens filed subsequently to its own lien. An abstractor's certificate will provide the lien holder with a list of individuals/entities who should be given notice if the judicial foreclosure is to have an affect on their liens. Further, the Texas Property Code provides that an unrecorded conveyance of real property, or an interest in real property, or a deed of trust is void as to a creditor or a subsequent purchaser for valuable consideration without notice.<sup>27</sup> Simply put, what is not revealed in the abstractor's certificate may be just as important as what is present, as any party who attempts to assert an interest in the property that was not recorded will not be able to successfully assert their interest.

**B. Tax Liens.** When requesting the abstractor's certificate from a title company, you may request that the title company include a search for federal and state tax liens as well as FDIC (Federal Deposit Insurance Corporation) and RTC (Resolution Trust Corporations) liens. If the title company is unwilling and/or unable to conduct the tax lien search, you should examine the tax lien records in the county where the property is located to determine whether a tax lien has been filed. Most county appraisal districts and/or county clerks will also have record of any ad valorem taxes that are due on the property, and will issue a tax certificate for a small fee.

**C. EPA Considerations.** Super-fund. The words themselves are scary. It is imperative to know whether the property you are about to foreclose your lien on has pollution problems. Owners or operators of a site of pollution are strictly liable, jointly

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<sup>27</sup> Tex. Prop. Code § 13.001 (Vernon 1989).

and severally, for hazardous waste cleanup.<sup>28</sup> A party merely holding a security interest in property is not an owner/operator, and therefore, is not liable if it does not participate in the management of the property and/or owner.<sup>29</sup> Therefore, if you hold your security interest in the property you won't be liable for a Super-fund clean up, but if you foreclose your lien then the United States Environmental Protection Agency will be tapping your pockets to fund a clean up of the pollution site.

**V. The Basics of Judicial Foreclosure.**

**A. Jurisdiction and Venue.** Petitions for judicial foreclosure must be filed in a District Court<sup>30</sup> in: (a) the county where the cause of action accrued, (b) in the county of the defendant's residence (if defendant is an individual) or principal place of business (if defendant is a corporation, partnership, unincorporated association, or other legal entity), (c) in the county of plaintiff's residence (if plaintiff is an individual) or principal place of business (if plaintiff is a corporation, partnership, unincorporated association, or other legal entity).<sup>31</sup> Attorneys may be led to believe that venue of a judicial foreclosure action must occur in the county in which the property is located, however, the Texas Supreme Court has held that an action to foreclose a lien does not primarily involve title to real property.<sup>32</sup> Consequently, venue is not mandatory in the county in which the land is located.

**B. Pleading Requirements.** In order to obtain the relief of judicial foreclosure from a District Court, the lien holder must: (a) allege execution and delivery

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<sup>28</sup> 42 U.S.C. § 9607.

<sup>29</sup> 42 U.S.C. § 9601(20)(a).

<sup>30</sup> Tex. Const. art. V, § 8; Tex. Gov. Code § 24.007 (Vernon 2004).

<sup>31</sup> Tex. Civ. Prac. & Rem. Code §§ 15.001, 15.002, and 15.035 (Vernon 2002).

<sup>32</sup> *Bennett v. Langdeau*, 362 S.W.2d 952, 955 (Tex. 1962).

of a secured debt instrument, (b) allege ownership of the debt instrument, (c) provide a description of the property secured by the lien, (d) allege the execution and delivery of the lien instrument (an exception is an abstract of judgment), (e) allege the amount of the unpaid debt, and (f) allege a default by the maker of the debt instrument.<sup>33</sup> The prayer for relief in the petition should pray for the foreclosure of the lien along with a judgment against the debtor for the amount of the debt. The lien holder may recover attorneys fees if recovery of attorneys fees is: (a) provided for in the lien instrument and/or debt instrument,<sup>34</sup> and (b) pled for in the petition.

**C. The Judgment.** A valid judgment foreclosing the lien must be obtained from the District Court, which should include: (a) an award of the debt owed to the lien holder, (b) court costs and attorneys' fees (if provided for in the lien or debt instrument), (c) a decretal paragraph ordering the foreclosure of the lien, (d) and a decretal paragraph directing a sheriff or constable to seize and sell the collateral of the lien in satisfaction of the debt, and (e) a decretal paragraph instructing the sheriff or constable that if the collateral does not sell for an amount sufficient to satisfy the debt that the sheriff or constable should proceed to execute on other property of the defendant as in ordinary judgment execution.<sup>35</sup> Once a valid judgment foreclosing the lien has been entered by the District Court, a sale must be held in order to pass the title to a subsequent

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<sup>33</sup> See generally *Graves v. Drane*, 1 S.W. 905 (Tex. 1886); and *Shaw v. American Life Ins. Co.*, 60 S.W.2d 1110, 1111 (Tex. Civ. App. – Fort Worth 1933, writ dismissed).

<sup>34</sup> 30 Tex. Jur. 3d Deeds of Trust and Mortgages § 207 (citing *Jeffreys v. McGlamery*, 96 S.W.2d 572 (Tex. Civ. App. – Amarillo 1936, no writ).

<sup>35</sup> Tex. R. Civ. P. 309.

purchaser.<sup>36</sup> The writ of sale should be directed to the sheriff or constable in the county in which the property is located.<sup>37</sup>

**D. The Writ and Sale.** The clerk of the District Court will issue the writ of sale<sup>38</sup> upon the application of the successful party in a suit thirty (30) days after the judgment is rendered.<sup>39</sup> The writ of sale must particularly describe the property<sup>40</sup>, and shall direct the sheriff to give public notice of the sale.<sup>41</sup> The sale of the real property will be held at the courthouse door of the county, unless the court orders that such sale shall be at the place where the real property is situated.<sup>42</sup> The sale of the real property shall occur on the first Tuesday of the month, between the hours of ten o'clock, a.m. and four o'clock p.m.<sup>43</sup> The sheriff must give notice of the sale in a newspaper in the county (in English) once a week for three consecutive weeks preceding the sale, the first of said notices must be published not less than twenty (20) days immediately preceding the day of sale.<sup>44</sup> The notice must contain a statement of the authority by virtue of which the sale is to be made, the time of levy, the time and place of sale, a brief description of the property to be sold, the number of acres, the original survey, locality in the county, and the name by which the land is most generally known.<sup>45</sup> Proceeds from the sale are applied first to the sheriff's/constable's cost of the sale, then to the indebtedness of the

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<sup>36</sup> *Warnecke v. Broad*, 161 S.W.2d 453, 454 (Tex. 1942).

<sup>37</sup> *De Guerra v. De Gonzalez*, 232 S.W. 896, 899 (Tex. Civ. App. 1921, no writ).

<sup>38</sup> Tex. R. Civ. P. 622.

<sup>39</sup> Tex. R. Civ. P. 627.

<sup>40</sup> Tex. R. Civ. P. 631.

<sup>41</sup> Tex. R. Civ. P. 630.

<sup>42</sup> Tex. R. Civ. P. 646a.

<sup>43</sup> *Id.*

<sup>44</sup> Tex. R. Civ. P. 647.

<sup>45</sup> *Id.*

suit, and then to junior lien holders who were parties to the suit, and then the property owner.<sup>46</sup>

**E. Post Sale Matters.** While a judicial foreclosure sale will prevent a borrower from asserting a wrongful foreclosure based upon defects in the lien or debt instrument, a sheriff's sale may be set aside with proof of (a) an irregularity in the sale calculated to affect the sale, (b) a grossly inadequate sales price, and (c) a causal connection between the irregularity and the selling price.<sup>47</sup> Guarantors and borrowers have a statutory right to have the District Court in the county in which the property is located determine the fair market value of the property within ninety (90) days after the date of the date of the sale or (applicable only to guarantors) ninety (90) days after the guarantor received notice of the sale.<sup>48</sup> This right is independent of whether the lien holder brings an action for collection of the deficiency amount. Note that a mortgagee must file suit for deficiency within two years after the foreclosure sale.<sup>49</sup>

## **VI. Home Equity and Reverse Mortgage Foreclosures.**

Prior to November 1997, the only liens allowed against homesteads in Texas were tax liens, purchase money liens, and mechanic's liens. This paper will not address the historical background of the amendments to the Texas Constitution that allowed for home equity loans, home equity lines of credit, and reverse mortgages to be secured against a Texas homestead, nor will this paper address the various notices and procedures for

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<sup>46</sup> *Huselby v. Allison*, 25 S.W.2d 1108 (Tex. Civ. App. – Amarillo 1930, writ dismissed w.o.j.).

<sup>47</sup> *Apex Financial Corp. v. Brown*, 7 S.W.3d 820, 827-28 (Tex. App. – Texarkana 1999, no pet.) (citing *McKennon v. McGown*, 11 S.W. 532, 533 (Tex. 1889) and *Kaufman & Runge v. Morris*, 60 Tex. 119 (Tex. 1883)).

<sup>48</sup> Tex. Prop. Code §§ 51.004 and 51.005 (Vernon August 2005).

<sup>49</sup> *Lighthouse Church of Cloverleaf v. Texas Bank*, 889 S.W.2d 595 (Tex. App. – Houston [14th Dist.] 1994, writ denied).



securing a home equity loan, home equity line of credit, or a reverse mortgage to a Texas homestead. Instead, this paper will focus on the judicial and quasi-judicial methods that holders of home equity liens and reverse mortgages have at their disposal to enforce their liens against a Texas homestead.

**A. Home Equity Foreclosures.** Article 16 § 50(a)(6)(D) of the Texas Constitution allows for the foreclosure of a home equity lien only by court order. The Supreme Court of Texas promulgated the rules for obtaining such a court order by creating Rules 735 and 736 of the Texas Rules of Civil Procedure. Oddly, Rule 735 allows a home equity lien holder to apply for an order allowing foreclosure pursuant to Rule 736.<sup>50</sup> Rule 735 allows a home equity lien holder to file a suit seeking judicial foreclosure of the home equity lien, or to bring a suit seeking a final judgment that allows foreclosure under the security instrument and pursuant to Texas Property Code § 51.002.<sup>51</sup> If the home equity lien holder elects to pursue a judicial foreclosure of its lien pursuant to Rule 735(1), then this paper should be relatively helpful in assisting the home equity lender achieve the judicial foreclosure of its home equity lien. If the home equity lien holder elects to seek a final judgment allowing foreclosure under the security instrument and Texas property Code § 51.002, the lien holder will want to consult the paper on non-judicial foreclosures presented for this seminar.

Essentially, the difference between Rule 735(1), Rule 735(2), and 735(3) of the Texas Rules of Civil Procedure is that 735(1) allows the home equity lien holder to proceed with a judicial foreclosure of its home equity lien. Rule 735(2) allow for the

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<sup>50</sup> Tex. R. Civ. P. 735(3).

<sup>51</sup> Tex. R. Civ. P. 735(1) and (2).

home equity lender to seek an order from a district court allowing the non-judicial foreclosure of a home equity lien. Rule 735(3) allows for an order allowing foreclosure of the home equity lien pursuant to the application process set forth in Rule 736 of the Texas Rules of Civil Procedure. Since this paper has already addressed judicial foreclosures, and another esteemed colleague of mine has already addressed non-judicial foreclosures, the remainder of this section will focus on the application process for foreclosing a home equity lien pursuant to Rule 735(3) and 736 of the Texas Rules of Civil Procedure.

The Texas Constitution instructed the Texas Supreme Court to promulgate rules for the expedited foreclosure of liens home equity liens and reverse mortgage foreclosures.<sup>52</sup> Rule 736 of the Texas Rules of Civil Procedure was promulgated by the Supreme Court of Texas to provide an expedited method to apply for a court order authorizing a foreclosure of a home equity lien in accordance with the home equity lien instrument and Texas Property Code § 51.002.

**B. The Application.** Rule 736 of the Texas Rules of Civil Procedure allows for the home equity lien holder to file a verified application setting forth that (a) the debt exists, (b) the debt is secured by a lien created under Tex. Const. Art. 16 § 50(a)(6) that encumbers the property, (c) a default under the security instrument exists, (d) the applicant has given the requisite notices to cure the default and accelerate the maturity of the debt under the security instrument, Texas Property Code § 51.002, and applicable

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<sup>52</sup> Tex. Const. Art. 16 § 50(r).

law.<sup>53</sup> The application must be styled in a particular manner,<sup>54</sup> must identify the name of the party who is obligated to pay the debt according to the records of the lien holder,<sup>55</sup> identify the mailing address and legal description,<sup>56</sup> and identify the security instrument by reference to a volume and page number or other identifying recording information.<sup>57</sup> Apparently, the Supreme Court was not satisfied with requiring that the verified application set forth a default exists (Rule 736(1)(E)(3)), because the Supreme Court also requires that the lien holder describe the facts which establish the existence of the default as well.<sup>58</sup> The application must also set forth that the applicant is seeking a court order pursuant to Tex. Const. Art. 16 § 50(a)(6)(D) to sell the property under the home equity lien instrument and the Texas Property Code § 51.002.<sup>59</sup>

**C. Service.** The application is served by certified and first class mail to each party who is obligated to pay the debt.<sup>60</sup> Service is complete upon the deposit of the application and the notice in a post office or official depository under the care and custody of the United States Postal Service.<sup>61</sup> If a person who is obligated to pay the debt is represented by an attorney and the applicant's attorney is aware that fact, then the applicant's attorney must also serve a copy of the application and notice to the debtor's attorney as well.<sup>62</sup>

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<sup>53</sup> Tex. R. Civ. P. 736(1)(E)(1-4).

<sup>54</sup> Tex. R. Civ. P. 736(1)(A).

<sup>55</sup> Tex. R. Civ. P. 736(1)(B).

<sup>56</sup> Tex. R. Civ. P. 736(1)(C).

<sup>57</sup> Tex. R. Civ. P. 736(1)(D).

<sup>58</sup> Tex. R. Civ. P. 736(1)(F).

<sup>59</sup> Tex. R. Civ. P. 736(1)(G).

<sup>60</sup> Tex. R. Civ. P. 736(2)(A).

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

**D. The Notice.** The form of the notice that must accompany the application is set forth in Rule 736(2)(C). Rule 736(2)(C) is very complete in the recitation of the requirements of the notice including the requirement of indicating the response date, despite this fact, and apparently in an attempt to over-emphasize the importance of including the response date in the notice, the Supreme Court restates the need for the notice to contain the response date in Rule 736(2)(D).

**E. Default or Answer.** The debtor's response is due on or before the first Monday after the expiration of thirty-eight (38) days after the date of mailing of the application and the notice as set forth in the certificate of service.<sup>63</sup> If the debtor fails to respond by the deadline, then the court shall grant the application without further notice or hearing if the application complies with Rule 736(1), the debtor has not responded, and the certificate of service has been on file for at least ten (10) days exclusive of the date of filing.<sup>64</sup> However, if the debtor files a response a hearing will be held within ten (10) days after a request for hearing by either party.<sup>65</sup> No discovery of any kind will be allowed, and at the hearing on the application the applicant bears the burden to prove by affidavits or evidence presented the grounds for the granting of the order sought in the application.<sup>66</sup>

**F. The Order.** An order granting or denying an application under Rule 736 is not appealable,<sup>67</sup> but the determination of fact or law in the order granting or denying the application does not have the affect of res judicata, judicial estoppel, or estoppel by

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<sup>63</sup> Tex. Civ. R. P. 736(3).

<sup>64</sup> Tex. Civ. R. P. 736(5)(A-C).

<sup>65</sup> Tex. Civ. R. P. 736(6).

<sup>66</sup> *Id.*

<sup>67</sup> Tex. Civ. R. P. 736(8)(A).

judgment in any other proceeding or suit.<sup>68</sup> An order granting an application shall set forth the debtor's mailing address, direct that the foreclosure proceed under the terms of the security instrument and Texas Property Code § 51.002, provide that a copy of the order and the notice of sale be sent to the debtor and all third parties reasonably necessary to conduct the foreclosure sale, and if applicable, that a copy of the notice of sale shall be mailed to debtor's counsel by certified mail.<sup>69</sup> A certified copy of the order must be filed by the applicant in the county where the property is located within ten (10) days of the entry of the order by the court.<sup>70</sup> At this point the lien holder is authorized to non-judicially foreclose the property in accordance with the provisions of the lien instrument and the § 51.002 of the Texas Property Code.

**G. Abatement and Dismissal.** If the debtor files a notice with the clerk of the court in which the application is pending a notice that the debtor has filed a petition contesting the applicant's right to foreclose in a district court where the application is pending, then the proceeding in which the application is pending shall automatically be abated.<sup>71</sup> An application that has been abated will be dismissed.<sup>72</sup>

**H. Reverse Mortgage Foreclosures.** Article 16 § 50(k)(11) of the Texas Constitution allows for the foreclosure of a reverse mortgage lien only by court order if the foreclosure is sought for a reason other than those set forth in Article 16 § 50(k)(6)(A-

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<sup>68</sup> Tex. Civ. R. P. 736(9).

<sup>69</sup> Tex. Civ. R. P. 736(8)(B).

<sup>70</sup> Tex. Civ. R. P. 736(8)(C).

<sup>71</sup> Tex. Civ. R. P. 736(10).

<sup>72</sup> *Id.*

B).<sup>73</sup> Consequently, the only reasons for a reverse mortgage foreclosure left in the Texas Constitution are those set forth in Article 16 § 50(k)(6)(C-D). Subsection (C) pertains to a situation in which all the borrowers cease occupying the homestead for a period longer than twelve (12) months without prior written approval from the lender. Subsection (D) pertains to more traditional default provisions, including, but not limited to: a default in payments; and, a failure to maintain the priority of the lender's lien. A reverse mortgage foreclosure application under 735 or 736 of the Texas Rules of Civil Procedure for a default under Article 16 § 50(k)(6)(C-D) of the Texas Constitution, differs only slightly from an application for foreclosure of a home equity lien. In fact, the only difference is the citations to different provisions of the Texas Constitution in the application relating to reverse mortgages instead of home equity loans. The sections of the Texas Constitution to be cited in an application for a reverse mortgage foreclosure are set forth in Rules 735 and 736 of the Texas Rules of Civil Procedure.

### **SUMMARY**

No one can predict the circumstances that may arise as you attempt to foreclose your interest in real property located in Texas, after all, truth is stranger than fiction. Nevertheless, it was the intent of this author to provide a general summary of the procedural methods that you will use to foreclose your liens, as well as provide some insight into the possible pitfalls that could cause your foreclosure experience to be less than satisfactory. In the event that this paper does not address the questions you have, please do not hesitate to contact me and I will do my best to answer your questions.

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<sup>73</sup> Article 16 § 50(k)(6)(A) refers to the death of all the borrowers. Article 16 § 50(k)(6)(B) refers to the sale or transfer of the homestead property.