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Locke Lord QuickStudy: Texas Supreme Court Affirms a Lender's Equitable Subrogation Rights Following Expiration of the Statute of Limitations on the Lender's Lien

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Earlier today the Texas Supreme Court confirmed that the voiding of a lender's lien due to the expiration of the statute of limitations does not preclude the lender from foreclosing on a pre-existing lien under the doctrine of equitable subrogation. *PNC Mortg. v. Howard*, ___ S.W.3d ___, 2021 WL 297579, at *1 (Tex. 2021) (per curiam). This holding throws a lifeline to Texas lenders, especially those holding nonrecourse home-equity or reverse mortgage loans, and provides them with a powerful defense and significant foreclosure alternative in the event that limitations has run on their lien or their lien is unenforceable for some other reason.

The borrowers in *Howard* originally purchased a home with two purchase-money mortgages. Two years later, they refinanced those mortgages into a single loan secured by a lien on the property. Nearly all of the proceeds from the new loan were used to pay off the two purchase-money mortgages. The new lien was later assigned to PNC Mortgage, which accelerated the loan in June 2009, after the borrowers stopped making their payments and then failed to cure their default.

Meanwhile, the original lender initiated foreclosure proceedings. The borrowers challenged that foreclosure on the basis that the original lender no longer held the mortgage, and added PNC as a defendant. PNC counterclaimed seeking a foreclosure of its lien. But concerned that the limitations period had already passed, PNC alternatively sought a judgment declaring its right to foreclose on the purchase-money liens through equitable subrogation. The court of appeals held that, to the extent PNC held equitably subrogated liens, those liens became unenforceable when PNC forfeited its own lien by failing to timely foreclose on it.

After the court of appeals' opinion, the Texas Supreme Court decided *Federal Home Loan Mortgage Corporation v. Zepeda*, in which it explained that equitable subrogation "allows a lender who discharges a valid lien on the property of another to step into the prior lienholder's shoes and assume that lienholder's security interest in the property, even though the lender cannot foreclose on its own lien." 601 S.W.3d 763, 766 (Tex. 2020). The Court also "observed that equitable-subrogation rights become fixed at the time the proceeds from a later loan are used to discharge an earlier lien[.]" and that "[a] lender's negligence in preserving its rights under its own lien does not deprive the lender of its rights in equity to assert an earlier lien that was discharged using proceeds from

the later loan.” *Howard*, 2021 WL 297579, at *3 (describing the Court’s holding in *Zepeda*). The Court noted that a lender’s negligence may only be considered as part of the equitable-subrogation analysis in lien-priority cases. *Id.* (citing *Zepeda*, 601 S.W.3d at 767 n.17). Applying *Zepeda* to the facts of the case before it, the Texas Supreme Court held that PNC’s failure to timely foreclose under its deed of trust did not bar its subrogation rights, and that those rights permit a lender to assert rights under a lien its loan satisfied when the lender’s own lien is infirm, regardless of the reason for such infirmity.

Texas lenders should find great comfort in both the holding and reasoning of *Howard* because it means they may still have an option to enforce a mortgage debt even after the lien securing that debt has been voided due to the running of limitations. Given the large numbers of limitations cases ongoing in Texas, lenders should immediately take stock of such cases and, in consultation with competent counsel, determine where it would be appropriate and advisable to assert their equitable-subrogation rights in the alternative to foreclosure of their own lien. In doing so, lenders should take care to ensure that the statute of limitations has not also run on the pre-existing lien to which they are subrogated by checking the maturity date of the pre-existing lien, and confirming that four years have not elapsed since that date.

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