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FORUM

INTRODUCTION: THE TEXAS HOME EQUITY CONTROVERSY IN CONTEXT

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I. INTRODUCTION

The notion that a person's home should be protected from creditors is not unique to Texas, nor was the idea completely unknown before it was codified by Republic of Texas lawmakers. Nonetheless, to say that "[t]he homestead exemption was a Texas creation"[1]

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1. TEX. CONST. ANN. art XVI, § 50 interp. commentary (Vernon 1993).

is no great exaggeration. During the last decade, some significant developments have affected the most unusual aspect of Texas homestead law—the prohibition against home equity lending for anything other than home improvements.[2] Proponents of equity lending argue that recent changes in federal tax law now make home loans the only significant interest deduction;[3] opponents point out the human misery arising from a wave of highly publicized home equity loan foreclosures in the Northeast during the economic "bust" of the late 1980s.[4]

Events of the past year have brought the debate to a head, triggering the most significant controversy over the proper scope of the Texas homestead exemption in more than a century. These events—principally a federal appellate court's ruling that federal law preempts the Texas prohibition on home equity lending[5] and

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2. Texas apparently is the only state with such a restriction. *See* Remarks by Sen. Cyndi T. Krier, Statement at the Home Equity Borrowing Press Conference (Feb. 23, 1987) (on file with the *St. Mary's Law Journal*) (explaining that every state in country, except Texas, permits equity loans for things other than purchase money, improvements, and taxes); *see also Home Equity: Texans Deserve a Shot at Home Equity Loans*, DALLAS MORNING NEWS, July 29, 1994, at 16A (noting that Texas is sole state in which one cannot borrow against home equity "to start businesses, finance educations and buy goods"). Article XVI, § 50 of the Texas Constitution currently provides:

> The homestead of a family, or of a single adult person, shall be . . . protected from forced sale, for the payment of all debts except for the purchase money thereof, . . . the taxes due thereon, or for work and material used in constructing improvements thereon . . . ; nor may the owner or claimant of the property claimed as a homestead, if married, sell or abandon the homestead without the consent of the other spouse, given in such manner as may be prescribed by law. No mortgage, trust deed, or other lien on the homestead shall ever be valid, except for the purchase money therefor, or improvements made thereon, as hereinbefore provided, whether such mortgage, or trust deed, or other lien, shall have been created by the owner alone, or together with his or her spouse, in case the owner is married. All pretended sales of the homestead involving any condition of defeasance shall be void . . . .

TEX. CONST. art. XVI, § 50.

3. *See* Janet Novack, *Endangered Deduction*, FORBES, Oct. 14, 1991, at 58 (describing 1986 tax reform phaseout of consumer interest tax deduction, but noting preservation of interest deduction of debt secured by home).

4. *See* Bill Hunt, *Knocking at Our Doors, Has Come the Heavy Hand of Government*, HOUS. CHRON., Jan. 24, 1993, at 1F, 4F (reviewing unconscionable lending practices leading to "victimization of vulnerable homeowners" when lenders foreclosed home equity loans in economic downturn of 1980s).

5. First Gibraltar Bank, FSB v. Morales, 19 F.3d 1032, 1053 (5th Cir.), *cert. denied*, 115 S. Ct. 204 (1994), *vacated with substitute opinion*, No. 93-8170, 1995 U.S. App. LEXIS 251 (5th Cir. Jan. 4, 1995). Following the United States Supreme Court's denial of certiorari, the Fifth Circuit vacated its original opinion. First Gibraltar Bank, FSB v. Morales, 1995 U.S. App. LEXIS 251, at *1 (5th Cir. Jan. 4, 1995); *see infra* note 78.

subsequent sparring between Texas lawmakers in the United States Congress[6]—provide the backdrop for what undoubtedly will be a major effort at constitutional revision during the current Texas legislative session.

This introductory essay provides some historical and legal context for the current debate. It begins with an examination of early Texas homestead law, which, contrary to the belief of some,[7] did not clearly prohibit home equity lending. It then examines some of the reasons behind the introduction of this provision in the Texas Constitution of 1876, together with an overview of the criticism of this provision over the years. Finally, this essay traces the events leading up to the current controversy.

II. HOMESTEAD HISTORY: THE TEXAS REVOLUTION THROUGH RECONSTRUCTION

The genesis of the homestead exemption is one of the minor mysteries of Texas history.[8] First enacted by the Congress of the Republic of Texas in 1839,[9] the exemption was elevated to constitutional status some six years later.[10] While some similarities to the laws of Spain and the American states from which early Texas settlers came have been noted, the first Texas statute on the subject added an element not found in common or civil law—the protection of every family's home from creditors.

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6. *See* Bill Mintz, *Gonzalez, Gramm Face Off on Loan Ban: Home Equity Issue Could Block Banking Bill*, HOUS. CHRON., July 25, 1994, at 1 (reporting political maneuvering by Representative Henry B. Gonzalez and Senator Phil Gramm).

7. *See* Anne M. Kilday, *Gonzalez Puts Home Equity in Bank Bill: But Gramm Vows to Derail Effort to Prevent Borrowing*, DALLAS MORNING NEWS, July 26, 1994, at 1D (referring to "Texas' 155-year-old constitutional ban on most home equity loans"); *Texas' Inequity: Legislature Should Address Home-Equity Issue*, HOUS. CHRON., July 30, 1994, at A26 (referring to 155-year-old Homestead Act that currently restricts home equity loans).

8. *See* ALOYSIUS A. LEOPOLD, 39 TEXAS PRACTICE: MARITAL PROPERTY AND HOMESTEAD § 23.1–23.5, at 225–30 (1993) (reporting history and evolution of Texas homestead exemptions). *See generally* Joseph W. McKnight, *Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle*, 87 SW. HIST. Q. 369 (1983) (outlining creation and development of Texas homestead laws).

9. Act approved Jan. 26, 1839, 3d Cong., R.S., 1839 Republic of Texas Laws 125, 125–26 *reprinted in* 2 H.P.N. GAMMEL, LAWS OF TEXAS 125, 125–26 (1898).

10. TEX. CONST. of 1845, art. VII, § 22.

Between 1839 and 1845, several other states adopted the Texas innovation.[11] The homestead law's popularity increased through the years, and a great majority of American jurisdictions now have some sort of homestead law.[12] Homestead protection ultimately came full circle from its Hispanic roots: In the early twentieth century, the concept was introduced into the laws of Spain and Mexico, the lands from which early Texans originally drew at least some of their inspiration.[13]

Although legislative history of the original Texas homestead law is virtually nonexistent, more light may be shed on the causes impelling the incorporation of the homestead exemption into the Texas Constitution of 1845. Public policy surrounding the homestead law had at least three components: protection of debtors, protection of women, and the fostering of an independent spirit in Texas settlers.[14] Each of these public policy concerns deserves a brief explanation.

First, the Texas homestead law was an anti-creditor measure. Legislators designed the constitutional provision to encourage immigration by providing settlers a haven from prior creditors. Many early immigrants to Texas had lost their homes and property during the financially devastating Panic of 1837.[15] The homestead exemption encouraged this influx of new citizens by assuring that these settlers would get a fresh start in life, free from the fear that old creditors could take away their family's new home and necessities. Abner Lipscomb, likely author of the constitutional homestead

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11. *See* Joseph W. McKnight, *Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle*, 87 SW. HIST. Q. 369, 396 n.81 (1983) (noting that Mississippi, Georgia, and Florida adopted version of Texas's 1839 homestead law).

12. *See* Ralph A. Peeples, *Five into Thirteen: Lien Avoidance in Chapter 13*, 61 N.C. L. REV. 854, 863 n.100 (1983) (stating that only five states have no homestead protection).

13. *See* Joseph W. McKnight, *Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle*, 87 SW. HIST. Q. 369, 399 (1983) (noting 1917 incorporation of homestead provision in Mexican Constitution and similar incorporation into Spanish law in 1907 and 1921).

14. These categories roughly parallel those set out in the interpretive commentary to the Texas Constitution. *See* TEX. CONST. art. XVI, § 50, interp. commentary (Vernon 1993) (delineating public policy components of constitutional homestead provision).

15. *See* Joseph W. McKnight, *Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle*, 87 SW. HIST. Q. 369, 393–94 (1983) (suggesting that Panic of 1837 precipitated movement of debtors to Texas and was likely catalyst to 1839 homestead law).

provision[16] and soon-to-be Texas Supreme Court justice, expounded on this aspect of homestead law in constitutional debate:

> Considering the situation of the country, and looking back to the embarrassments I have witnessed in several of the United States, and the distress I have often seen come upon families, who have been so paralyzed by it as to be incapable of decision[,] I believe it important to introduce a provision of this kind into the Constitution, lest the Legislature, not feeling the danger, might omit it, until too late.[17]

Family legend has it that Justice Lipscomb himself lost heavily in the Panic of 1837;[18] available data lend some support to that story.[19] No matter what the cause, Justice Lipscomb was no friend of creditors.[20]

A second clear strain of thought in Texas homestead law was the protection of women. In marked contrast to the first statute on the subject, the first state constitution did not protect every person's home from forced sale; only "heads of families" were constitutionally protected.[21] Moreover, the homestead constituted a major restriction on the husband's general right to manage all family property; the 1845 Constitution provided that if the owner of property were a married man, he could not sell the homestead without his wife's consent.[22] An exchange during constitutional debate made this element of the law clear:

> Mr. *Anderson* said . . . [i]f the object was to check the credit system, single men as well as the heads of families should be protected from the griping hand of the law.

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16. *But see* C.W. Raines, *Enduring Laws of the Republic of Texas*, 1 TEX. ST. HIST. ASS'N Q. 96, 105–07 (1898) (revealing that originator of provision is unknown, but speculating originator to be Judge Emory Raines, who personally claimed honor, or Louis P. Cook, who introduced bill in Texas House of Representatives).

17. DEBATES: THE TEXAS CONVENTION 423 (William F. Weeks rep., 1846).

18. Interview with William C. Lipscomb, in Houston, Tex. (Aug. 15, 1992).

19. *See* DOROTHY G. HELMER, LIPSCOMB: 300 YEARS IN AMERICA, 1679-1979 at 252 (1979) (stating that Abner Lipscomb left Alabama Supreme Court in 1835 "to practice law and engage in extensive land speculation"). Justice Lipscomb emigrated to Texas in 1839 with time remaining in his Alabama legislative term. JAMES D. LYNCH, THE BENCH AND BAR OF TEXAS 86 (1885).

20. Justice Lipscomb's statements in convention debate bordered on the fanatic. As but one example: "Commercial men," he said, "will never give up any hold; they will exact the eye or the tooth, or draw the last drop of blood, if necessary, for the payment of their debt." DEBATES: THE TEXAS CONVENTION 306 (William F. Weeks rep., 1846).

21. TEX. CONST. OF 1845, art. VII, § 22.

22. *Id.*

> Mr. *Davis* would say to the gentleman that the Convention was not regulating here for the heads of families, but for women and children.[23]

This element of paternalism carried through in Texas homestead law until 1973, when the state legislature, in the same year it adopted the Texas Equal Rights Amendment,[24] granted homestead rights to single adults.[25]

The final ingredient in the public policy mix was a spirit of personal independence. The key phrase in the constitutional provision was "forced sale."[26] In 1845, Texans could sell their homesteads voluntarily, as they can today, but the homestead law protected them from "forced" or court-ordered sales to satisfy the demands of general creditors. Early homestead law was designed "to retain in pioneers the feeling of freedom and sense of independence which was deemed necessary to the continued existence of democratic institutions."[27] Indeed, some debate centered on the sole restriction on a man's power to sell his homestead—the requirement of his wife's consent—on the basis that "God himself has said that the woman shall be subject to the man."[28] Since the wife often "lords it over the man," the delegate argued, "[t]he husband alone should be the judge of the manner and time of disposing of his property."[29]

The present question, of course, is how home equity loans fit into the original constitutional framework. The answer is simple: The drafters of the 1845 constitution gave no thought to the question of voluntary mortgages of the homestead. Because the constitution was silent on the subject, the question became one for the courts. The first clear ruling on the issue came in the 1851 decision of *Sampson & Keene v. Williamson*.[30] This case was in no way typical; two of the three members of the Texas Supreme Court, Justice Ab-

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23. DEBATES: THE TEXAS CONVENTION 419 (William F. Weeks rep., 1846) (statements of delegates John D. Anderson of Gonzales and James Davis of Liberty).

24. TEX. CONST. art. I, § 3a.

25. *Id.* at art. XVI, § 50 (1876, amended 1973).

26. *See* TEX. CONST. of 1845, art. VII, § 22 (granting state legislature power to protect certain property owned by heads of families from "forced sale").

27. TEX. CONST. art. XVI, § 50 interp. commentary (Vernon 1993).

28. DEBATES: THE TEXAS CONVENTION 424 (William F. Weeks rep., 1846) (statement of delegate James Love of Galveston).

29. *Id.*

30. 6 Tex. 102 (1851).

ner Lipscomb and Chief Justice John Hemphill, had played key roles in constitutional deliberations on the homestead issue.[31] Yet, on this issue, the two men split. Indeed, *Sampson & Keene* is unique for the antebellum period because the case generated three separate opinions—one from each member of the court.

Simplified slightly, the decision in *Sampson & Keene* hinged on the interpretation of the constitutional phrase "forced sale." Justice Lipscomb stated that a mortgage sale of the homestead would be invalid. He believed that a mortgage was not a conveyance of title or a "sale." Thus, even though the original mortgage may have been voluntary, the sale occurred at the time of foreclosure and therefore was a forced sale.[32] Justice Wheeler took the opposite position: If the husband and wife had the power to sell the homestead outright, they obviously had the power to execute a valid mortgage, which he viewed as a conditional sale.[33] Chief Justice Hemphill's opinion decided the issue: A forced sale was a judicial sale. While a power of sale contained in a mortgage could not be enforced through the courts, a voluntary mortgage could be enforced through nonjudicial means.[34] Chief Justice Hemphill's opinion carried the day, and with the passage of years, even the restriction on judicial foreclosure was eased.[35]

From the late 1850s to the mid-1870s, Texas law was in a state of turmoil. Two of the three seats on the Texas Supreme Court changed hands in 1857. New justices came on the bench during the Civil War, and more changes occurred during Reconstruction.

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31. *See generally* DEBATES: THE TEXAS CONVENTION (William F. Weeks rep., 1846). Both Chief Justice Hemphill and Justice Lipscomb were strong supporters of the constitutional provision protecting the homestead. *See* C.W. Raines, *Enduring Laws of the Republic of Texas*, 1 TEX. ST. HIST. ASS'N Q. 96, 103 (1898) (reporting Chief Justice Hemphill and Justice Lipcomb's support). As previously stated, Justice Lipscomb probably drafted the provision. *See supra* note 16 and accompanying text. Chief Justice Hemphill "gave the measure his hearty support." C.W. Raines, *Enduring Laws of the Republic of Texas*, 1 TEX. ST. HIST. ASS'N Q. 96, 103 (1898).

32. *See Sampson & Keene*, 6 Tex. at 126 (Lipscomb, J., concurring) (exclaiming that "[a]ny sale by order of the Court would be a forced sale").

33. *See id.* (Wheeler, J., concurring) (questioning whether decree of foreclosure of mortgage is "forced sale" as term is used in constitution).

34. *See Sampson & Keene*, 6 Tex. at 110, 118 (distinguishing between mortgage, which relies on judicial process for enforcement, and sale under power of mortgagee or trustee, which is voluntary).

35. *See* Morrison v. Bean, 15 Tex. 267, 268-69 (1855) (permitting judicial foreclosure to extent of non-exempt value).

Throughout this period, possibly because of the general instability of the times and the ever-changing makeup of the supreme court, the validity of homestead mortgages was repeatedly challenged. As a contemporary opinion described it, "[t]he lien, even when effective without a forced sale, was generally fiercely litigated through all the courts."[36] Nonetheless, the supreme court consistently upheld the validity of loans secured by the homestead.[37]

III. The Home Equity Ban: The Constitution of 1876

The contours of the Texas homestead exemption changed markedly in 1876, the year the state adopted its current constitution. The framers introduced the concept of the "business homestead," a prohibition on the involuntary sale of urban business property similar to that which already applied to residential homesteads.[38] The delegates to the 1875 convention also wrote into the Texas Constitution the prohibition on equity lending that forms the basis of the current debate—a ban on voluntary mortgages for any reason other than purchase money, taxes, or improvements.[39]

As was the case with the original statute and the 1845 constitution, the legislative history of the current homestead provision is not entirely clear. However, some of the same policy concerns were undoubtedly present. One of the faces was even the same: N.H. Darnell had participated in the drafting of the 1845 constitution and took an active role in debate on the 1876 homestead provision. In a reprise of the circumstances surrounding the passage of the original homestead statute, a recent national financial crisis—in this case, the Panic of 1873[40] rather than the Panic of 1837—reminded delegates of the need to protect debtors from rapacious creditors. Delegates also continued to show concern for

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36. Inge v. Cain, 65 Tex. 75, 80 (1885).

37. *See* Bomback v. Sykes, 24 Tex. 217, 218 (1859) (upholding deed of trust executed pursuant to note secured by homestead); *see also Inge*, 65 Tex. at 77–80 (tracing interpretations of homestead law by Texas Supreme Court before adoption of 1876 Texas Constitution).

38. *See* Tex. Const. art. XVI, § 51 (expanding scope of constitutional protection to include homestead in city, town, or village used as home or as place of business of homestead claimant).

39. *See supra* note 2 (providing text of Article XVI, § 50 of Texas Constitution).

40. *See* A.J. Thomas, Jr. & Ann Van Wynen Thomas, *The Texas Constitution of 1876*, 35 Tex. L. Rev. 907, 911 (1957) (recounting events caused by bank failures of 1873 and Texans' increased distrust of financial institutions).

"protecting the wife's property from drunken and reckless husbands."[41]

One new element had surfaced. Delegates to the 1845 convention balanced the scales in favor of individual freedom, and therefore did not forbid voluntary sales and mortgages of the homestead. The 1875 delegates, however, were more paternalistic, prohibiting the voluntary and consensual mortgage of homes and, for good measure, imposing the same restriction on the mortgage of urban businesses. It is tempting, and perhaps even correct, to attribute some of this change in attitude to the temper of the times. While the drafters of the 1845 constitution had achieved victory in a war for independence and were entering the federal union as the nation's newest and largest state, the 1875 delegates had recently lost a bitter and highly destructive war, followed by the political ignominies and financial depression of Reconstruction.

The Grangers composed another element in the equation. This ostensibly social organization, though it denied any such intent, effectively "packed" the 1875 convention. The largest single group at the convention, about one-third of the delegates, were farmers; about half of all delegates were members of the Grange.[42] These delegates had a distinct vision of the future for Texas—a land of small farmers with a cash economy and severely limited government. Changes in the homestead law reflected this anti-urban, anti-credit sentiment. Institution of the concept of the business homestead, coupled with a prohibition against mortgaging that business, served the deliberate purpose of making expansion capital difficult to obtain; the concomitant prohibition on home mortgages reinforced this effect.

Evidence for this anti-credit rationale is scant, but is sufficient to provide a fair sketch of the drafters' motives. The change was controversial. In fact, the prohibition on home equity loans was removed in committee, then reinstated when a "majority report" issued with the claim that the committee had acted on a day when

41. DEBATES IN THE TEXAS CONSTITUTIONAL CONVENTION OF 1875 at 435 (Seth S. McKay ed., 1930) (statement of N.H. Darnell).

42. *See* A.J. Thomas & Ann Van Wynen Thomas, *The Texas Constitution of 1876*, 35 TEX. L. REV. 907, 908–09 (1957) (reporting history of the Grangers, first known as "the Society of Patrons of Husbandry," their goals of improving social and cultural opportunities for farmers, and finally their political influence through convention delegates).

several supporters of the equity restriction were absent.[43] The same report made it clear that equity loans were prohibited to discourage a credit economy:

> [I]t is not the policy of Texas to encourage the credit system, which has periodically engulfed in disaster almost every State in the South and West. On the contrary, sound public policy, based upon demonstrated experience, demands that government should rather restrict than encourage the system of credit in the business of life.[44]

The report concluded with the hope that the homestead exemption, "the grandest foundation yet conceived,"[45] would "build up in our State an industrious, independent, self-sustaining and landholding yeomanry"[46] and that these small farmers would "forever be the great pillars of the State."[47] An unsuccessful opponent of the amendment, Judge John H. Reagan, provided a more negative assessment in a contemporary news report. Judge Reagan predicted that the amendment "would tie up, and, to all practical purposes, destroy as a basis for credit nearly two-thirds of the property of the State."[48]

Though the original concept of the homestead spread like wildfire throughout the nation, the 1876 Texas innovations have proven less popular.[49] While every state now provides some form of homestead protection, no other state has imposed the strict limitations incorporated in the 1876 Texas Constitution.[50] Moreover, as Texas grew in population and wealth, and as an urban credit economy took hold despite the Grangers' best efforts, occasional voices began to be heard in protest. For example, in 1917, during a period

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43. COMMITTEE ON GEN. PROVISIONS, REPORT TO THE HON. E.B. PICKETT, PRESIDENT OF THE CONVENTION OF 1875 (Nov. 5, 1875), *reprinted in* JOURNAL OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF TEXAS, BEGUN AND HELD AT THE CITY OF AUSTIN, SEPTEMBER 6TH, 1875 at 569 (1875).

44. *Id.*

45. *Id.* at 570.

46. *Id.*

47. *Id.*

48. *From the Capitol*, GALVESTON DAILY NEWS, Nov. 19, 1875, at 1.

49. Joseph W. McKnight, *Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle*, 87 SW. HIST. Q. 369, 497 (1983) (explaining lack of popularity of Texas ban on home equity lending).

50. *See* HOUSE RESEARCH ORG., SPECIAL LEGISLATIVE REPORT: SECOND MORTGAGES AND THE TEXAS HOMESTEAD EXEMPTION 1 (Dec. 21, 1988) (reporting that Texas is only state that restricts use of homestead as collateral to strictly preclude second mortgages).

of agitation for constitutional reform, a Dallas Bar address questioned the economic rationale for the prohibition on equity borrowing.[51] A Dallas newspaper interview with a surviving member of the 1875 convention also expressed doubts about the continued utility of the homestead restrictions.[52] Finally, a 1925 article in the *Texas Law Review* termed the Texas homestead provision "the most illogical of all" state constitutional provisions on the subject,[53] claiming that the ban on equity borrowing denied Texans the full benefit of federal farm loans.[54] In a much-dated observation, the author also argued that national Prohibition had removed the "drunken husband" rationale for the homestead law.[55]

In the mid-1950s, criticism of the home equity prohibition surfaced again in the pages of the *Texas Law Review*. Professor M.K. Woodward set out a "catalog of the inequities and inconveniences"[56] resulting from this provision of the constitution, which included distress sales of homes to meet financial emergencies and decreased opportunities for Texans to take advantage of "innovations in financing which have been found desirable in other states."[57] In the early 1970s, when a new Texas constitution appeared imminent, a spate of negative commentary appeared. The homestead provision was criticized for failing to protect the wife's

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51. *Compares Homestead Law to Millstone*, DALLAS MORNING NEWS, Nov. 4, 1917, at 9 (reporting on November 3 bar speech by Lewis M. Dabney entitled "The Homestead Law Considered from an Economic Standpoint").

52. *See* Sarah T. Hughes, *Development of the Homestead Exemption in Texas* (conveying content of 1917 news interview with Colonel W.L. Crawford, delegate to 1875 convention), in THE DALLAS BAR SPEAKS 397, 407–08 (1937). Concerning the business homestead exemption, Colonel Crawford stated:

> "I remember very well how [the business homestead] amendment came to be offered. . . . Nick Darnell's suggestion that, as we would permit a man who had a home to keep it against his creditors, we ought to permit a blacksmith who had no home to keep his shop. That sounded fair enough and we adopted the amendment, little believing that men would be able to keep costly hotels, office buildings, factories and the like."

Id. at 408.

53. *See* Brady Cole, *The Homestead Provisions in the Texas Constitution*, 3 TEX. L. REV. 217, 223 (1925) (comparing Texas homestead exemption to similar provisions of other states).

54. *Id.* at 230.

55. *Id.* at 230 n.67.

56. M.K. Woodward, *The Homestead Exemption: A Continuing Need for Constitutional Revision*, 35 TEX. L. REV. 1047, 1053 (1957).

57. *Id.* at 1047.

interests,[58] for making it more difficult to refinance homes at lower interest rates,[59] and for making it difficult for Texas homeowners to act as their own home improvement contractors.[60] The proposed constitution responded to this criticism in a limited way by removing the prohibition on mortgages of business homesteads.[61] This draft constitution, however, was defeated.

Although criticism of the prohibition on equity borrowing has recurred through the years, readers should consider the fact that critics tend to speak out, while those who are satisfied with the status quo often remain silent. So far as this author is aware, no serious proposal to remove the 1876 additions to Texas homestead law has ever come close to passage. This single fact may say as much as all the public criticism.

IV. THE CURRENT CONTROVERSY: *FIRST GIBRALTAR BANK, FSB V. MORALES* AND ITS AFTERMATH

Ironically, after all the agitation for change and serious discussion over the years, the current debate seems to have come about almost by accident. The story begins with the passage of the Alternative Mortgage Transaction Parity Act of 1982.[62] As part of a comprehensive federal effort to revitalize the ailing thrift industry, the Parity Act authorized federally chartered savings banks to make nontraditional loans, including reverse mortgages and line-of-credit conversion mortgages.[63] The Parity Act contains a broad preemption clause, which states that the Act's provisions should

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58. *See* Jack H. Garrett, Comment, *The Wife's Illusory Homestead Rights*, 22 BAYLOR L. REV. 178, 190 (1970) (contending that, to extent homestead is husband's separate property which can be abandoned in good faith, wife's homestead right is illusory).

59. *See* Michael R. Davis, *New Money for Old Homesteads*, TEX. B.J. 39, 40-41 (1972) (explaining that Texas Constitution precludes lenders from making valid post-homestead mortgages and thus prevents homeowners from refinancing).

60. *See* 2 GEORGE D. BRADEN ET AL., THE CONSTITUTION OF THE STATE OF TEXAS: AN ANNOTATED AND COMPARATIVE ANALYSIS 790 (1977) (reporting difficulty homestead exemption causes homeowners by limiting their financing options).

61. JOSEPH W. MCKNIGHT & WILLIAM A. REPPY, JR., TEXAS MARITAL PROPERTY LAW 234 n.2 (1983).

62. 12 U.S.C. §§ 3801-3805 (1988).

63. *See id.* §§ 3801-3802 (stating policy rationale for enactment of legislation encouraging "alternative mortgage transactions" and defining scope of statute); *see also* First Gibraltar Bank, FSB v. Morales, 815 F. Supp. 1008, 1009 n.3 (W.D. Tex. 1993) (interpreting phrase "alternative mortgage transactions" to include reverse mortgages and line-of-credit conversion mortgages (citing 12 U.S.C. § 3802(l) (1988))), *rev'd*, 19 F.3d 1032 (5th Cir.),

prevail "notwithstanding any State constitution, law, or regulation."[64]

The Parity Act's legislative history contains no evidence that the United States Congress ever consciously considered the peculiarities of Texas homestead law. Instead, for all states adversely affected by the Parity Act, Congress provided a three-year "opt out" mechanism.[65] Several states took advantage of this escape hatch; Texas did not. The federal measure, in fact, escaped the notice of Texans altogether until 1987. In that year, Congress authorized the Secretary of Housing and Urban Development to carry out a nationwide demonstration program of federally insured home-equity conversion mortgages for the elderly.[66] Texas lenders declined to participate, citing the state's homestead laws.[67] A Federal Home Loan Bank Board opinion letter, later confirmed by the Office of Thrift Supervision (OTS), took the position that federal law preempted the Texas constitutional prohibition on equity lending.[68] A Texas Attorney General opinion disagreed.[69]

The issue went to court in *First Gibraltar Bank, FSB v. Morales*.[70] At the trial level, the State of Texas prevailed on a technical argument that an OTS regulation incorporated Texas law defining secured loans and, by implication, also incorporated the homestead prohibition.[71] In June of 1994, the United States Court of Appeals for the Fifth Circuit reversed, influenced by an OTS

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cert. denied, 115 S. Ct. 204 (1994), *vacated with substitute opinion*, No. 93-8170, 1995 U.S. App. LEXIS 251 (5th Cir. Jan. 4, 1995).

64. 12 U.S.C. § 3803(c) (1988).

65. *See id.* § 3804(a) (allowing states to avoid federal preemption by vote expressly stating that voters do not want to be affected by preemption mechanism set forth in § 3803(c)).

66. *Id.* § 1715z-20. *See generally* Celeste M. Hammond, *Reverse Mortgages: A Financial Planning Device for the Elderly*, 1 ELDER L.J. 75 (1993) (providing recent discussion of such mortgages).

67. Brief for Appellant at 10, First Gibraltar Bank, FSB v. Morales, 19 F.3d 1032 (5th Cir. 1994) (No. 93-8170).

68. Letter from Jack D. Smith, Deputy General Counsel, Federal Home Loan Bank Board, to John A. Maxim, Jr., Associate General Counsel, United States Department of Housing and Urban Development 11–12 (Aug. 4, 1989) (on file with the *St. Mary's Law Journal*).

69. Op. Tex. Att'y Gen. No. JM-1269 (1990).

70. 815 F. Supp. 1008 (W.D. Tex. 1993), *rev'd*, 19 F.3d 1032 (5th Cir.), *cert. denied*, 115 S. Ct. 204 (1994), *vacated with substitute opinion*, No. 93-8170, 1995 U.S. App. LEXIS 251 (5th Cir. Jan. 4, 1995).

71. *First Gibraltar Bank*, 815 F. Supp. at 1014.

brief as amicus curiae refuting the district court's interpretation of its regulation.[72] The United States Supreme Court denied certiorari on the first day of the 1994 Term.[73] By that time, however, the focus already had shifted to the legislative arena, where United States Representative Henry B. Gonzalez attached a rider to the proposed Riegle-Neal Interstate Banking and Branching Efficiency Act[74] which specifically preserved the Texas constitutional ban on equity lending.[75] National banking interests were willing to tolerate this unpalatable provision in a basically favorable bill; even Texas lenders fell into line, albeit with greater reluctance.[76] Thus, despite last-minute procedural maneuvers by Senator Phil Gramm,[77] the preemptive federal provision acquired a Texas homestead exception.[78]

What lies in store for the immediate future cannot be predicted easily. The six-month "scare" created by the *First Gibraltar Bank* decision focused a great deal of public attention on the wisdom of the Texas home equity loan prohibition, and a legislative initiative in the current Texas Legislature is a foregone conclusion.[79] State-

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72. *See* First Gibraltar Bank, FSB v. Morales, 19 F.3d 1032, 1035-36 (5th Cir.) (singling out OTS as amicus curiae and confirming judicial deference to agency interpretation of statutes unless interpretation is arbitrary and capricious), *cert. denied*, 115 S. Ct. 204 (1994), *vacated with substitute opinion*, No. 93-8170, 1995 U.S. App. LEXIS 251 (5th Cir. Jan. 4, 1995).

73. Morales v. First Gibraltar Bank, FSB, 115 S. Ct. 204 (1994) (order denying certiorari).

74. Pub. L. No. 103-328, 108 Stat. 2338 (1994).

75. *Id.* § 102(b)(5) (amending Home Owners' Loan Act of 1933, 12 U.S.C. § 1462(a) (1989)).

76. *See Lone Star Shootout Threatens Interstate Bill*, AM. BANKER WASH. WATCH, Aug. 1, 1994, at 3 (reporting decision of Texas Bankers Association to back interstate branching bill, even with Gonzalez amendment attached).

77. *See* Anne M. Kilday, *Gonzalez Puts Home Equity in Bank Bill: But Gramm Vows to Derail Effort to Prevent Borrowing*, DALLAS MORNING NEWS, July 26, 1944, at 1D (reporting Senator Gramm's threat to raise objections in Senate that would kill entire bill).

78. Recognizing the effect of the Gonzalez amendment, the Fifth Circuit rang in the new year by vacating its earlier decision in *First Gibraltar Bank* and affirming the district court's ruling. *See* First Gibraltar Bank, FSB v. Morales, No. 93-8170, 1995 U.S. App. LEXIS 251, at *20 (5th Cir. Jan. 4, 1995) (holding that amendment to Riegle-Neal Interstate Banking and Branching Efficiency Act precluded preemption of Texas homestead exemption by OTS regulations).

79. *Texas Constitution Preempted to Allow Home Equity Borrowing*, LEGAL BRIEFS (Texas Bankers Ass'n, Austin, Tex.) (Laura M. Hale & Kelly Rodgers eds.), May 16, 1994, at 2 (stating that "it is clear that the Fifth Circuit has considerably raised the visibility of the home equity issue and made it more likely that the Texas Legislature will finally address the issue in 1995"). Before this issue went to press, Senator Jerry Patterson and

wide interim hearings by a select committee of the Texas Senate concluded in July 1994 with a recommendation that the issue be submitted to the voters.[80] Meanwhile, the Republican sweep in the 1994 elections has created the possibility that Representative Gonzalez's federal end-run could be countered in 1995 with a tit-for-tat rider on another federal banking bill repealing the Gonzalez amendment and resurrecting *First Gibraltar Bank*. No matter what the ultimate result of this legislative and judicial agitation may be, however, all involved surely could agree that the issue is important enough to warrant the fullest public debate. The essays that follow develop the arguments for and against home equity reform.

Representative Debra Danburg submitted companion bills and proposed joint resolutions to the Texas Legislature. *See* Tex. S.B. 301, 74th Leg., R.S. (1995); Tex. H.B. 749, 74th Leg., R.S. (1995); Tex. S.J. Res. 25, 74th Leg., R.S. (1995); Tex. H.R.J. Res. 59, 74th Leg., R.S. (1995).

80. *See* Charlotte-Anne Lucas, *Panel Urges Referendum on Home Equity Loans: Plan Would Amend Texas Constitution*, DALLAS MORNING NEWS, July 30, 1994, at 1F (quoting John T. Montford, Chairman of Interim Senate Committee on Home Equity Lending as stating that "'the issue can best be resolved by a vote of the people'").