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Statutory Equitable Subrogation
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Let me describe a recent case first, and then tell you what I would do about it.

In *Countrywide Home Loans v. First National Bank of Steamboat Springs*, Supreme Court of Wyoming, 144 P.3d 1224, Oct. 17, 2006. The Ketchams gave a first mortgage on their property to AWL in 1997. Then in 2002, they gave a second mortgage to First National Bank. And in April 2003, they gave a third mortgage to Countrywide for a loan which was used to pay off the AWL mortgage. (it is too bad that *First Bank* had to be holding a *second* mortgage, but I will avoid continuing the confusion by referring to the three lenders as AWL (A), Bank (B) and Countrywide (C)). All three mortgages were promptly recorded when they were executed, and Countrywide knew of the Bank's mortgage; it apparently assumed that it would take priority over it by stepping into AWL's shoes.

Later that year the Ketchams defaulted on their Bank mortgage, and it sued to foreclose, naming Countrywide as a defendant. Bank and Countrywide both claimed priority over each other. Bank's claim was based upon the Wyoming recording act, which dates priority from date of recordation and meant that Bank's earlier recorded mortgage came before Countrywide's later recorded one,

Countrywide's counter claim to priority was based on the doctrine of equitable subrogation, promulgated by the Restatement (Third) of Property (Mortgages) in 1997. Section 7.6 provides:

"(a) One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment. Even though the performance would otherwise discharge the obligation and the mortgage, they are preserved and the mortgage retains its priority in the hands of the subrogee."

Countrywide claimed that it fit the Restatement standard because: 1) it, and the borrowers, and the original lender all expected it to have first priority; 2) it would not have agreed to re-finance otherwise; 3) Bank's position would not be lowered; 4) Bank should not move up in priority simply because Countrywide knew of its mortgage when it paid off the AWL mortgage; and 5) this gave Bank an "inappropriate windfall".

Countrywide's arguments fell on deaf ears. The trial court saw no reason to give Countrywide the protection that it could easily have gotten for itself by either asking for a subordination agreement from First National Bank or an assignment from AWL, whereas to allow it to leapfrog over Bank would amount to an unjust enrichment that it had done nothing to deserve. The Wyoming Supreme Court felt even more strongly that equitable subrogation should not be allowed. It quoted extensively from its earlier decisions to show that it had fully accepted as one of the "great principles of equity" the idea that one who is compelled to satisfy a superior lien in order to protect his own lien

should be subrogated to the rights of the superior lien holder. But that principle does not require extending the doctrine, as the Restatement does, "to allow a refinancing mortgagee to step into the shoes of a prior mortgagee for purposes of obtaining lien priority." The refiner does not pay the debt because of its good conscience or because it is necessary to protect its own interest, but rather as a volunteer. "In our view equitable subrogation simply has no application where a financial institution extends a loan for the purpose of enabling a mortgagor to pay off an existing mortgage, knowing that a subordinate lien exists on the real estate."

Given the lack of any equitable compulsion, there was no reason to reject the express demand of the recording statute that priority go to the party who has recorded first. "Countrywide was charged with knowing Wyoming is a "first in time" jurisdiction. We are charged with the duty of giving effect to the statutes our legislature has enacted. Where the language of a statute is plain and unambiguous and conveys a clear and definite meaning, the court has no right to look for and impose another meaning, but has the duty to give full force and effect to the legislative product." The statute's primary purpose of securing certainty of title "outweighs the interests of private lending institutions which can be protected by simple due diligence." So Countryside lost.

The Wyoming Supreme Court is not alone in refusing to accept the Restatement's argument that equitable subrogation ought to be available to refinancers even when they know or have constructive notice of intervening other creditors. A quick search of post 1997 decisions shows that courts in Florida (Picker Financial Group L.L.C. v. Horizon Bank, 293 B.R. 253, M.D.Fla.2003), Kansas (Bankers Trust Co. v. U.S., 25 P.3d 877, .2001), Minnesota (Ripley v. Piehl, 700 N.W.2d 540 2005), Pennsylvania.(First Com. Bank v. Heller, 863 A.2d 1153, 2004) , and Washington (Kim v. Lee, 145 Wash.2d 79, 31 P.3d 665, 2001) have reached the same result.

Against these six jurisdictions, the Restatement lists seven on its side: Arizona (Lamb Excavation, Inc. v. Chase Manhattan Mortgage Corp., 208 Ariz. 478, 95 P.3d 542, 2004), Colorado (Hicks v. Londre, 125 P.3d 452, 2005), DC (Eastern Savings Bank, FSB v. Pappas, 829 A.2d 953. 2003), Florida (Suntrust Bank v. Riverside Nat. Bank of Florida, 792 So.2d 1222, 2001), Indiana (Bank of New York v. Nally, 820 N.E.2d 644, 2005), Massachusetts, East Boston Sav. Bank v. Ogan, 428 Mass. 327, 701 N.E.2d 331, 1998), Nevada (Houston v. Bank of America Federal Savings Bank, 119 Nev. 485, 78 P.3d 71, 2003). Seven to six does not quite add up to an overwhelming victory for this new "enlightened" position.

What separates the courts on this issue is, I think, a difference between economics and morals. Restatementers see the intervening creditor as suffering no economic harm when its junior loan remains no less junior, merely subject to a different senior. Traditional moralists, on the other hand, will not forgive refinancing lenders for their audacity in wanting to leapfrog over existing creditors who they knew about but were too careless to deal with properly. Those are deepseated differences, not likely to be overcome when a real dispute has already arisen.

However, it seems to me that the matter is much more easily resolved if we view it in the abstract under a complete veil of ignorance as to which side we might be, rather than from the afterthought perspective of a judge who knows what everybody did. If C's funds are used to pay off A's debt, does fairness require that C be below B if C knew of B but above C if he did not? How does fairness to B or C depend on C's knowledge? What has B done to deserve an elevation of priority, or is that unjust enrichment? Does C's knowledge or carelessness justify his being denied A's original priority or is that punitive damages? If you don't know that your client will be B or C, which rule would you want to have in your jurisdiction?

A prudent refinancing lender will of course ask for an assignment from the old senior or for a subordination from the existing junior (who, however, in many of the cases appeared to be a judgment creditor rather than a consensual lender, and therefore less likely to agree). That is a wise precaution, but it does not deal with the problem of the lender who fails to be so prudent. Jack Murray, writing in DIRT, urged refinancers to have their loan documents declare the mutual intention of lender and borrower that the new loan take the original priority of the loan it is paying off. That too may help by bringing the matter closer to "conventional" subrogation if equitable subrogation is denied, but it will still require a court to be sympathetic – as the Wyoming and others are too often not.

I think this is one of those cases where legislation is appropriate. ACMA should consider pushing for a model act based on the Restatement: one who fully performs another's obligation should become by subrogation owner of the obligation and its security to the extent necessary to prevent unjust enrichment. It is difficult to imagine who would oppose this in the abstract. As a rule with statutory effect, it would be far more effective than all the best language in the world in the loan documents.

I think it not likely that refinancers would get careless in their title searches or lending habits if they knew that equitable subrogation was always available. Winning that way would still leave them at the mercy of litigation and uncertainty. This would only be damage control for those (too frequent) cases where someone below has messed up.