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Equitable Subrogation Doctrine Hampered in Mortgage Disputes

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The Michigan Supreme Court, on May 31, 2006, declined to review the Michigan Court of Appeals decision in *Washington Mutual Bank v. ShoreBank Corp.,* 267 Mich. App. 111; 703 NW2d 486 (2005), which severely limited the doctrine of equitable subrogation.

In *Washington Mutual Bank, supra,* the plaintiff, a bank, had given a loan, which was secured by a mortgage on the defendant's property. The proceeds from this loan were used to obtain discharge of a prior first mortgage on the property. The plaintiff, however, was unaware that two intervening mortgages had been recorded against this same property. Ultimately, the defendant defaulted on the intervening mortgages and foreclosure proceedings were initiated.

The plaintiff filed suit and argued that it was entitled to be equitably subrogated to the prior first mortgage because the proceeds of its loan were used to satisfy and discharge the prior first mortgage. The plaintiff urged the court to conclude that, although the two intervening mortgages had been recorded first, its mortgage was entitled to priority. The trial court granted summary disposition to the defendant and the plaintiff appealed.

The Michigan Court of Appeals agreed with the trial court and upheld the trial court's grant of summary disposition to the defendant. The appellate court explained that equitable subrogation is only appropriate when a party is compelled to the pay the debt of another party in order to protect a security interest. In such a case the party paying the debt of another is entitled to be substituted in the place of, and vested with the rights of, the party to whom it made the payment.

However, the appellate court reasoned that equitable subrogation was not appropriate in this case. The court cited the Michigan Supreme Court's decision in *Lentz v. Stolfert,* 280 Mich. 446 (1937), and explained that the plaintiff, as a stranger to the title, was a "mere volunteer."

The Michigan Court of Appeals concluded that the mere fact that the proceeds of the plaintiff's loan were used to pay off the prior first mortgage was insufficient to invoke the doctrine of equitable subrogation. The appellate court also rejected the plaintiff's arguments that it should not be considered a mere volunteer because of fraud or mistake of fact. However, the appellate court stated that a lender may be able to rely on the doctrine of equitable subrogation where the lender pays off its own mortgage.

To read the full text of the ruling, click here.

Mobile Home Security Interests Can Be Perfected with Mortgage Liens

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In a recent published opinion, *In Re Oswalt,* 444 F.3d 524 (6th Cir. 2006), the United States Court of Appeals for the Sixth Circuit held that, under Michigan law, a security interest in an affixed mobile home could be perfected through a traditional mortgage lien.

The *Oswalt* decision clarified this area of the law, which had been in dispute, given the Michigan Mobile Home Commission Act and *In Re Kroskie,* 315 F.3d 644 (6th Cir. 2003).

In *Oswalt,* the debtors had given the lender a mortgage on real property and the affixed mobile home. The lender attempted to perfect its security interest in the mobile home through a traditional mortgage lien. The Chapter 7 bankruptcy trustee sought to avoid the security interest in the debtor's affixed mobile home by arguing that the security interest was unperfected.

The language of the Michigan Mobile Home Commission Act, in existence at the time of the mortgage, specified that a security interest in an affixed mobile home was perfected by noting the lien on the certificate of title. The act did not provide for the perfection of a security interest through the use of a traditional mortgage lien.

The Chapter 7 bankruptcy trustee relied heavily on *In Re Kroskie,* 315 F.3d 644 (6th Cir. 2003). In *Kroskie*, the Sixth Circuit held that security interests in affixed mobile homes could only be perfected by noting the security interest on the certificate of title. The court reached this conclusion based on the language contained in the Mobile Home Commission Act. The court held that a lender relying on a traditional mortgage did not have a perfected security interest in the mobile home.

However, the Sixth Circuit, in *Oswalt*, recognized that the Michigan Legislature, in response to *Kroskie*, amended the Mobile Home Commission Act to clarify that security interests in affixed mobile homes could be perfected through a traditional mortgage lien. The Sixth Circuit also noted that, in a subsequent amendment, the Michigan Legislature, added additional language to clarify that the amendment applied retroactively. Ultimately, the court in *Oswalt* held that the amendment to the Mobile Home Commission Act was to be given retroactive effect.

To read the full text of the ruling, click here.

Court Clarifies Lender Duty with Respect to Future Advance Mortgages

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In a recent published opinion, *Deutsche Bank Trust Company Americas v Spot Realty, Inc.,* 269 Mich. App. 607 (2005), the Michigan Court of Appeals held that a lender was not required to discharge a future advance mortgage where that mortgage had been paid off and the homeowners had never requested that the lender close the home equity line of credit account.

The homeowners, James and Terry Robinson, issued a mortgage on their property to NF Investments in the amount of $284,000 (hereinafter referred to as “Mortgage A”). Thereafter, the Robinsons gave a future advance mortgage to NBD Bank in the amount of $40,000 (“Mortgage B”). The Robinsons later refinanced and gave a mortgage on their property to Decision One Mortgage in the amount of $424,000 (“Mortgage C”). The Decision One Mortgage paid off both Mortgage A and Mortgage B. However, Decision One failed to have the homeowners close the home equity line of credit account with NBD Bank.

Mortgage B was then assigned to Bank One. The Robinsons also obtained additional advances from Bank One. The homeowners subsequently defaulted on the

future advance mortgage and Bank One foreclosed on the property. Spot Realty purchased the property at the foreclosure sale. After the expiration of the redemption period, Deutsche Bank, the successor in interest to Decision One, moved to quiet title to the property. Ultimately, the trial court granted summary disposition in favor of Spot Realty. Deutsche Bank subsequently appealed.

The Michigan Court of Appeals affirmed the trial court ruling and held that because the future advance mortgage was never discharged, it was senior to Deutsche Bank's mortgage. Additionally, the court held that MCL 565.41 indicates that a mortgagee only has to discharge a mortgage "within 90 days after a mortgage has been paid or otherwise satisfied." The appellate court explained that, although the Bank One mortgage had been paid, it was not "otherwise satisfied" because written permission to close the account had not been obtained from the homeowners. Furthermore, the court reasoned that MCL 565.902 explained that the priority of advances made under a future advance mortgage is determined by the date that the future advance mortgage was recorded, regardless of when those advances were made.

As a final matter, the court flatly rejected Deutsche Bank's argument that it was entitled to equitable subrogation. The court reiterated that the doctrine of equitable subrogation was not intended to protect "sophisticated financial institutions that can choose the terms of their credit agreements." Indeed, the appellate court noted that Deutsche Bank was a "mere volunteer" and was not entitled to equitable relief.

To read the full text of this ruling, click here.

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