92373-6

No. _____

SUPREME COURT
OF THE STATE OF WASHINGTON

NO. 71544-5-1

COURT OF APPEALS
FOR THE STATE OF WASHINGTON
DIVISION I

CITY OF KENT,

Appellant,

and

BEL AIR & BRINEY, a general partnership; NICK BRINEY, a single man; and ROGER B. BEL AIR and CANDACE A. BEL AIR, husband and wife,

Respondents.

PETITION FOR REVIEW

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I. IDENTITY OF PETITIONER

The City of Kent ("Kent'), respondent, asks this Court to accept review of the Court of Appeals decision terminating review.

II. COURT OF APPEALS DECISION

The Court of Appeals filed its decision on September 14, 2015. Kent seeks review of that portion of the decision reversing the trial court, and finding that Kent may not foreclose its equitable lien. A copy of the decision is in the Appendix.

III. ISSUES PRESENTED FOR REVIEW

1. Does an owner of real property with an equitable lien thereon have the right to foreclose the lien?

2. Does Kent have the right to foreclose its equitable lien by means of a sheriff's sale?

IV. STATEMENT OF THE CASE

A. Factual Background

1. Kent planned to build a community pool

The plaintiff-respondent, Kent, began purchasing properties on a certain city block in Kent, Washington to develop an Aquatic Center in 2006. CP 69, ¶ 13. Kent entered into a Purchase and Sale Agreement dated November 26, 2006 with Hoang Tran, the owner of one of the properties on the block. CP 68-69, ¶¶ 7 and 14.

2. Bel Air & Briney made a hard-money loan to Ms. Tran

The defendant-appellant, Bel Air & Briney, a general partnership, is a hard-money lender. CP 65, ¶ 1; CP 117, ¶ 1.

In June 2007, Bel Air & Briney loaned $134,000 to Ms. Tran and two other individuals at a 12 percent interest rate. CP 66, ¶ 2; CP 73; CP 118, ¶ 4. The loan term was six months, with monthly interest-only payments with a balloon payment due on December 13, 2007. *Id.* Bel Air & Briney granted two six-month extensions to December 13, 2008, imposing a seven percent loan fee each time. CP 66, ¶¶ 3-4; CP 118, ¶ 7.

Bel Air & Briney received regular monthly payments from Ms. Tran from July 2007 through July 2008. CP 66, ¶ 5; CP 118, ¶ 7. It also received a payment in October 2008 which included a late fee. *Id.*

3. Bel Air & Briney's deed of trust was in second position

Bel Air & Briney secured its loan with a deed of trust recorded on June 15, 2007 which encumbered four properties. CP 66-68, ¶ 6; CP 118, ¶ 5. Bel Air & Briney knew that its deed of trust would be in a junior position on each property. CP 68-69, ¶ 8; CP 118, ¶ 5. It was in second-position behind a deed of trust securing a $189,000 debt on the property which is the subject of this lawsuit. CP 69, ¶ 12; CP 118, ¶ 5.

4. Kent purchased the property and paid off MortgageIt's loan

Three months before Bel Air & Briney recorded its deed of trust in June 2007, Kent received a preliminary commitment for title insurance. CP 69-70, ¶ 17. The preliminary commitment included a special exception for a 2005 deed of trust to MortgageIt, securing a loan for $189,000. *Id.* It did not include an exception for Bel Air & Briney's deed of trust, which had not yet been recorded. CP 70, ¶ 18.

Ms. Tran did not inform Kent of Bel Air & Briney's deed of trust at any time. CP 70, ¶ 21.

The sale of the property from Ms. Tran to Kent closed on January 31, 2008. CP 69, ¶ 15. Kent paid cash of $392,500. *Id.* MortgageIt was paid $196,894.17 from the sale proceeds in satisfaction of its outstanding lien. CP 70, ¶ 19. Ms. Tran received $193,499.50. CP 69, ¶ 15.

5. Four years after Ms. Tran ceased making payments, Mr. Briney researched the status of the property

In July 2012, almost four years later after Ms. Trans' last payment and four and a half years after the sale, Mr. Briney contacted Kent about Bel Air & Briney's deed of trust. CP 70, ¶¶ 22 and 23; CP 120, ¶ 13. It was the first time Kent learned of the deed of trust. CP 70, ¶ 23.

Bel Air & Briney took no actions in reliance on the reconveyance of the MortgageIt deed of trust. CP 70, ¶ 24.

Kent obtained an appraisal stating that the property's fair market value on October 30, 2012 was $110,000. CP 71, ¶ 26; CP 120-21, ¶ 15.

B. Procedural History

1. The trial court granted Kent an equitable lien

On January 21, 2014, the trial court entered an order granting Kent's motion for summary judgment and denying Bel Air & Briney's motion. CP 221-26 (Order); CP 15-64 and 151-165 for Respondent; CP 98-116, 117-150, and 166-220 for Appellants. The court stated that, "[w]hile the court is troubled by the present situation, where both the City and BAB were in effect innocent victims of market forces, it appears from the appellate decisions in Washington State that the doctrine of equitable subrogation should be applied in this case." CP 225. In analyzing the equities, the court concluded that "BAB would indeed have experienced an unearned windfall at the time of the City's purchase of the property, if BAB's security interest in the property advanced to first-position solely because the City caused the first mortgage to be satisfied as a condition of its purchase of the property." *Id.*

2. Bel Air & Briney appealed the summary judgment order granting equitable subrogation

Bel Air & Briney filed a motion for reconsideration of the order and a notice of appeal of the summary judgment order simultaneously. CP

235-242; CP 227-234. The motion was denied on April 9, 2014. CP 282-284. The court stated it:

> is unable to find that applying the doctrine of equitable subrogation is prejudicial to the defendants in this case to the degree that equitable subrogation should not be applied.
> ...
> the defendants would have received an unearned windfall if the doctrine of equitable subrogation were not applied. While the City likely would have required BAB's lien to be satisfied from the sale proceeds if the City had known of BAB's security interest at or before closing, the City had no affirmative duty to do so. Moreover, BAB was not prejudiced by the City's purchase of the property, since BAB's security interest remained precisely the same as it would have been if the City had not purchased the property. The subsequent decline in Parcel C's value was not the fault of any party, and BAB has not cited any authority in support of its argument that equity requires the court to assign the risk of loss to the City because the City had title insurance, which presumably would be liable to the City for the amount of BAB's security interest.

CP 282-83 (emphasis in original).

At the same time it entered its order, the trial court entered a judgment in favor of Kent, although it had not been presented to the court. CP 285-288; CP 295-296, ¶¶2-5. The judgment ordered equitable subrogation in favor of Kent:

> ORDERED, ADJUDGED and DECREED that City of Kent is equitably subrogated in the amount of $196,894.17 to the first-position lien held by MortgageIt as of January 30, 2008...
>
> ORDERED, ADJUDGED and DECREED that any interest in the Property held by Bel Air & Briney is subordinate to City of Kent's lien on the Property...

CP 286.

In addition to ordering equitable subrogation in favor of Kent, the judgment also ordered foreclosure of Kent's equitable lien by means of a sheriff's sale. CP 287.

3. Bel Air & Briney appealed the order granting Kent the right to foreclose its equitable lien

Bel Air & Briney filed a motion for reconsideration of the judgment. CP 289-294. It argued that Kent could not foreclose its equitable lien. *Id.* The court reversed course, stating "the portions of the Judgment (pp 3-4) that grant the City the right to foreclose on its equitable mortgage are vacated and stricken," and granted the motion. CP 346-348.

The next day, May 15, 2014, Bel Air & Briney sent a Notice of Default to the last known addresses of Ms. Tran and the other grantors, and posted the Notice of Default on the property. CP 364-374.

Kent filed a motion for reconsideration of the court's order granting the motion for reconsideration and amending the judgment. CP 349-361. The court granted Kent's motion, stating that it was "persuaded that without the remedy of foreclosure, the City's equitable mortgage is essentially worthless." CP 405-407. The trial court then entered an Amended Judgment, ordering foreclosure of Kent's equitable lien by means of a sheriff's sale. CP 408-412.

Bel Air & Briney filed a supplemental notice of appeal of the Order Granting Plaintiffs' Motion for Reconsideration and Amended Judgment. CP 413-422.

V. ARGUMENT WHY REVIEW SHOULD BE ACCEPTED

What the Court of Appeals' decision gives with one hand, it takes away with the other. In the first part of its decision, the court correctly applied the precedent established by this Court in recent equitable subrogation cases and held that equitable subrogation should be applied to give Kent an equitable lien with priority over Bel Air & Briney's deed of trust to the extent of Kent's payment of the MortgageIt note. Appendix pp. 11-16. However, in the second part of its decision, it eviscerates the doctrine of equitable subrogation by holding that Kent has no right to foreclose the very equitable lien it had acknowledged. The Court of Appeals' decision is irreconcilable with the very doctrine of equitable subrogation itself. Foreclosure is the *sine qua non* of a lien. Without the right to foreclose, an equitable subrogation is nothing at all and the doctrine is entirely ineffective because Bel Air & Briney will reap an unearned windfall anyway.

Accordingly, the holding is inconsistent with the equitable subrogation jurisprudence carefully crafted by the Washington Supreme Court over the past fourteen years. It also conflicts with other appellate

decisions which followed the precedent set by the Washington Supreme Court, including the first part of the very decision at hand. Finally, the Court of Appeals' decision eliminating the remedy associated with equitable subrogation presents an issue of substantial public interest that should be determined by the Supreme Court. In recent cases, the Court has developed the doctrine of equitable subrogation in Washington as a means to prevent unjust enrichment in certain real estate transactions. By eliminating the remedy, the Court of Appeals has restored opportunities for unearned windfalls causing harm to lenders and the public.

A. The Court of Appeals' Decision Presents a Conflict with this Court's Prior Decisions Under RAP 13.4(b)(1)

In the past fourteen years, the Court has decided three significant equitable subrogation cases. In each case, the Court advanced the doctrine, adopting a liberal application to prevent unjust enrichment.

In 2001, in *Kim v. Lee*, the Court adopted the doctrine of equitable subrogation in the mortgage refinance context as set forth in the *Restatement (Third) of Prop.: Mortgages § 7.3.* 145 Wn.2d 79, 31 P.3d 665 (2001), *as amended* (Dec. 12, 2001), *opinion corrected,* 43 P.3d 1222 (Wash. 2001). Although the Court recognized the doctrine, it declined to apply equitable subrogation on the facts of that case.

Six years later, in *Bank of Am., N.A. v. Prestance Corp.*, the Court "define[d] the contours of equitable subrogation." 160 Wn.2d 560, 561,

160 P.3d 17 (2007). The Court held that a refinancing mortgagee's actual or constructive knowledge of intervening liens does not automatically preclude a court from applying the doctrine of equitable subrogation. *Id.* at 579. This holding was based upon the Court's adoption of § 7.6 of the *Restatement (Third) of Property*. *Id.* at 582. However, the Court limited its holding by stating it only adopted § 7.6 for the purposes of resolving the question of knowledge. *Id.*

Regardless of this limitation, the Court expressly stated that it was following "the more liberal approach." *Prestance Corp.*, 160 Wn.2d at 576. The Court gave two policy reasons for this. First, the court explained that "by facilitating more refinancing, equitable subrogation helps stem the threat of foreclosure." *Id.* at 580. Second, the Court asserted that "a liberal equitable subrogation doctrine can save billions of dollars by reducing title insurance premiums" and that those savings would be passed on to homeowners. *Id.* at 580-81.

Another six years later, in *Columbia Cmty. Bank v. Newman Park, LLC*, the Court adopted § 7.6 of the *Restatement (Third)* in full. 177 Wn. 2d 566, 580, 304 P.3d 472 (2013). In that case, the Court applied the doctrine more broadly than for the determination of priorities among competing lenders. Specifically, the Court held that a lender who was tricked into loaning money secured by a lien on property that the borrower

lacked authority to encumber could invoke equitable subrogation to step into the shoes of a paid-off senior mortgagee, even though the lender had no preexisting interest in the property. *Id.* at 569.

The Court acknowledged that the public benefit of liberalizing equitable subrogation may have been overstated in *Prestance*, but did not retreat from the liberal approach itself, explaining that it is "the more simple and clear approach," "consistent with our recent prior case law," and "effective." *Id.* at 580.

In each of these cases, the Court, adhering to the liberal application of the doctrine of equitable subrogation, did not limit the rights of an equitably subrogated party in the mortgage loan context as compared to those of any other lienholder. Importantly, the Court did not apply the doctrine to benefit a party but then limit the equitably subrogated party's rights as a lienholder, such as by denying it the right to foreclose the lien.

However, this is precisely what the Court of Appeals did when it held that equitable subrogation does not carry with it a remedy. Appendix pp. 11-16. This holding is based upon a fundamental fallacy borrowed from an equally fallacious decision of the Arizona Supreme Court. Both courts seem to think that, absent a right to foreclose, the holder of an equitable lien retains some right to get paid from a subsequent sale. The Court of Appeals, laboring under this glaring misconception about the

essential nature of liens, explained, "[t]he equitable purpose of subrogation is fully served by permitting the City to succeed to first position *with priority to right of proceeds, in the amount of its equitable lien, from any sale."* *Id.* at p. 15 (emphasis added). That view is completely wrong.

The only way to enforce a lien is through foreclosure. There is no "right to proceeds from a sale," other than that established by private contract. There is no statute or common law principal that compels a party to a real estate transaction to pay off a lien in a sale. It is not a crime to sell real estate without paying off all liens. The recorder's office does not reject the recording of a deed because a lien was not paid off. The treasurer's office, which collects excise tax before a deed can be recorded, does not require that liens be paid off. Escrow agents are bound by their escrow instructions, so an escrow agent will not pay off a lien in closing unless the parties to the transaction instruct it to do so.[1] Normally, a purchase and sale contract will provide for the delivery of clear title, but there is nothing that compels the parties to enter into such an agreement.

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[1]An escrow company has a duty to follow the instructions of the seller and purchaser. *Denaxas v. Sandstone Court of Bellevue, L.L.C.*, 148 Wn.2d 654, 663, 63 P.3d 125, 129 (2003). After Bel Air & Briney forecloses its lien and takes title to the property, Kent will not have standing to object to escrow instructions from Bel Air & Briney and its purchaser ordering a payout without any proceeds for Kent.

The one and only reason that parties agree to pay off a lien in the context of a sale is because, if they do not do so, the lienholder can foreclose and eliminate the buyer's title.[2] But a payoff will not happen if the lien cannot be foreclosed as there will be no incentive or reason for anyone to do so. Without foreclosure, there is nothing—no fines, no rejection of the sale by the offices of the recorder or treasurer, no instructions to the escrow company, no prosecution for violation of a criminal statute—that will compel anyone to pay off the lien.

The Court of Appeals justified its position by citing as persuasive authority a decision from the state of Arizona. But that decision is based upon the same misconception that a lienholder without a remedy somehow gets paid from the proceeds of a sale.[3] In its decision, the Court of Appeals does not explain how or why Kent will have a "right to proceeds . . . from any sale." Of course it could not do so because a lien does not

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[2] The owner usually loses its title to the property at a foreclosure sale because the foreclosing lienholder makes a credit bid in the amount it is owed and the owner is unlikely to bid more than this amount. (If the owner had the amount necessary to pay off the lienholder, it would have done so before the lienholder foreclosed.) This is especially common where the value of the property is less than the lien, as is the case here. Alternatively, a third party can outbid the credit bid, but again, the owner loses its title to this highest bidder.

[3] The Arizona Supreme Court made the same incorrect assumption in *Sourcecorp, Inc. v. Norcutt* (Appendix pp. 20-27), stating that, "it is not appropriate to confer on the Norcutts a right to 'foreclose' on the interest to which they are subrogated. Instead, the purposes of equitable subrogation are fully served by deeming *the Norcutts to have a priority to proceeds from any sale of the property* in the amount they paid to satisfy the debt" and "[a]pplying equitable subrogation in this manner does not eliminate Sourcecorp's judgment lien." 229 Ariz. 270, 276, 274 P.3d 1204, 1210 (2012), *as amended on denial of reconsideration* (Apr. 25, 2012) (emphasis added).

create a "right to proceeds . . . from any sale." It creates a right to foreclose and that is all. By eliminating that right in arguably all equitable subrogation cases, the Court of Appeals gutted the doctrine of equitable subrogation. Kent is left with a lien in name only.

Moreover, Bel Air & Briney will reap the windfall the doctrine of equitable subrogation was designed to prevent. Bel Air & Briney can foreclose its lien, eliminate Kent's title, and resell the property for full value because the buyer will have no fear of losing its property in a subsequent foreclosure by Kent and therefore no reason to direct that any of the proceeds of the sale be paid to Kent.[4]

The Court of Appeals does not cite any Washington authority in support of its decision. Instead, it argues that Kent (and for that matter any equitable subrogation lienholder) cannot foreclose because, the court claims, there is no Washington authority permitting such foreclosure. But the court brushes off several Washington cases in which the Court held that an equitable lienholder can foreclose.

In a recent case, *Worden v. Smith*, the appellate court stated that the equitably subrogated party had "the remedy of foreclosure" and

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[4] If a subordinate lienholder forecloses, the senior lien is unaffected. It does not get paid off and the senior lienholder has no statutory or other right to demand a payoff. The lien merely continues to encumber the property subject to subsequent foreclosure which cannot happen under the Court of Appeals' decision.

remanded "with instructions to enter an order imposing and foreclosing a lien." 176 Wn. App. 309, 332, 314 P.3d 1125 (2013). In *Worden*, the equitably subrogated party was a bank that paid the taxes and assessments on the owner's interest in its property. *Id.* Similarly, in 1940 in *Olson v. Chapman*, the Supreme Court of Washington expressly stated that the party in whose favor it granted equitable subrogation was entitled to "a decree foreclosing the lien." 4 Wn.2d 522, 539, 104 P.2d 344 (1940). In *Olson*, a tenant in common paid the taxes on another owner's interest in the property. *Id.*[5]

The Court of Appeals distinguished those cases by contending that, in those cases, the lienholder foreclosed to collect its lien "to recover the amounts owed," and in this case, Kent wants to "foreclose for the sole purpose of eliminating a subordinate lien." Appendix p. 12. Again, this analysis reveals a fundamental lack of understanding about the nature of liens and the foreclosure process. In *all* cases of foreclosure by a senior lien, the subordinate liens are extinguished (as well as the foreclosed

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[5] *See also Burgert v. Carolina*, 31 Wash. 62, 64, 71 P. 74 (1903) (complaint stated a cause of action where plaintiff sought "to have the amount paid by her as taxes declared a lien...and to have the lien foreclosed and the land sold to satisfy the same"); *City of Spokane v. Security Savings Soc.*, 46 Wash. 150, 89 P. 466 (1907) ("awarding the respondent a lien upon appellants' lot for the delinquent general taxes paid...if they be not so paid, an order of sale issue on behalf of the respondent for the enforcement of its lien"); *Stone v. Marshall*, 52 Wash. 375, 379, 100 P.858 (1909) ("Stone by the payment of the tax...acquired a lien on the respondents' interests for their just proportion of the taxes so paid, which he could have foreclosed").

senior lien). The subordinate lienholders (and the owner) can protect their interests by paying off the senior lien during the foreclosure process or bidding at the foreclosure sale and thereby acquire title to the property. That is no less true in this case than in any foreclosure, such as in the cases cited above. If Kent commences a foreclosure, Bel Air & Briney can protect its interest by paying off Kent's lien or by outbidding Kent in the foreclosure sale. If that happened, Bel Air & Briney would take title to the property, but Kent would recover the money it paid to MortgageIt. The court was simply wrong when it attempted to distinguish a foreclosure by Kent from any other foreclosure.

The Court of Appeals also ignored the Restatement, which this Court adopted in whole in *Newman Park*. In affirming Kent's equitable subrogation in the first part of its decision, the court cites the following illustration from the Restatement:

> Mortgagor holds Blackacre subject to two mortgages, held respectively by Mortgagee-1 and Mortgagee-2. Mortgagor sells Blackacre to Grantee, falsely stating to Grantee that Blackacre is subject only to the first mortgage and promising that Mortgagor will pay and satisfy that mortgage obligation with the proceeds of the sale. Grantee, believing this statement, makes no title examination and is unaware of the existence of the second mortgage. Grantee completes the purchase. Mortgagor uses the proceeds of the sale to satisfy the first mortgage but does not satisfy the second. Grantee is entitled to be subrogated to the rights of Mortgagee-1 as against Mortgagee-2 and may enforce the first mortgage against Mortgagee-2.

Restatement (Third) of Property Mortgages § 7.6(d), Ill. 21. But in the second part of the decision, the court ignores the last sentence of that illustration: "Grantee is entitled to be subrogated to the rights of Mortgagee-1 as against Mortgagee-2 *and may enforce the first mortgage against Mortgagee-2." Id.* (emphasis added.)

The court also argues that, "[c]hapter 6.21 RCW, Sales Under Execution, is likewise unavailing." Appendix p. 12. However, Kent did not cite RCW Ch. 6.21 as the source of the right to foreclose. Rather, it was cited in response to a complaint by Bel Air & Briney that it did not know what procedure Kent would use to foreclose. RCW Ch. 6.21 sets forth the procedure for a sheriff's sale of a lien. It does not create liens. In this case, the superior court created the lien by applying the doctrine of equitable subrogation. It then set forth the sheriff's sale procedure as the means to enforce the lien. The court argues that Kent cannot rely upon RCW Ch. 6.21 because "the City has no money judgment to enforce" because it does not have a "personal judgment against a mortgagor." This is another mistaken view of the facts and the foreclosure process. As the owner of the MortgageIt lien under the doctrine of equitable subrogation, Kent is owed the money that it paid for that lien. The superior court granted Kent an *in rem* judgment in that amount. RCW Ch. 6.21 sets forth a process for enforcing that *in rem* judgment against the property. In the

foreclosure, a bidder will buy the property and pay off Kent's lien. If no bidder exceeds Kent's credit bid, Kent will acquire the property. As in the case of every foreclosure, the foreclosed lien and all subordinate liens will be eliminated and the buyer, whether that be a third party, Bel Air & Briney, or Kent, will acquire the property free and clear of all liens.

The Court of Appeals' denial of Kent's ability to foreclose its equitable lien conflicts with the Court's fourteen years of liberal application of the doctrine of equitable subrogation because it renders the doctrine of equitable subrogation meaningless, and confers a de facto windfall on subordinate lienholders, such as Bel Air & Briney. This conflict warrants review.

B. The Court of Appeals' Decision Presents a Conflict with Other Decisions of the Court of Appeals Under RAP 13.4(b)(2)

The Court of Appeals' decision is also in conflict with other decisions of the Court of Appeals, warranting review pursuant to RAP 13.4(b)(2). These cases not only followed the liberal application of the doctrine of equitable subrogation set out in *Kim*, *Prestance Corp.*, and *Newman Park*, but also either specifically ordered foreclosure or, at the least, did not deny the equitably subrogated party the right to foreclose.

The decision conflicts with a recent decision of Division Three. In *Worden v. Smith*, Division Three, citing *Newman Park* and *Prestance Corp.*, held that a bank which paid the county's lien for taxes and

assessments on property was equitably subrogated and that the appropriate remedy was foreclosure. 178 Wn. App. 309, 314 P.3d 1125 (2013). There is a direct conflict: Division Three held that foreclosure was the remedy for an equitably subrogated lienholder whereas the Court of Appeals denied Kent the remedy of foreclosure.

Division Two of the Court of Appeals expressed an entirely different view about the remedy of foreclosure in an unpublished case based on facts nearly identical to those in *Prestance Corp.* 145 Wn. App. 1039, 2008 WL 2655805 at *7 (2008).[6] Relying on the reasoning in *Prestance Corp.*, the court held that by virtue of equitable subrogation, the lender which provided the property owner with funds to pay off the first position lien obtained the first lien position. *Id.* As a result, the second position lien remained a subordinate lienholder entitled to surplus funds

[6] Although GR 14.1 prohibits a party from citing "as an authority" an unpublished opinion of the Court of Appeals, this case is cited not as authority, but rather to show a conflict between the divisions of the Court of Appeals. *See Durland v. San Juan Cnty.*, 182 Wn.2d 55, 82, 340 P.3d 191, 205 (2014) (concurrence) (discussing how the "divisions continue to assert their conflicting interpretations of the statute, as is evident in several unpublished Court of Appeals opinions."); *State v. Arreola*, 176 Wn.2d 284, 297, 290 P.3d 983, 991 (2012) (noting that "[c]onsistent with GR 14.1(a), which prohibits parties from citing an unpublished opinion of the Court of Appeals *as an authority,* we cite to such unpublished opinions not as precedent but instead to show that, in practice, the *Ladson* test has been applied by our courts to weed out pretextual traffic stops."); *State v. Franklin*, 172 Wn. 2d 831, 838, 263 P.3d 585, 588 (2011) (citing unpublished decisions of Division One and Division Two to show "the Court of Appeals is divided on the issue.").

from the trustee's foreclosure sale on behalf of the first position lienholder. *Id.* Neither the court nor the parties took issue with the fact that the first position lienholder foreclosed its equitable lien. The reasonable expectation is that Division Two would not deny an equitably subrogated lienholder its right to foreclose, as Division One has done.

The decision even conflicts with a previous decision by Division One. In *Norcon Builders, LLC v. GMP Homes VG, LLC*, Division One relied on the adoption of the liberal approach to the doctrine of equitable subrogation in *Prestance* and *Kim* in considering whether condominium unit owners were entitled to equitable subrogation where they paid off the primary lender's first priority position for the purchase of their units without the approval of a construction lender with secured rights that it negotiated to protect. 161 Wn. App. 474, 499, 254 P.3d 835, 849 (2011). The *Norcon Builders* court did not then backtrack and remove the owners' right to foreclosure as the Court of Appeals did here. *Id.*

The Court of Appeals' denial of Kent's ability to foreclose creates a conflict with these appellate decisions, warranting review.

C. Review Would Further a Substantial Public Interest Under RAP 13.4(b)(4)

Before the Court of Appeals' decision, Washington State had a strong body of law favoring the doctrine of equitable subrogation. The decision undercuts this law by removing the foreclosure remedy not just in

this particular case, but arguably in every case. All of those parties which the courts intended to have the benefit of the application of equitable subrogation will be stripped of this benefit as a lien without the foreclosure remedy is the same as having no lien at all.

Further, the removal of the foreclosure remedy would negatively impact consumers. Applications for refinancing could be denied or interest rates increased because the lenders will face new risks that their equitable subrogation right is worthless without the ability to foreclose. Similarly, the risk associated with the lack of any remedy will lead to an increase in title insurance premiums which are passed on to homeowners. *Prestance Corp.*, 160 Wn.2d at 580-81.

Not only does the Court of Appeals' decision harm lenders who pay off liens on property, but it also harms buyers who pay off liens when they purchase their property.

VI. CONCLUSION

Kent requests that the Court take review because without the right to foreclose its equitable lien, Kent loses all of the benefit of the doctrine of equitable subrogation and Bel Air & Briney obtains a windfall anyway. On review, it seeks an order affirming the Court of Appeals in part and reversing the Court of Appeals in part, and holding that Kent is entitled to foreclose its equitable lien by a sheriff's sale.

Respectfully submitted this 14th day of October, 2015.

SOCIUS LAW GROUP, PLLC

By _____

Thomas F. Peterson, WSBA #16587
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Attorney for Petitioner City of Kent

APPENDIX

1. *Bel Air & Briney v. City of Kent*, -- P.3d --, 2015 WL 5330512

2. *Sourcecorp, Inc. v. Norcutt*, 229 Ariz. 270, 274 P.3d 1204 (2012)

CERTIFICATE OF SERVICE

I certify that on the 14th day of October , 2015, I caused a true and correct copy of this Petition for Review to be served on the following in the manner indicated below:

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IN THE COURT OF APPEALS FOR THE STATE OF WASHINGTON

BEL AIR & BRINEY, a general Partnership, NICK BRINEY, a single man, ROGER C. BEL AIR AND CANDACE BEL AIR,	)	No. 71544-5-I
Appellants,	)	DIVISION ONE
v.	)	
CITY OF KENT,	)	PUBLISHED OPINION
Respondent.	)	FILED: September 14, 2015

SPEARMAN, C.J. — When the City of Kent (City) bought the property that is the subject of this action, it paid off the first position lien but did not discover the junior lien until after the proceeds had been disbursed. The City filed a complaint for declaratory relief, seeking equitable subrogation to the prior first position lienholder and the right to foreclose on the resulting equitable lien. On the City's motion for summary judgment, the trial court granted the requested relief. The junior lienholders appeal, claiming the trial court erred in so ruling because they will be materially prejudiced by subrogating the City to the first position lien and the City was not entitled to foreclose on the lien. We affirm in part and reverse in part, finding that while the City is entitled to equitable subrogation, it may not foreclose on its equitable lien.

FACTS

Appellant Bel Air & Briney (B&B) is a general partnership between Roger B. Bel Air and Nick Briney.[1] In June 2007, B&B loaned Hiep Nguyen, Hoang Tran, and Dun Tram (Borrowers) $134,000 in return for a promissory note with an interest rate of 12 percent (Note). This interest rate would rise to 24 percent on default. The Note required interest-only payments of $1,345 until its maturity on December 13, 2007, at which time the total unpaid balance would be due. On December 7, 2007, the Note's maturity date was extended to June 13, 2008, and the principal amount increased by $9,500. The Borrowers' monthly payments increased to $1,435, reflecting the additional interest for increased principal. The Note was extended again on June 27, 2008, resulting in an additional $10,000 in principal, monthly payments of $1,535, and a maturity date of December 13, 2008.

The Note was secured by a deed of trust (B&B deed of trust) that encumbered four parcels of land, listed as Parcels A, B, C, and D. The B&B deed of trust was recorded on June 15, 2007, and was in either second or third position on each parcel. The senior liens on parcels A and D were foreclosed in 2009, extinguishing B&B's junior interests. Parcel B was sold at a short sale in 2012, and B&B received $3,500 in exchange for release of its interest in Parcel B.

[1] Although Nick Briney and Roger and Candace Bel Air are also named as parties, the activity giving rise to this appeal was primarily that of the general partnership, Bel Air and Briney. For that reason we refer to the entity of the general partnership rather than the individuals during the course of this opinion. No disrespect is intended.

The City wanted to develop an aquatic center on the block of Parcel C (Property). The City and the Borrowers entered into negotiations to purchase the Property in 2006. The City received a preliminary title commitment from Pacific Northwest Title Company (PNWT) on March 14, 2007, three months before B&B recorded its deed of trust. PNWT issued a title policy to the City on January 31, 2008, based on the preliminary title commitment. The B&B deed of trust was not included in the title report or the policy. The sale closed in January 2008 and the City paid $392,500 cash for the Property. MortgageIt, the first position lender, received $196,894.17 from proceeds and reconveyed its deed of trust. The Borrowers received $193,499.50 from the sale and ceased making regular payments on the B&B deed of trust. The last payment B&B received was $1,850, which included a late-payment fee, in October of 2008. As of January 31, 2008, the total outstanding amount on the Note was $143,305.42.

The Borrowers did not inform the City about the B&B deed of trust. As a result, the City did not learn about the deed of trust until it was contacted by Briney in July 2012. Briney learned about the sale of the Property in July 2012, while in negotiations to reconvey B&B's interest in Parcel B. Until then, B&B was unaware that the MortgageIt deed of trust had been reconveyed.

The City gave notice of B&B's claim to its title insurer, First American Title Insurance Company (First American), successor to PNWT. First American accepted tender of defense. On May 1, 2013, the City filed a complaint for declaratory relief, seeking a judgment of equitable subrogation declaring that B&B's interest is junior to the City's interest in the amount of $196,894.17. The City later amended its complaint to add a second claim for foreclosure of the

resulting equitable lien to extinguish all junior interests in the property. As of October 2012, the Property's fair market value was approximately $110,000.

The parties filed cross motions for summary judgment on October 18, 2013. The trial court granted the City's motion on January 21, 2014 and denied B&B's cross motion. The trial court entered judgment in favor of the City, declaring B&B's deed of trust to be second to the City's lien, and ordering foreclosure of the City's lien. At the sale, the City would be permitted to credit bid up to $196,894.17, and would receive any proceeds from the sale after deducting costs. B&B filed a motion for reconsideration, which the court denied on April 9, 2014.

B&B filed a second motion for reconsideration on April 21, 2014, contending that the trial court had no basis for ordering foreclosure of the lien. The trial court granted B&B's second motion and struck the right to foreclose on the equitable lien. B&B immediately served a notice of default, instituting foreclosure of its junior lien. The City then filed a motion for reconsideration on the issue of foreclosure. B&B filed this appeal before the trial court had ruled on the City's motion. On July 30, 2014, the trial court granted the motion and entered an order permitting the City to foreclose on its lien. B&B assigns additional error to that order.

DISCUSSION

We review a trial court's order granting summary judgment de novo. Columbia Cmty. Bank v. Newman Park, LLC, 177 Wn.2d 566, 573, 304 P.3d 472 (2013). On review, we view all evidence in the light most favorable to the nonmoving party. Id. Summary judgment is appropriate if there is "no genuine

issue as to any material fact" and "the moving party is entitled to a judgment as a matter of law." CR 56(c).

Equitable Subrogation

Subrogation is "'an equitable remedy,'" and is "'founded in the facts and circumstances of each particular case.'" Newman Park, 177 Wn.2d at 581 (quoting, RESTATEMENT (THIRD) OF PROPERTY MORTAGES § 7.6 CMT. A); Credit Bureau Corp. v. Beckstead, 63 Wn.2d 183, 186, 385 P.2d 864 (1963)). The doctrine allows an outside party to step into the lender's shoes and receive the benefit of the outstanding debt, without an agreement or assignment of rights among the outside party, the lender, or the debtor. Id. at 573. In other words, if a third party pays the debtor's outstanding loan to the lender without any formal agreement among the parties, then equity may permit the third party to take over the lender's interest and receive the debtor's payments. Id. at 574. The rationale for subrogation is to prevent the unearned windfall that would otherwise accrue to the debtor, who could deny the obligation to make further payments on the debt because it has been satisfied by another to whom the debtor owed no obligation by reason of assignment of rights or other agreement. Id.

In the context of mortgage refinancing, equitable subrogation takes a somewhat different form. There, it is considered "'a tool by which real property lenders, or lienors, may replace the prior, senior lien position of an earlier in time lender by paying off that prior lender's loan.'" Id. (quoting Scott B. Mueller, *Is Equitable Subrogation Dead for Lenders and Insurers in Missouri?*, 66 J. Mo. B. 196, 196 (2010)). Thus, in the refinancing context it is generally not the debtor

who would be unjustly enriched by the payment of his or her debt by a third party, rather it is the junior lienholder. This is so because, absent subrogation:

> [T]he third party's payment would bump the number two security interest into the number one position without the junior lienholder having taken any action to warrant such an advancement. We prevent this unjust enrichment by subrogating the party paying off the priority interest to the party who held that interest, to the extent of the former lienholder's interest at that time.

Id. at 575 (citation omitted). Stated differently, in this context, "equitable subrogation simply seeks to maintain the proper order of priorities." Bank of America, N.A. v. Prestance Corp., 160 Wn.2d 560, 564, 160 P.3d 17 (2007) (citing Burgoon v. Lavezzo, 68 Wn. App., D.C. 20, 92 F.2d 726, 729 (1937)).

Washington has explicitly adopted the "liberal approach" to equitable subrogation as expressed in the *Restatement (Third)* § 7.6. See Newman Park, 177 Wn.2d at 580 ("We now explicitly adopt *Restatement (Third)* § 7.6 in full.) That section reads as follows:

> (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.
>
> (b) By way of illustration, subrogation is appropriate to prevent unjust enrichment if the person seeking subrogation performs the obligation:
>
> (1) in order to protect his or her interest;
>
> (2) under a legal duty to do so;
>
> (3) on account of misrepresentation, mistake, duress, undue influence, deceit, or other similar imposition; or
>
> (4) upon a request from the obligor or the obligor's successor to do so, if the person performing was promised repayment and reasonably expected to receive a security interest in the real estate with the priority of the mortgage being discharged, and if subrogation will not materially prejudice the holders of intervening interests in the real estate.

Under the liberal approach of § 7.6, "[e]quitable subrogation should never be allowed if a junior interest is materially prejudiced, but if the junior interests are unaffected, then there is no reason to deny it." Prestance, at 572. See also Newman Park, 177 Wn.2d at 582. ("If the circumstances are such that subrogation to a prior mortgage will relieve the payor, and *if no prejudice to any innocent person will result,* the payor may have subrogation." (Quoting RESTATEMENT (THIRD) § 7.6, cmt d.))

B&B argues that equitable subrogation is not applicable to this case because it would be materially prejudiced thereby and because its absence would not cause B&B to be unjustly enriched.[2] B&B points out that the Borrowers, who ceased making payments shortly after the sale, pocketed the amount in excess of that necessary to pay off the senior loan. Thus, it received nothing from the proceeds of the sale even though the amount was more than sufficient to pay off its lien. B&B also points out that in the interim, the property's value has decreased to such an extent that it is worth less than the amount owed on its lien. As a result, according to B&B, if equitable subrogation is applied, it will be materially prejudiced because it will lose any opportunity to recoup any of its losses. And, in the absence of its application, even if B&B's priority is advanced,

[2] B&B also argue that equitable subrogation is not properly applied where the senior lien is paid off as part of a sale and not a refinance. In the latter circumstance, B&B contends the lender fully expects to be substituted in the prior lender's position, but a purchaser who buys the property outright has no such expectation. We reject the argument for three reasons. First, other than the fact that Prestance and Newman Park arose in the context of a refinancing, B&B cite no case authority in support of this argument. Second, under the liberal approach to equitable subrogation adopted in Newman Park, we find no meaningful distinction between the two circumstances. And, third, Illustration 21 to Restatement § 7.6, cmt. d, contemplates just such a situation as here, where equitable subrogation is properly applied in favor of the purchaser of a property who pays off the senior lien, but which, unbeknownst to the purchaser, is also subject to a junior lien. See infra at 9.

it cannot be unjustly enriched, given the Borrowers' retention of the sale proceeds and subsequent default and the substantial decrease in the property's value.

In support of its position, B&B relies primarily on Centreville Car Care, Inc. v. N. Am. Mortgage Co., 263 Va. 339, 559 S.E.2d 870 (2002). But the case is unavailing because it is distinguishable both on its facts and because Virginia, unlike Washington, has not adopted § 7.6 of the Restatement.

In Centreville, the plaintiff, Centreville Car Care (Centreville) held a second deed of trust on a property that was overlooked when the property was purchased. 559 S.E. 2d at 871. The purchasers paid off the first deed of trust and gave the remainder of the sale proceeds to the original owners. Id. The purchasers had borrowed money from a third lender, North American Mortgage, to pay for the sale, and secured that loan with a first mortgage on the property. Id. The original owners defaulted on their loan to Centreville, and Centreville sought to foreclose. Id. North American Mortgage sought equitable subrogation, claiming that its deed of trust should be senior to the Centreville mortgage. Id. The Virginia court disagreed, concluding that equitable subrogation was inapplicable because Centreville was not unjustly enriched since it had the right to anticipate that its secured interest would be improved and/or paid based on the satisfaction of the first deed of trust, and that subrogation, if imposed would materially prejudice Centreville because it would get virtually nothing in return on its lien. Id. at 874.

Although no Washington cases have addressed this precise factual scenario, the result in Centreville appears to be directly at odds with § 7.6 of the

Restatement. The Centreville court found that subrogation would prejudice Centreville because satisfaction of the senior lien did not result in payment of its lien and that the improvement in the position of its lien was warranted. But the comment to RESTATEMENT (THIRD) § 7.6(d) contemplates just such a situation and concludes otherwise. Illustration 21 presents the following circumstance:

> Mortgagor holds Blackacre subject to two mortgages, held respectively by Mortgagee-1 and Mortgagee-2. Mortgagor sells Blackacre to Grantee, falsely stating to Grantee that Blackacre is subject only to the first mortgage and promising that Mortgagor will pay and satisfy that mortgage obligation with the proceeds of the sale. Grantee, believing this statement, makes no title examination and is unaware of the existence of the second mortgage. Grantee completes the purchase. Mortgagor uses the proceeds of the sale to satisfy the first mortgage but does not satisfy the second. Grantee is entitled to be subrogated to the rights of Mortgagee-1 as against Mortgagee-2 and may enforce the first mortgage against Mortgagee-2.

The comment concludes that "if the cash price paid by the grantee included the second mortgage balance, subrogation to, rather than extinction of, the first mortgage will result in order to prevent unjust enrichment of the second mortgagee." In other words, under the Restatement, the City's payment would bump B&B into the number one position without B&B having to take any action to warrant such an advancement. See, Newman Park, 177 Wn.2d at 575 (" . . . absent subrogation, the third party's payment would bump the number two security interest into the number one position without the junior lienholder having taken any action to warrant such an advancement."). Thus, in Washington, under the circumstances presented here, absent the application of equitable subrogation B&B would be unjustly enriched.

B&B's contention that it will be materially prejudiced by the application of equitable subrogation is similarly unavailing. B&B offers examples of the difficulties it has suffered at the hands of its Borrowers, but it fails to explain how the application of equitable subrogation affects it in any material way. It bargained for a second position mortgage and in exchange for that risk, it obtained more favorable terms for the loan than it could have obtained otherwise.[3] Granting the City an equitable lien leaves B&B in the same bargained for position as it was before. The Borrowers' default on the loan and the decrease in value of the property are not effects attributable to subrogation.

B&B argues that Kim v. Lee, 145 Wn.2d 79, 31 P.3d 665 (2001), supports its claim that it will be prejudiced by equitable subrogation. But the case is distinguishable. Kim involved the parents' loan to purchase property for their children, secured by a deed of trust, with the children making payments. 145 Wn.2d at 82. The children later took out a new loan, secured by a new deed of trust, to pay off their parents' loan. Id. Kim had a judgment lien against the children that he claimed succeeded to first position when the parents' loan was paid off. Id. at 83. The Kim court held that the judgment lien had priority under the rule of replacement and modification. Id. at 90. Under the rule, modification will ordinarily cause a mortgage to lose priority to junior interests to the extent that the modification is materially prejudicial to those interests. Id. The loan to the

[3] "If the first-priority mortagee forecloses, then a second-priority mortagee knows he can recover any surplus remaining only after the first-priority mortagee has been fully satisfied. Therefore, second-priority mortages often include terms to help alleviate this risk, such as higher interest rates. It is unfair to allow a second-priority mortagee to take a first-priority but still enforce the previously bargained-for terms. He gains the security of a first-priority loan, while keeping the favorable conditions of a second-priority loan." Prestance, 160 Wn.2d at 564, n.4.

children was "not merely an extension of the maturity date or stretching out the installment payments of the existing mortgage; rather, it was a new mortgage and the change was from a 6-year maturity date to a 30-year maturity date." Id. The court found that these modifications materially prejudiced Kim, because they affected the loan's payoff time and Kim's ability to move into first priority. Id. Here, however, there was no modification or replacement of the MortgageIt loan and, as noted above, B&B does not explain how subrogating the City to first position puts B&B in any worse position than before.

We affirm the trial court's ruling and find that equitable subrogation should be applied in this case. Accordingly, the City shall have an equitable lien with priority over the B&B's deed of trust to the extent of the City's payment of the MortgageIt note.

Foreclosure of the Equitable Lien

The City argues that if it is entitled to equitable subrogation, it must necessarily be entitled to foreclose on the resulting equitable lien because "[w]ithout the ability to foreclose, a lien is meaningless." Supp. Br. of Respondent at 1. According to the City, Ch. 6.21 RCW and case law allow an equitably subrogated party to foreclose its equitable lien, citing Olson v. Chapman, 4 Wn.2d 522, 104 P.2d 344 (1940), Worden v. Smith, 178 Wn. App. 309, 332, 314 P.3d 1125 (2013), and a string of earlier cases allowing tenants in common to

acquire and foreclose upon equitable liens.[4] The cited cases are inapposite. For example, in Olson and Worden, the principle cases on which the City relies, the county had a tax lien on the subject properties and the parties seeking subrogation to the lien had paid the taxes. In each case, the court permitted subrogation and ordered foreclosure to recover the amounts owed. In neither case did the subrogee, as the City does here, pursue foreclosure for the sole purpose of eliminating a subordinate lien.

Chapter 6.21 RCW, Sales Under Execution, is likewise unavailing. That statute allows a creditor to seek a sheriff's sale to execute against property owned by a debtor to satisfy a money judgment. But here, the City has no money judgment to enforce, nor could it have. It is uniformly recognized that a subrogee has no right to a personal judgment against a mortgagor as a mortgagee would. See 107 A.L.R. 785.[5] Thus, Ch. 6.21 RCW is inapplicable under the facts of this case.

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[4] These cases include Burget v. Carolina, 31 Wash. 62, 71 P.724 (1903) (tenant in common paid taxes on property and court found she had stated a cause of action for declaring a lien on the land in that amount, and to have the lien foreclosed); Stone v. Marshall, 52 Wash. 375, 100 P. 858 (1909) (co-owner acquired a lien on the interests of others that could be foreclosed by a suit in equity, but not by a tax sale); and City of Spokane v. Sec. Savings Soc., 46 Wash. 150, 89 P.466 (1907) (court invalidated a local assessment lien to the City but awarded it a lien for delinquent general taxes).

[5] "A subrogee is, generally speaking, placed in the precise position of the one to whose rights he is subrogated, and is entitled to all the rights and securities and to the benefit of all the remedies which were available to such person. It follows from the very principles of the doctrine of subrogation that one cannot thereby succeed to or acquire any claim or right which the person for whom he is substituted did not have, the extent of his remedies and the measure of his rights being controlled by those possessed by the creditor, and those rights, claims, and securities to which he succeeds are taken subject to the limitations, burdens, and disqualifications incident to them in the hands of his predecessor. Beyond this he has no right and no valid claim for protection."

Nor does the City explain how its position, that it may properly foreclose on its equitable lien, is consistent with controlling authority. As previously discussed our supreme court has adopted in full Restatement (Third) § 7.6, which permits equitable subrogation under the circumstances presented here, but only "to the extent necessary to prevent unjust enrichment."

SourceCorp, Inc. v. Norcutt, 229 Ariz. 270, 274 P.3d 1204 (2012), a case cited by the City, is instructive. There, Sourcecorp obtained a substantial judgment against the Shills in September 2004. Id. at 272. The Shills owned property that was then subject to a first mortgage in favor of Zions National Bank (Zions Bank) that secured a debt of nearly $689,000. Id. Sourcecorp recorded its judgment lien against this property. Id. Accordingly, the property was then subject to both the first mortgage in favor of Zions Bank and the subordinate judgment lien in favor of Sourcecorp.

In November 2004, the Shills sold their property to the Norcutts for $657,000. Id. Zions Bank accepted $621,000 of these proceeds in full satisfaction of the note secured by the first mortgage. Id. While the opinion does not expressly say so, it appears the Shills told neither the closing agent nor the Norcutts about the substantial judgment lien also encumbering the property. Although the Norcutts purchased title insurance, the title insurance company failed to discover the judgment lien in favor of Sourcecorp in the public records. Id.

After closing of the sale, Sourcecorp sought a sheriff's sale of the Norcutts' property based on the judgment lien against it. Id. at 276. The Norcutts sued to enjoin the sale, and the trial court granted that relief. Id. The Norcutts

then argued that they were equitably subrogated to the first lien position of Zions Bank, which was prior to the judgment lien of Sourcecorp. Id. The trial court rejected this position. Id. at 272.

When the case reached the Supreme Court of Arizona, the Court noted there was some ambiguity in that state's case law regarding the proper test for equitable subrogation. But the Court resolved that ambiguity by adopting RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES, § 7.6. Sourcecorp, 229 Ariz. at 273.

When the court applied § 7.6 to the facts of the case, it concluded that the Norcutts were entitled to be equitably subrogated to the first mortgage lien position formerly held by Zions Bank. The extent of the subrogation was for the $621,000 they paid to that bank from the proceeds of sale at closing to fully satisfy the debt then owed by the Shills to the bank.

In addressing the argument of Sourcecorp that foreclosure of the equitable subrogation lien in favor of the Norcutts would be improper, the court stated:

> Recognizing that equitable subrogation depends on the facts of the particular case, *see Mosher,* 45 Ariz. at 468, 46 P.2d at 112, we conclude that it is not appropriate to confer on the Norcutts a right to "foreclose" on the interest to which they are subrogated. Instead, the purposes of equitable subrogation are fully served by deeming the Norcutts to have a priority to proceeds from any sale of the property in the amount they paid to satisfy the debt, $621,000.

Id. at 276. The court remanded the case to the trial court for entry of summary judgment in favor of the Norcutts, the subrogees of Zion Bank's first lien. But that relief was without the power to eliminate the subordinate judgment lien of Sourcecorp.

The similarities between Sourcecorp and this case are striking. There, the Shills' failed to disclose to the purchasers of their property the subordinate judgment lien in favor of Sourcecorp. Here, the City purchased the property from the Borrowers, who failed to disclose the existence of the subordinate deed of trust held by B&B. There, the title insurance company failed to discover the judgment lien that was subordinate to the first mortgage in favor of Zions Bank. Here, the title insurance company failed to discover the second deed of trust that was recorded in the public records at the time of the closing of the sale. There, the closing agent disbursed part of the purchase price funds to satisfy the first mortgage to Zions Bank without paying the subordinate lien. Here, the closing agent disbursed part of the purchase funds to satisfy the first mortgage without paying the debt secured by the second deed of trust. And, notably, both jurisdictions have adopted the same provision of RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES, § 7.6.

Applying the Restatement and the reasoning from Sourcecorp, we find that the prevention of unjust enrichment does not extend so far as to grant the City the right to foreclose on its equitable lien. The equitable purpose of subrogation is fully served by permitting the City to succeed to first position with priority of right to proceeds, in the amount of its equitable lien, from any sale. Equity is preserved by allowing B&B to retain its second position lien. To the extent that B&B's lien adversely affects the City's equity or renders the Property less marketable, we neither address nor foreclose any claims the City may have against its title insurer.

We affirm the grant of equitable subrogation and creation of an equitable lien to the extent of the City's payment of the MortgageIt loan. The City's lien has priority over B&B's deed of trust. We reverse the order permitting the City to foreclose on its equitable lien and remand to the trial court for entry of judgment consistent with this opinion.

Affirm in part, reverse in part, and remand for entry of judgment.

WE CONCUR:

Specimen, C.J.

Dwyer, J.

Bel Air & Briney, et al. v. City of Kent, No. 71544-5-I

COX, J. (concurring) — I concur. I write separately to address additional aspects of the City's attempt to clear title to its property by use of a sheriff's sale. Namely, the City seeks to extinguish the subordinate deed of trust held by Bel Air & Briney that encumbers the property.

The trial court's amended judgment ordering foreclosure states that:

> "upon completion of such Sheriff's Sale, Bel Air & Briney's Lien upon the Property shall be ***extinguished*** and Bel Air & Briney, and any and all persons claiming by, through, or under them, shall be forever barred and foreclosed from any right, title, interest, lien, or estate in and to the [City's] Property . . . ."[1]

The question is whether it is proper to use the sheriff's sale statutes to extinguish the lien of the Bel Air & Briney deed of trust against the City's property. Specifically, may the City enforce its equitable subrogation lien arising from the former Mortgagelt, Inc. deed of trust, which has a higher lien priority, against the subordinate Bel Air & Briney deed of trust?

The lead opinion discusses why the City is entitled to be equitably subrogated to the lien priority of the former Mortgagelt, Inc. deed of trust, to the extent the City paid the obligation secured by that encumbrance. Moreover, the opinion correctly concludes that the City is not entitled to foreclose its equitable subrogation lien due to prejudice to Bel Air & Briney.

In seeking to obtain clear title to its property in this case, the City ignores the fact that it holds two distinct interests in its property. First, it holds title to the property by virtue of the deed from Ms. Hoang Tran, the former owner. Second,

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[1] Clerk's Papers at 410-11 (emphasis added).

it also holds a first lien by equitable subrogation because it paid off the obligation to MortgageIt, Inc., which was secured by a deed of trust held by that lender. Distinct rights are associated with these distinct property interests.

These distinct interests in the property do not merge, as the City properly concedes. As the City correctly states "the merger doctrine [does not] defeat the equitable subrogation rights of the City of Kent."[2] Specifically, because merger is a question of intent, there is a presumption that the City did not intend its two interests in the property to merge. This is consistent with long-standing case law:

> the existence of a junior, or intervening, encumbrance or equity will, in the absence of a showing of an intention to the contrary, prevent a merger of a prior mortgage in the fee, where the continued existence of the mortgage is necessary to protect the mortgagee against the intervening, junior claims.[3]

Any right to clear title that the City may have arises from its interest as the holder of title to the property. This stems from the warranties arising from the statutory warranty deed that Ms. Tran, the former owner of the property, presumably signed and delivered at the closing of the sale.[4]

Of course, Bel Air & Briney was not a party to the deed given by Ms. Tran. And Bel Air & Briney never represented to the City that title to the property was clear of encumbrances. To the contrary, Bel Air & Briney always claimed the property was subject to its deed of trust.

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[2] Respondent's Statement of Additional Authorities Pursuant to RAP 10.8 at 1.

[3] Gill v. Strouf, 5 Wn.2d 426, 431, 105 P.2d 829 (1940).

[4] RCW 64.04.030(2) ("that the [property is] then free from all encumbrances"); Ensberg v. Nelson, 178 Wn. App. 879, 886, 320 P.3d 97 (2013), *review denied*, 180 Wn.2d 1012 (2014).

Accordingly, the claim of a ***right*** to clear title by the City primarily arises from its status as title holder to the property. This status is distinct from the grant of an equitable subrogation lien against its property. It is the status of lien holder that would, ordinarily, permit foreclosure under the sheriff's sale statutes. The status of title holder does not. There simply is no authority for the City to use the sheriff's sale statutes to extinguish the lien of Bel Air & Briney's deed of trust against the City's property under the circumstances of this case.

For the reasons discussed in the lead opinion and here, I concur.

COX, J.

229 Ariz. 270
Supreme Court of Arizona,
En Banc.

SOURCECORP, INCORPORATED,
Plaintiff/Appellee,
v.
Dean D. NORCUTT and Stacey L. Norcutt,
husband and wife, Intervenors/Appellants.

No. CV–11–0269–PR. | April 6, 2012. | As Amended on Denial of Reconsideration April 25, 2012.

Synopsis
Background: In action by judgment creditor to obtain forced sale of real property, purchasers intervened, seeking injunction based on equitable subrogation. The Superior Court, Maricopa County, No. CV2002-020676, J. Kenneth Mangum, J., entered summary judgment in favor of creditor. Purchasers appealed. The Court of Appeals, 227 Ariz. 463, 258 P.3d 281, reversed and remanded. Review was granted.

Holdings: The Supreme Court, Bales, J., held that:

[1] equitable subrogation should not turn on whether the person invoking the doctrine is labeled a volunteer;

[2] purchasers, who paid a preexisting mortgage debt to protect their concurrently acquired interest in the property, had a sufficient interest to allow them to seek equitable subrogation; and

[3] fact that purchasers had obtained title insurance did not preclude them from receiving equitable subrogation.

Court of Appeals affirmed.

West Headnotes (17)

[1] **Subrogation**
⚖ Nature and theory of right
Subrogation
⚖ Mode and effect of subrogation in general

"Equitable subrogation" is the substitution of another person in the place of a creditor, so that the person in whose favor it is exercised succeeds to the rights of the creditor in relation to the debt.

4 Cases that cite this headnote

[2] **Subrogation**
⚖ Nature and theory of right

Equitable subrogation is designed to avoid a person's receiving an unearned windfall at the expense of another. Restatement (Third) of Property (Mortgages) § 7.6 comment.

2 Cases that cite this headnote

[3] **Subrogation**
⚖ Protection of interest in property
Subrogation
⚖ Assignment or Benefit of Security or Incumbrance

The general rule regarding equitable subrogation is that a person having an interest in property who pays off an encumbrance in order to protect his interest is subrogated to the rights and limitations of the person paid.

2 Cases that cite this headnote

[4] **Subrogation**
⚖ Nature and theory of right

No general rule can be stated which will afford a test for equitable subrogation in all cases, and instead, whether it is applicable depends upon the particular facts and circumstances of each case as it arises.

1 Cases that cite this headnote

[5] **Subrogation**
⁘Persons making voluntary payments

When one, to protect his own interest, pays a debt which he honestly believes must be paid to accomplish that purpose, he cannot be held to be a mere volunteer, as basis for precluding a right of equitable subrogation.

Cases that cite this headnote

[6] **Subrogation**
⁘Assignment or benefit of mortgage, judgment, or lien

A person 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. Restatement (Third) of Property (Mortgages) § 7.6.

6 Cases that cite this headnote

[7] **Mortgages**
⁘Release, satisfaction, or discharge of mortgage
Subrogation
⁘Assignment or benefit of mortgage, judgment, or lien

Equitable relief through subrogation may be appropriate if the person seeking subrogation expected to receive a security interest in the real estate with the priority of the mortgage being discharged. Restatement (Third) of Property (Mortgages) § 7.6.

2 Cases that cite this headnote

[8] **Subrogation**
⁘Protection of interest in property
Subrogation
⁘Persons making voluntary payments

Equitable subrogation should not turn on whether the person invoking the doctrine is labeled a volunteer, and instead, it is appropriate to focus on other circumstances of the party seeking to invoke subrogation, including whether the party has paid a preexisting obligation to protect the party's interest in the property.

2 Cases that cite this headnote

[9] **Mortgages**
⁘Release, satisfaction, or discharge of mortgage
Subrogation
⁘Liens in general
Subrogation
⁘Protection of interest in property

Home purchasers, who paid a preexisting mortgage debt on the home to protect their concurrently acquired interest in the property, had a sufficient interest to allow them to seek equitable subrogation, as basis for priority over judgment lien.

2 Cases that cite this headnote

[10] **Subrogation**
⁘Assignment or Benefit of Security or Incumbrance

An agreement that the person who pays the secured debt of another will be substituted for the holder of the prior encumbrance is not a condition for equitable subrogation.

1 Cases that cite this headnote

[11] **Subrogation**
⁘Agreements for subrogation

Parties may achieve subrogation by agreement.

Cases that cite this headnote

[12] **Subrogation**
⁘Nature and theory of right

Equitable subrogation does not turn on contractual principles, but instead on the concern to prevent unjust enrichment.

1 Cases that cite this headnote

[13] **Mortgages**
⁘Release, satisfaction, or discharge of mortgage
Subrogation
⁘Protection of interest in property
Subrogation
⁘Assignment or benefit of mortgage, judgment, or lien

Equitable subrogation is allowed when a party pays a mortgage to protect an interest in the property, irrespective of an express or implied agreement that the party will succeed to the position of the prior lienholder.

Cases that cite this headnote

[14] **Mortgages**
⁘Release, satisfaction, or discharge of mortgage
Subrogation
⁘Liens in general
Subrogation
⁘Defenses and Grounds of Opposition

Fact that home purchasers had obtained title insurance, from which they allegedly could recoup their losses, did not preclude home purchasers, who paid off a mortgage loan on the home, from receiving equitable subrogation, as basis for priority over judgment lien which had not been discovered by the title insurer.

Cases that cite this headnote

[15] **Subrogation**
⁘Assignment or benefit of mortgage, judgment, or lien

There is no general requirement that a person seeking subrogation lack notice of a lien in order to obtain equitable subrogation, as basis for priority over that lien.

3 Cases that cite this headnote

[16] **Subrogation**
⁘Assignment or benefit of mortgage, judgment, or lien

Ordinarily, one who is entitled to subrogation is permitted to enforce both the mortgage and the secured obligation. Restatement (Third) of Property (Mortgages) § 7.6 comment.

2 Cases that cite this headnote

[17] **Mortgages**
⁘Merger

The merger doctrine generally holds that if a fee owner acquires a mortgage on the property, the lien is extinguished because the lesser interest merges into the greater.

Cases that cite this headnote

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OPINION

BALES, Justice.

*271 ¶ 1 Dean and Stacey Norcutt bought a home for cash and satisfied the existing first mortgage. They later discovered the home was also subject to a judgment lien far exceeding the property's value. We hold that the purchasers were equitably subrogated to the mortgage lien's priority for the amount they paid to satisfy the mortgage.

**1206 *272 I.

¶ 2 In September 2004, Sourcecorp, Incorporated obtained a judgment exceeding $3 million against Steven and Rita Shill, who owned residential property in Prescott. The property was subject to a first mortgage in favor of Zions National Bank securing a debt of nearly $689,000.[1] Sourcecorp recorded a judgment lien. In November 2004, the Shills sold the property to the Norcutts for $667,500 in cash. Zions Bank accepted $621,000 of the proceeds in full satisfaction of the debt secured by its first mortgage. Although the Norcutts purchased title insurance from First American Title Insurance Company, the title insurer did not discover Sourcecorp's judgment lien.

[1] Zions Bank held a deed of trust, but we refer to this interest as a "mortgage" because Sourcecorp and the opinion of the court of appeals use this term. The distinction between a mortgage and a deed of trust is immaterial to our analysis. *Cf.* Restatement (Third) of Property: Mortgages § 1.1 (1997) (defining "mortgage" to include deeds of trust).

¶ 3 After the Norcutts bought the property, Sourcecorp initiated a sheriff's sale to foreclose on its judgment lien. The Norcutts sued to enjoin the sale. Granting relief, the trial court ruled that the Norcutts' interest in the property was superior to Sourcecorp's judgment lien. The court of appeals reversed for reasons not before this Court. *Sourcecorp, Inc. v. Shill,* No. 1 CA–CV 05–0425 (Ariz.App. Sept. 26, 2006) (mem. decision). On remand, the Norcutts argued that they were equitably subrogated to the position of Zions Bank in priority over Sourcecorp. The trial court rejected this argument and entered summary judgment for Sourcecorp. Reversing again, the court of appeals held that the Norcutts were equitably subrogated. *Sourcecorp, Inc. v. Norcutt,* 227 Ariz. 463, 471 ¶ 37, 258 P.3d 281, 289 (App.2011).

¶ 4 We granted review because application of the equitable subrogation doctrine in this context is an issue of first impression and statewide importance. Jurisdiction exists under Article 6, Section 5(3) of the Arizona Constitution and A.R.S. § 12–120.24 (2009).

II.

[1] [2] [3] ¶ 5 Equitable subrogation is "the substitution of another person in the place of a creditor, so that the person in whose favor it is exercised succeeds to the rights of the creditor in relation to the debt." *Mosher v. Conway,* 45 Ariz. 463, 468, 46 P.2d 110, 112 (1935). This equitable remedy is "designed to avoid a person's receiving an unearned windfall at the expense of another." Restatement (Third) of Property: Mortgages § 7.6 cmt. a (1997) ("Restatement"); *see Mosher,* 45 Ariz. at 468, 46 P.2d at 112 (noting that purpose of doctrine is to prevent injustice). "The general rule is that a person having an interest in property who pays off an encumbrance in order to protect his interest is subrogated to the rights and limitations of the person paid." *Id.* at 472, 46 P.2d at 114; *see also* Restatement § 7.6(a) (providing that "[o]ne 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").

¶ 6 *Mosher* concerned "paving liens" on residential lots assessed for street improvements. Under the statutory scheme, the city could auction liens for delinquent assessments to private parties. If the property owner or a "party in interest" did not redeem the lien within a year, the purchaser would obtain the property free of encumbrances. 45 Ariz. at 465–67, 46 P.2d at 111–12. In *Mosher,* one lot was subject to three liens, which were sold separately. Applying equitable subrogation, this Court held that the second purchaser was subrogated to the positions of the first and third purchasers when he redeemed their liens. The owner could not complain about this result because it merely required her to pay one person rather than another to release the liens. *Id.* at 471, 46 P.2d at 113.

[4] [5] ¶ 7 *Mosher* said that "no general rule can be stated which will afford a test [for equitable subrogation] in all cases." *Id.* at 468, 46 P.2d at 112. Instead, "[w]hether it is applicable or not depends upon the particular facts and circumstances of each case as it arises." *Id.,* 46 P.2d at 112. Noting "the modern tendency" to extend the doctrine's ***273 **1207** use, *id.,* 46 P.2d at 112, the Court also observed that

> [A] mere volunteer, who has no rights to protect, may not claim the right of subrogation, for one who, having no interest to protect, without any legal or moral obligation to pay, and without an agreement for subrogation or an assignment of the debt, pays the debt of another, is not entitled to subrogation, the payment in his case absolutely extinguishing the debt.

Id. at 470, 46 P.2d at 113. The Court immediately added that "when one, to protect his own interest, pays a debt which he honestly believes must be paid to accomplish that purpose, ... he cannot be held to be a mere volunteer." *Id.,* 46 P.2d at 113.

¶ 8 Because the Court declined to adopt a bright-line test in *Mosher* and has not revisited the issue, the court of appeals has developed guidelines for applying equitable subrogation. In 1965, the court of appeals stated that subrogation would occur if (1) a third person discharges an encumbrance on the property of another; (2) the person is not a volunteer; and (3) there is an express or implied agreement "that he will be substituted in place of the holder of the encumbrance." *Peterman–Donnelly Eng'rs & Contractors Corp. v. First Nat'l Bank of Ariz.,* 2 Ariz.App. 321, 325, 408 P.2d 841, 845 (1965).

¶ 9 Nearly forty years later, the court of appeals described several tests for equitable subrogation. *See Lamb Excavation, Inc. v. Chase Manhattan Mortg. Corp.,* 208 Ariz. 478, 480–82 ¶¶ 8–14, 95 P.3d 542, 544–46 (App.2004). Reviewing cases from different jurisdictions, the court said the "majority approach" requires four primary elements: (1) the party claiming equitable subrogation has paid the debt; (2) the party was not a volunteer; (3) the party was not primarily liable for the debt; and (4) no injustice will be done to the other party by allowing subrogation. *Id.* at 480 ¶ 8, 95 P.3d at 544.

[6] [7] ¶ 10 *Lamb Excavation* explained, however, that the Restatement has adopted a more expansive standard. *Id.* at 481 ¶ 10, 95 P.3d at 545; Restatement § 7.6. Under this test, a person 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." Restatement § 7.6. Such equitable relief may be appropriate, for example, if the person seeking subrogation "expected to receive a security interest in the real estate with the priority of the mortgage being discharged." *Id.*

¶ 11 In *Lamb Excavation,* the court of appeals distinguished *Peterman–Donnelly* from the "majority approach," 208 Ariz. at 480–81 ¶¶ 7–8, 95 P.3d at 543–44, and observed that Arizona's approach "appears consistent with the Restatement." *Id.* at 482 ¶ 13, 95 P.3d at 546. In the instant case, the court of appeals cited the "primary elements" of the "majority approach," noted other factors considered in Arizona cases, and quoted *Lamb Excavation*'s comment about the Restatement. 227 Ariz. at 466–67, 469 ¶¶ 14, 25, 258 P.3d at 284–285, 287.

¶ 12 There is thus some ambiguity in Arizona case law regarding the test for equitable subrogation. For reasons explained below, we adopt the Restatement approach because it is most consistent with the rationale for equitable subrogation.

III.

¶ 13 Absent equitable subrogation, once the debt to Zions Bank was fully satisfied by the Norcutts, Sourcecorp's judgment lien advanced in priority. Sourcecorp claims that it is entitled to execute on its $3 million judgment lien through a sheriff's sale. The Norcutts would receive nothing from such a sale, but would likely have a claim

against their title insurer for failing to discover Sourcecorp's lien. In contrast, the Norcutts argue that they are subrogated to the position of Zions Bank and therefore have a priority over Sourcecorp's judgment lien.

¶ 14 Relying on *Mosher* and other cases, Sourcecorp argues that equitable subrogation is not appropriate because the Norcutts acted as mere volunteers in purchasing the property. Alternatively, Sourcecorp contends that subrogation is not available because there was no agreement, express or implied, that the Norcutts would be subrogated. Finally, Sourcecorp contends that equitable ***274 **1208** considerations preclude subrogation. We consider these arguments in turn.

A.

¶ 15 *Mosher* and later cases state that a "mere volunteer" cannot claim equitable subrogation. But *Mosher* also explained that a person who pays a debt to protect the person's interests is not a volunteer. 45 Ariz. at 470, 46 P.2d at 113. *Mosher* is thus consistent with the Restatement, which does not use the term "volunteer" as a talisman, but instead recognizes that a person who has paid a debt to protect his or her own interests may seek equitable subrogation. *See* Restatement § 7.6.

[8] ¶ 16 We agree with the Restatement that equitable subrogation should not turn on whether the person invoking the doctrine is labeled a volunteer. "[T]he meaning of the term 'volunteer' is highly variable and uncertain, and has engendered considerable confusion." Restatement § 7.6 cmt. b. Instead, the Restatement appropriately focuses on other circumstances of the party seeking to invoke subrogation, including whether the party has paid a preexisting obligation to protect the party's interest in the property. *See* Restatement § 7.6; *see also Dietrich Indus., Inc. v. United States,* 988 F.2d 568 (5th Cir.1993) (permitting equitable subrogation without discussing whether purchaser was a volunteer); Grant S. Nelson & Dale A. Whitman, 2 *Real Estate Finance Law* § 10.7 (5th ed. 2010) ("[T]he issue is only whether the payor expected that the payment would free the property; if this was the grantee's understanding, subrogation should be available.").

[9] ¶ 17 The Norcutts paid the preexisting debt to Zions Bank to protect their concurrently acquired interest in the property. The Norcutts thus had a sufficient interest to allow them to seek equitable subrogation. *Cf. Han v. United States,* 944 F.2d 526, 530 (9th Cir.1991) (purchasers paid off mortgagee's interest "to establish and protect their own interest" and therefore were not volunteers); *E. Boston Sav. Bank v. Ogan,* 428 Mass. 327, 701 N.E.2d 331, 336 (1998) (same).

B.

¶ 18 Quoting *Herberman v. Bergstrom,* Sourcecorp also argues that "[f]or equitable subrogation to apply, there must be an agreement ... that the subsequent lender will be substituted for the holder of the prior encumbrance." 168 Ariz. 587, 590, 816 P.2d 244, 247 (App.1991). Other decisions of the court of appeals contain similar language. *See Lamb Excavation,* 208 Ariz. at 482 ¶ 13, 95 P.3d at 546 (requiring an "express or implied agreement" to subrogate); *Peterman–Donnelly,* 2 Ariz.App. at 325–26, 408 P.2d at 845–46 (same).

¶ 19 *Mosher,* however, did not require an "agreement" in holding that the purchaser of paving liens was equitably subrogated to the positions of other lienholders. *See* 45 Ariz. at 471, 46 P.2d at 113. Moreover, to the extent that the court of appeals has required an "agreement," it has adopted a very elastic notion of the concept. In *Lamb Excavation,* property owners obtained a construction loan secured by a deed of trust. After several subcontractors served preliminary notices of mechanics' liens, *see* A.R.S. § 33–992.01, the owners obtained permanent financing and satisfied the construction loan. The court of appeals concluded that the permanent lender was equitably subrogated to the prior lien position of the construction lender. *See* 208 Ariz. at 483 ¶ 16, 95 P.3d at 547. In reaching this conclusion, the court found "at least an implied agreement to subrogate" based on statements in the permanent loan documents and closing instructions that the new lender would have a first lien. *Id.*

¶ 20 The Restatement and case law from other jurisdictions do not require an agreement as a condition for equitable subrogation. *See* Restatement § 7.6 cmt. a; *Han,* 944 F.2d at 529 (listing five factors justifying the use of equitable subrogation without requiring an agreement). The requirement of an "agreement" for subrogation—like the disqualification of "volunteers"—has been subject to varying interpretations. *Compare Citizens' Mercantile Co. v. Easom,* 158 Ga. 604, 123 S.E. 883, 886 (1924) (holding that a purchaser was not entitled to equitable subrogation because he did not pay "debts under an agreement, express or implied, ... that ***275 **1209** he would be subrogated"),*with In re Mortgages Ltd.,* 459 B.R. 739, 742 (Bankr.D.Ariz.2011) ("Arizona case law seems to hold that the subsequent lender's intent to obtain first lien priority is sufficient

evidence, standing alone, to satisfy the agreement requirement.").

[10] [11] [12] [13] ¶ 21 We adopt the Restatement approach and reject any requirement of an "agreement" as a condition for equitable subrogation. To be sure, parties may achieve subrogation by agreement, such as through an assignment of a promissory note and related mortgage. *See* Restatement § 7.6 cmt. a (distinguishing "conventional subrogation" by assignment or agreement from equitable subrogation). Equitable subrogation, however, does not turn on contractual principles, but instead on the concern to prevent unjust enrichment. That goal is served by allowing subrogation when a party pays a mortgage to protect an interest in the property, irrespective of an express or implied agreement that the party will succeed to the position of the prior lienholder.

C.

[14] ¶ 22 Finally, Sourcecorp argues that because the Norcutts obtained title insurance from which they could recoup any losses, equitable considerations preclude subrogation. Sourcecorp contends that neither the Norcutts nor the insurer should benefit from the insurer's negligence in failing to discover the recorded lien.

¶ 23 Accepting these arguments, however, would require us to ignore the key concern underlying equitable subrogation and would unjustly enrich Sourcecorp. Before the Norcutts purchased the home, Sourcecorp had a second lien on the property, which was worth less than the outstanding mortgage debt of $689,000. The Norcutts satisfied the first lien by paying Zions Bank $621,000 in cash. Sourcecorp contends that the result—unintended by the Norcutts—was that Sourcecorp obtained a first lien on property that had just sold for $667,500, and the Norcutts were left with nothing but a claim against their insurer.

[15] ¶ 24 Denying subrogation here, therefore, would give Sourcecorp a windfall independent of whether the Norcutts were insured or had constructive notice of the judgment lien. (There is no suggestion the Norcutts had actual notice of the lien, and we need not address whether a purchaser with actual notice could ever be equitably subrogated.) Moreover, there is no general requirement that a person seeking subrogation lack notice in order to obtain equitable relief. In *Lamb Excavation,* for example, the permanent lender was subrogated to a first lien position even though various subcontractors had served twenty-day notices of mechanics' liens. 208 Ariz. at 484 ¶ 20, 95 P.3d at 548 (observing that "constructive notice is not an element of equitable subrogation under Arizona law"); *see also* Restatement § 7.6 cmt. e (noting that "the payor's notice, actual or constructive, is not necessarily relevant. The question in such cases is whether the payor reasonably expected to get security with a priority equal to the mortgage being paid."). We also agree with the court of appeals that it would be anomalous to deny equitable subrogation merely because a party had been diligent in obtaining title insurance. 227 Ariz. at 471 ¶ 35, 258 P.3d at 289.

¶ 25 Sourcecorp further argues that subrogation would prejudice its interests by preventing it from moving up in priority as a lienholder after the satisfaction of the mortgage debt to Zions Bank. "Subrogation will be recognized only if it will not materially prejudice the holders of intervening interests." Restatement § 7.6 cmt. e. We do not accept, however, that subrogation would materially prejudice Sourcecorp.

¶ 26 Generally, the satisfaction of a superior lien results in subordinate lienholders advancing in priority, but preventing this result in certain circumstances is precisely the aim of equitable subrogation. As the Restatement notes:

> 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,* ***276 **1210** *they are preserved* and the mortgage retains its priority in the hands of the subrogee.

Restatement § 7.6(a) (emphasis added). Thus, preventing a junior lienholder from advancing in priority is an intended consequence of equitable subrogation. *See Lamb Excavation,* 208 Ariz. at 483 ¶ 18, 95 P.3d at 547 ("We fail to comprehend the nature of the perceived prejudice or inequity, as it appears the lienholders would remain in the *same* position they occupied before subrogation...."); Restatement § 7.6 cmt. e ("The holders of ... intervening interests can hardly complain [about subrogation]; their position is not materially prejudiced, but is simply unchanged."). Indeed, insofar as the Norcutts are subrogated only for the amount they paid to discharge the first mortgage, *see infra* ¶ 29, Sourcecorp is somewhat better off, because this amount was less than the outstanding debt to Zions Bank of $689,000.

¶ 27 Sourcecorp also argues that if the Norcutts are placed in the position of Zions Bank, they could eliminate Sourcecorp's judgment lien by a collusive refinancing followed by a foreclosure by the new first mortgage holder. *Cf. Centreville Car Care, Inc. v. N. Am. Mortg. Co.,* 263 Va. 339, 559 S.E.2d 870, 874 (2002) (noting concern about "friendly foreclosure" if purchaser were subrogated to position of first mortgage). This concern, however, is addressed by the limits to the equitable remedy. As a result of paying the obligation owed to Zions Bank, the Norcutts only "become[ ] by subrogation the owner of the obligation and the mortgage *to the extent necessary* to prevent unjust enrichment." Restatement § 7.6(a) (emphasis added).

[16] [17] ¶ 28 In determining the extent to which the Norcutts are subrogated to the prior position of Zions Bank, we note that they are cash purchasers rather than creditors looking to the property to secure a debt. With respect to creditors, "[o]rdinarily one who is entitled to subrogation is permitted to enforce both the mortgage and the secured obligation." Restatement § 7.6 cmt. a. Fee owners are in a different situation, because the merger doctrine generally holds that if they acquire a mortgage on their own property, the lien is extinguished because the lesser interest "merges" into the greater. *See Mid Kansas Fed. Sav. & Loan Ass'n v. Dynamic Dev. Corp.,* 167 Ariz. 122, 129, 804 P.2d 1310, 1317 (1991) (noting that equitable considerations may preclude merger).

¶ 29 Recognizing that equitable subrogation depends on the facts of the particular case, *see Mosher,* 45 Ariz. at 468, 46 P.2d at 112, we conclude that it is not appropriate to confer on the Norcutts a right to "foreclose" on the interest to which they are subrogated. Instead, the purposes of equitable subrogation are fully served by deeming the Norcutts to have a priority to proceeds from any sale of the property in the amount they paid to satisfy the debt, $621,000. *Cf. Lamb Excavation,* 208 Ariz. at 483 ¶ 19, 95 P.3d at 547 (noting that payor is subrogated only to the extent funds are applied toward payment of prior lien). Applying equitable subrogation in this manner does not eliminate Sourcecorp's judgment lien. To the extent that lien adversely affects the Norcutts' equity or renders the property less marketable, we neither address nor foreclose any claims the Norcutts might have against their title insurer.

IV.

¶ 30 For the reasons stated, we affirm the opinion of the court of appeals and remand to the superior court for entry of summary judgment in favor of the Norcutts consistent with this opinion. We deny the requests for attorneys' fees.

CONCURRING: REBECCA WHITE BERCH, Chief Justice, ANDREW D. HURWITZ, Vice Chief Justice, A. JOHN PELANDER and ROBERT M. BRUTINEL, Justice.

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229 Ariz. 270, 274 P.3d 1204

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Re: City of Kent v. Bel Air & Briney, a general partnership; Nick Briney, a single man; and Roger B. Bel Air and Candace A. Bel Air, husband and wife

COA No. 71544-5-1

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Sincerely,
Linda McKenzie, Legal Assistant to Thomas F. Peterson and Eleanor H. Walstad, Attorneys for Appellant, City of Kent

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