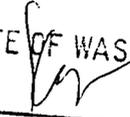


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DIVISION II

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STATE OF WASHINGTON

BY: 
DEPUTY

NO. 46200-1-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

AMERICA'S CREDIT UNION, fka Fort Lewis Community Federal
Credit Union, a Washington corporation,

Plaintiff/Respondent,

v.

COUNTRYWIDE HOME LOANS, INC.,

Defendant/Appellant,

and

CHARLES D. SHELTON and KATHRYN E. SHELTON, husband and
wife; MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC.,
as nominee for Countrywide Home Loans, Inc.; and LIENHOLDERS 1
THROUGH 10,

Defendants.

ON APPEAL FROM PIERCE COUNTY SUPERIOR COURT
(The Hon. Stanley J. Rumbaugh)

APPELLANT'S REPLY BRIEF

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I. INTRODUCTION

The Credit Union's response to Countrywide's Opening Brief tries, but fails, to distinguish the holdings of the Washington Supreme Court in *Bank of America, N.A. v. Prestance Corp.*, 160 Wn.2d 560, 160 P.3d 17 (2007) and *Columbia Community Bank v. Newman Park, LLC*, 177 Wn.2d 566, 304 P.3d 472 (2013). The Supreme Court's decisions in those two cases make clear that the doctrine of equitable subrogation has been adopted in the State of Washington and is to be liberally applied in the mortgage refinance context. Applying Restatement (Third) of Property: Mortgages § 7.6 (1997), as the Court is obligated to do here, requires this Court to apply the doctrine of equitable subrogation to the facts of this case.

II. ARGUMENT

A. THE DOCTRINE OF EQUITABLE SUBROGATION IS APPLIED LIBERALLY IN WASHINGTON, ESPECIALLY IN THE MORTGAGE REFINANCE CONTEXT

In two recent cases, the Washington Supreme Court has made clear that Washington courts are to apply the doctrine of equitable subrogation liberally in the mortgage refinance context. In *Prestance*, the Court held that the refinancing lender was equitably subrogated to a first priority lien "regardless of either its actual or constructive knowledge of intervening interests." *Prestance*, 160 Wn.2d at 582. The Court stated:

Equitable subrogation is a broad doctrine and should be followed whenever justice demands it and where there is no material prejudice to junior interest. A liberal approach is in line with the doctrine's equitable rationale and is becoming the more accepted rule, in no small part because of the immense benefits it holds for homeowners.

Id. at 581-82.

In *Newman Park*, the Court extended its application of equitable subrogation in the refinance context, holding that “the volunteer rule” does not apply in Washington. Indeed, the Court noted that “the result in *Prestance* would have been the opposite if we had applied a strict version of the volunteer rule in that case.” *Newman Park*, 177 Wn.2d at 581. The Court noted:

Equitable subrogation takes a somewhat different form in the context of mortgage refinancing. In the refinancing world, equitable subrogation 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. at 574 (quoting Scott B. Mueller, *Is Equitable Subrogation Dead for Lenders and Insurers in Missouri?*, 66 J. MO. B. 196, 196 (2010)).

The *Prestance* and *Newman Park* decisions make clear that Washington courts are to apply the doctrine of equitable subrogation liberally in the mortgage refinancing context.

B. THE TRIAL COURT SHOULD HAVE APPLIED THE DOCTRINE OF EQUITABLE SUBROGATION

The Credit Union argues that, as an equitable remedy, the doctrine of equitable subrogation should not be applied when it would result in a deviation from the statutory framework of the Washington recording act and that the doctrine of equitable subrogation should only be applied in “extreme factual circumstances” that were not present in this case. Both arguments are contrary to the liberal approach announced by the Washington Supreme Court in *Prestance* and *Newman Park*.

In *Prestance*, the Washington Supreme Court specifically rejected the argument that equitable subrogation should not be applied because it would yield a result that would be different from the result under the recording act:

[W]hile the recording act provides stability and notice to lenders (both vital elements to any successful real estate lending scheme), we cannot rigidly adhere to its strictures when it works an injustice. Furthermore, WFB West is not cutting in line; equity and the law are working toward the same end. While WFB West came along second, the mortgage it purchased from Washington Mutual came first, and Bank of America knew this mortgage had priority before its own. Equitable subrogation maintains the proper scheme and the original priorities.

Prestance, 160 Wn.2d at 570-71; *see also id.* at 565 (“Equitable subrogation preserves the proper priorities by keeping the first mortgage first and the second mortgage second.”).

In *Newman Park*, the Court also affirmed the view that the reason for the doctrine of equitable subrogation was to avoid the strictness of the recording act under appropriate circumstances, such as in the mortgage refinancing context:

The goal of equity is to do substantial justice. Equity exists to protect the interests of deserving parties from the “harshness of strict legal rules.” Washington courts embrace a long and robust tradition of applying the doctrine of equity.

Newman Park, 177 Wn.2d at 569 (quoting *Rodriguez v. Dep’t of Labor & Indus.*, 85 Wn.2d 949, 953, 540 P.2d 1359 (1975)); *see also id.* at 577 (“in the context of mortgage refinancing, this court has generally permitted a lender to be subrogated to the position of a priority interest holder simply by paying off that priority interest holder’s loan.”).

Thus, the Washington Supreme Court has rejected the argument made by the Credit Union here that the doctrine of equitable subrogation should not be applied because it would violate the established framework of the Recording Act.

Further, neither *Prestance* nor *Newman Park* stand for the proposition that equitable subrogation only applies in cases with “extreme factual circumstances.” Rather, the Washington Supreme Court found in both cases that refinancing lenders expect to step into the shoes of the priority lien and that denying equitable subrogation would result in unjust enrichment to the junior lienor. For example, the Court in *Prestance* noted that the practical effect of denying equitable subrogation in the refinance context would be that “the junior interest will be unjustly enriched because he will be given a higher priority merely because the debtor refinanced.” *Prestance*, 160 Wn.2d at 571-72.

Significantly, the fact that the borrower in *Newman Park* had presented forged documents was mentioned by the Court as a factor that made equitable subrogation “particularly appropriate” in that case, *Newman Park*, 177 Wn.2d at 582-83, but it was not necessary to the Court’s decision to apply the doctrine of equitable subrogation. “Under *Restatement (Third)* § 7.6, equitable subrogation is available in the mortgage refinance context, and it is especially appropriate where the potential subrogee’s payment is induced by deceit or fraud.” *Id.* at 583.

Both decisions make clear that the primary factor courts need to consider when deciding whether to apply the doctrine of equitable subrogation is whether the intervening lender will be unjustly enriched if

equitable subrogation is not applied. *Id.* at 582 (“granting equitable subrogation here would not result in any prejudice to Newman Park because it retains exactly the same position it would have had if CCB had never paid its loan”); *Prestance*, 160 Wn.2d at 575 (“Equitable subrogation is a remedy to avoid an unearned windfall.”) (quoting *Bank of N.Y. v. Nally*, 820 N.E.2d 644 (Ind. 2005)).

In its Opening Brief, Countrywide cited *Finance Center Federal Credit Union v. Brand*, 967 N.E.2d 1080 (Ind. Ct. Appeals 2012), which the Credit Union does not even address in its brief. In *Brand*, faced with a fact pattern virtually identical to the facts here, and applying Restatement (Third) of Property: Mortgages § 7.6 (1997), the same Restatement section that was adopted by the Washington Supreme Court in *Newman Park*, the Indiana Court of Appeals held that the doctrine of equitable subrogation applied. *Brand*, 967 N.E.2d at 1085. The court did not require a finding of misrepresentation, mistake, duress, undue influence or deceit. Rather, also citing the Indiana Supreme Court’s decision in *Nally* (as the Washington Supreme Court did in *Prestance*), the Indiana Court of Appeals focused on the fact that “[a]llowing GMAC to step into the shoes of the Meridian Group mortgage will leave [the credit union] in the very same junior position. This is a clearly equitable result.” *Id.*

So, too, here. The Court should rule that Countrywide be allowed to step into the shoes of the first lender, Knutson Mortgage, leaving the Credit Union in the same junior position it would have occupied if the first loan had not been repaid. “This is a clearly equitable result.” *Id.*

C. THE CREDIT UNION WILL NOT BE PREJUDICED BY THE APPLICATION OF EQUITABLE SUBROGATION

The Credit Union admits that it is not prejudiced by equitable subrogation in the amount of \$87,255.38, but objects to subrogation in any greater amount. Credit Union’s Brief at 14. Countrywide recognizes that typically, equitable subrogation is applied only to the amount of the payment on the first lien (here, \$87,255.37), plus interest and attorneys’ fees. However, as shown in its Opening Brief at 14-15, the documentary evidence here shows that in 2002 the parties intended to pay off the home equity line of credit, close the account and release the mortgage. CP 35, 48-50, 61. Thus, under these circumstances, and in equity, the Court should hold that Countrywide has lien priority to the full extent of its 2006 lien, \$224,000.00.

D. THE CREDIT UNION’S ARGUMENT THAT THE PROPERTY HAS SUFFICIENT EQUITY TO SATISFY BOTH LIENS AND THUS THERE IS NO NEED FOR EQUITABLE SUBROGATION IS SPECULATIVE AND SHOULD BE REJECTED

The Credit Union’s argument about the amount of equity in the property fails to take into account (i) the fact that properties are typically

sold at a discount at foreclosure sales and (ii) even if Countrywide is only subrogated in the amount of \$87,255.38, it is also entitled to interest and attorneys' fees. When the foreclosure sale discount is taken into account and the additional interest and attorneys' fees are added, it is clear that there may not be enough equity in the property to pay off both Countrywide's subrogated amount (plus interest and attorneys' fees) and the balance on the Credit Union's home equity line of credit.

According to a national report issued in September 2013, at least one in every four "low tier" properties with a market value under \$250,000 sold in foreclosure will be discounted more than 30%. FNC Residential Price Index, http://www.fncrpi.com/press_releases.aspx?pr=69 (last visited October 16, 2013). Applying a 30% discount to the Pierce County Assessor's 2014 valuation of the property, \$179,600, would result in a foreclosure sale at \$125,720, slightly more than the \$125,387.63 that the Credit Union claims would be needed to pay off both its home equity line of credit and Countrywide's subrogated interest.

However, even if Countrywide is only subrogated to the outstanding balance on the original loan at the time of the 2002 refinancing, it is entitled to recover more than \$87,255.38 -- Countrywide is also entitled to recover interest and attorneys' fees.

The filing of this lawsuit is a default under the 2006 Deed of Trust and thus, Countrywide is entitled to interest at the Note rate (7.25%) from the date of filing of the lawsuit (August 13, 2012), or approximately an additional \$13,660. *See* CP 88 (“Borrower shall be in default if any action or proceeding, whether civil or criminal, is begun that, in Lender’s judgment, could result in forfeiture of the Property or other material impairment of Lender’s interest in the Property or rights under this Security Instrument.”).

Countrywide is also entitled to recover its attorneys’ fees. Section 9 of the 2006 Deed of Trust provides in pertinent part:

If ... (b) there is a legal proceeding that might significantly affect Lender’s interest in the Property and/or rights under this Security Instrument (such as a proceeding in ... foreclosure, for enforcement of a lien which may attain priority over this Security Instrument), ... then Lender may do and pay for whatever is reasonable or appropriate for Lender to protect Lender’s interest in the Property and rights under this Security Instrument Lender’s actions can include, but are not limited to: ... (b) appearing in court; and (c) paying reasonable attorneys’ fees to protect its interest in the Property and/or rights under this Security Instrument Any amounts disbursed by Lender under this Section 9 shall become additional debt of Borrower secured by this Security Instrument. These amounts shall bear interest at the Note rate from the date of disbursement

CP 87; *see also* CP 89 (“Lender may charge Borrower fees for services performed ... for the purpose of protecting Lender’s interest in the Property and rights under this Security Instrument, including, but not limited to, attorneys’ fees”); CP 91 (“Lender shall be entitled to recover its reasonable attorneys’ fees and costs in any action or proceeding to construe or enforce any term of this Security Instrument.”).

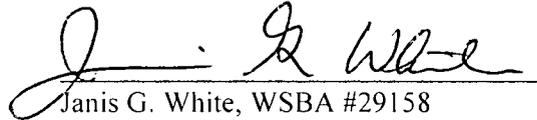
It is sheer speculation for the Credit Union to assert that there is enough equity in the property to cover Countrywide’s alleged subrogated interest of \$87,255.38 plus interest and attorneys’ fees, as well as the outstanding balance on the Credit Union’s home equity line of credit account. Thus, with respect to this issue, the Court should uphold the trial court’s finding that “[t]he value of the secured property ... would not be an appropriate issue to decide on Summary Judgment because, arguably, any valuation, particularly in the liquidation context, is speculated [sic]” CP 191.

III. CONCLUSION

The trial court erroneously granted the Credit Union’s motion for summary judgment and should have granted summary judgment in favor of Countrywide. Countrywide respectfully requests that this Court reverse the trial court’s ruling and instead order the entry of summary judgment in favor of Countrywide. Specifically, the Court should rule that, based on

the doctrine of equitable subrogation, Countrywide is the senior lienor, ahead of the Credit Union, to the full extent of Countrywide's 2006 lien, \$224,000.00, plus interest and attorneys' fees. Alternatively, the Court should hold that Countrywide is subrogated to the extent of the 2002 payoff to the first lender, \$87,255.38, plus interest and attorneys' fees.

DATED this 15th day of October, 2014.



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CERTIFICATE OF SERVICE

I hereby certify that on the date given below I caused to be served the foregoing document entitled **APPELLANT'S REPLY BRIEF** on the following individuals in the manner indicated:

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