

NO. 46200-1-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

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DIVISION II
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STATE OF WASHINGTON
BY DEPUTY

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)

BRIEF OF RESPONDENT

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I. INTRODUCTION

The trial court declined to apply the doctrine of equitable subrogation to allow Countrywide Home Loans, Inc. ("Countrywide") to leapfrog the prior recorded interest of America's Credit Union ("ACU") when Countrywide paid off a first position loan from 1994. The legal issues that this court must address are whether under Washington Law the doctrine of equitable subrogation can be applied, whether it should be applied, and if applied what amount is subject to subrogation. The trial court properly held that the facts of the case did not justify imposing an equitable remedy which deviates from the established statutory framework of the Recording Act.

II. STATEMENT OF THE CASE

The Sheltons own real property in Pierce County. CP 2. On February 25, 1994 they borrowed \$98,250.00 from Knutson Mortgage Corporation ("Knutson") and granted Knutson a Deed of Trust in the property. CP 41 - 46. The Knutson Deed of Trust was recorded in Pierce County and the note secured thereby was a closed end obligation with the entire balance due not later than March 1, 2024. CP 41.

On February 16, 2000, the Sheltons opened a \$40,000.00 revolving line of credit with ACU securing the line of credit with a "Revolving Credit Mortgage" recorded in Pierce County. CP 106, 125. At the time of opening

the ACU line of credit, the balance owed to Knutson was \$91,312.00 and such was reflected on the Sheltons' loan application with ACU. CP 106, 110.

In December 2002, the Sheltons borrowed \$132,000.00 from Countrywide securing that loan with a Deed of Trust. CP 107. The proceeds of the Countrywide loan were used to payoff the Knutson loan in the sum of \$87,255.38 and to pay \$38,934.93 against the ACU line of credit. CP 48 - 50. The Knutson Mortgage Deed of Trust was reconveyed in April, 2003. CP 75, 108. There was no request to cancel the ACU revolving credit mortgage and the payment that was made to that account resulted in a \$46.81 credit balance. CP 108, 222. The revolving account remained open with ACU and the Sheltons continued to draw on that open account. The present balance owing to ACU on this line of credit is \$38,934.97. CP 108.

In 2006 Countrywide granted the Sheltons two more loans, in the amount of \$224,000.00 and \$42,000.00. CP 82 - 83, 107. The Deed of Trust securing the 2002 Countrywide loan was reconveyed on May 3, 2006. CP 94. On March 11, 2010 ACU received a request for subordination in favor of Bank of America (successor to Countrywide) apparently in connection with a planned refinance of the 2006 loans which never came to fruition. CP 107, 134. The request for subordination was denied by ACU. CP 107.

The present recorded interests in the Shelton property consist of the following:

1. ACU Revolving Credit Mortgage - \$40,000.00 recorded February 22, 2000.
2. Countrywide Deed of Trust - \$224,000.00 recorded April 21, 2006.
3. Countrywide Deed of Trust - \$42,000.00 recorded April 21, 2006.

CP 97.

III. ARGUMENT

A. Standard of Review.

This case comes before the court for review of the trial court's order on cross motions for summary judgment. An appellate court reviews an order granting or denying summary judgment de novo, engaging in the same inquiry as the body that decided it. *C1031 Props, Inc. v. First American Title Insurance Co.*, 175 Wash.App. 27, 32, 301 P.3d 500 (2013) citing *Quadrant Corp. v. American States Insurance Co.*, 154 Wash.2d 165, 171, 110 P.3d 755 (2005). The only issue before the court is whether the trial court properly declined to create a remedy and apply the doctrine of equitable subrogation. The question of whether equitable relief is appropriate is a question of law and for issues of law the Appellate's Court review is de novo. *Bank of America v. Prestance Corp.*, 160 Wash.2d 560, 564, 160 P.3d 17 (2007).

B. Summary of Argument.

The doctrine of equitable subrogation is an equitable remedy and application of it in this case is contrary to the established framework of the Recording Act. As such it should be invoked only under compelling circumstances when justice requires an extreme deviation from statute. While the Supreme Court has expanded the circumstances under which a court *can* impose the doctrine of equitable subrogation, whether the doctrine *should* be imposed is a question which must be resolved based on the facts and circumstances of each case.

Here the doctrine should not be applied because if applied to the full extent sought by Countrywide (\$225,000.00) the rights of junior lien holders would be prejudiced contrary to the holdings in both *Prestance*, supra, and *Columbia Community Bank v. Newman Park, LLC*, 177 Wn.2d 566, 304 P.3d 472 (2013). And if the doctrine is applied only to the limit of the Knutson loan (\$87,000.00) which is all that *Prestance* and *Newman Park* would allow, the doctrine does not shift the equities of the parties since sufficient value exists in the real property for both of these liens to be satisfied. Finally, since the property has sufficient value, ACU is not unjustifiably enriched by the trial court decision to follow the established statutory framework of the Recording Act.

C. History of Equitable Subrogation in Washington.

The earliest adoption of the doctrine of equitable subrogation in the mortgage refinance context in the State of Washington is *Kim v. Lee*, 145 Wash.2d 79, 31 P.3d 665 (2001). *Kim* held a judgment lien on property owned by the Lees. The property had an existing first position Deed of Trust which was recorded prior in time to *Kim's* judgment lien. The Lees later refinanced the first position Deed of Trust but the title company insuring the transaction did not include *Kim's* judgment lien in the title policy.

The court held that the controlling authority in Washington, *Coy v. Raabe*, 69 Wash.2d 346, 418 P.2d 728 (1966), would allow equitable subrogation to the refinance lender but it should not apply to a title company that had either constructive or actual notice of a prior judgment. *Kim v. Lee*, 145 Wn.2d 79, 92, 31 P.3d 665 (2001). According to *Kim v. Lee*, the subrogee's knowledge of prior interests prevented application of the doctrine of equitable subrogation.

Justice Sanders authored a dissenting opinion in *Kim* which foreshadowed the direction the court would ultimately take in applying equitable subrogation. He wrote, "as to actual notice, the restatement does not condition application of the doctrine of equitable subrogation upon its absence." *Kim*, at 97.

Six years later the court again addressed equitable subrogation in the refinance context in *Bank of America v. Prestance*, 160 Wash.2d 560, 160 P.3d 17 (2007). The Prestance Corporation took a number of loans both from Washington Mutual and Bank of America securing those loans in part by assets of the corporation and in part by a Deed of Trust in the residence of the principals of the corporation. When Wells Fargo refinanced the loan secured by the first position Deed of Trust held by Washington Mutual, Wells Fargo was aware of a second position interest held by Bank of America. Justice Sanders, writing the opinion for the divided court opined that a lender can be equitably subrogated to a first priority lien despite having actual or constructive knowledge of junior lien holders. *Prestance*, at 562. The court adopted Section 7.6 of the Restatement (Third) of Property: Mortgages and held that actual or constructive knowledge of intervening liens does not automatically preclude the court from applying equitable subrogation. *Id.* at 564.

The most recent case where the Supreme Court has addressed the doctrine of equitable subrogation is *Columbia Community Bank v. Newman Park, LLC*, 177 Wash.2d 566, 304 P.3d 472 (2013) and here the court further expanded the circumstances under which the doctrine could be applied.

Newman Park was a real estate development company owned by 12 members, 11 of whom were individuals. The 12th member was a company called Landmark Development Ventures owned by Joseph Sturtevant. Landmark had a 39% interest in Newman Park.

Newman Park obtained a loan from Hometown National Bank (HNB) secured by a parcel of property it owned in Thurston County. Sturtevant, unbeknownst to the other owners of Newman Park, obtained a \$1,500,000.00 loan from Columbia Community Bank for a company Sturtevant owned that was completely separate from and unrelated to Newman Park. Sturtevant secured that loan with a Deed of Trust in Newman Park's Thurston County property. Because Sturtevant lacked the authority to pledge the Newman Park Thurston County property, Columbia Community Bank's Deed of Trust was unenforceable. The issue for the court was whether Columbia Community Bank was entitled to be equitably subrogated to HNB's first priority position in the Thurston County property owned by Newman Park.

The court held that even a lender who is tricked into refinancing property that a borrower lacked authority to pledge can benefit from equitable subrogation. *Newman Park*, at 569. The court confirmed its holding in *Prestance* and its adoption of the Restatement (Third) of Property: Mortgages Section 7.6.

In both *Prestance* and *Newman Park* equitable subrogation was limited to the amount of the first priority lien holder's then current obligation. *Id.* at 570. Columbia Community Bank was owed \$1,500,000.00 but was equitably subrogated only to the extent of \$400,000.00, the amount used to pay off HNB's loan. The same occurred in *Prestance*. Bank of America loaned \$1,000,000.00 but the court only applied equitable subrogation to the extent of the Washington Mutual debt that was paid off, \$499,477.00. *Prestance* at 563. After the holding in *Kim*, the court has gradually expanded the circumstances under which equitable subrogation can be applied. Nevertheless, imposition of the doctrine remains an equitable remedy which must be based upon the facts and circumstances of each particular case. And while the subrogee's knowledge of intervening interest no longer prohibits application of the doctrine, there must be equitable reasons grounded in the facts of each case to justify application of the doctrine.

D. Equitable Subrogation Is an Equitable Remedy That Is Contrary to Statutory Framework and Should Not Be Applied Absent Extreme Factual Circumstances.

Washington is a race-notice state in which priority in real property is determined by the timing of recording. *Zervas Group Architects, PS v. Bayview Tower LLC*, 161 Wash.App. 322, 325 (2011). Determinations of lien priority ordinarily rests on the chain of title as reflected in the county

auditor's records. *CD Trust UTD 10/22/92 v. Quality Loan Serv. Corp.*, 2012 Wash.App. (Lexis 2538). The general rule, derived from common law, is that as to lien interest in real property, "first in time is first in right." *Bank of America, NA v. Prestance Corp.*, 160 Wash.2d 560, 565 (2007).

In the case at bar, ACU's revolving credit mortgage was recorded on February 22, 2000. CP 106. ACU's mortgage is prior in time to any other recorded interest in the real property. CP 106-108. By virtue of Washington's Recording Act, codified at RCW 65.08.070, ACU's mortgage is superior to any unrecorded interest in the property or any recorded interest later in time. This statutory framework has long served to resolve priority disputes between competing claims of interest in real property in the State of Washington. The court should not deviate from application of statute and invoke an equitable remedy absent compelling circumstances. The trial court's ruling is in accord with this reasoning stating in its oral opinion:

The court, when statutory application will solve an issue of law, generally is then disinclined and, in fact, potentially even prohibited from imposing equitable remedies. The court is not a knight-errant imposing its own ideas of goodness and justice on the cases that come before it.

CP 222.

The question is are there circumstances in this case which compel the court to invoke this equitable remedy? "Subrogation is a consequence which

equity attaches to certain conditions. It is not an absolute right, but one which depends upon the equities and attending facts and circumstances of each case." *Kim v. Lee*, 145 Wash.2d 79, 88, 31 P.3d 665 (2001) *citing Coy v. Raabe*, 69 Wash.2d 346 (1966). The court in *Newman Park* also urged an evaluation of the particular facts and circumstances of each case. The court held, "our adoption of Restatement (Third) Section 7.6 does not change the fact that equitable subrogation remains 'an equitable remedy.' As such, it is 'founded in the fact and circumstances of each particular case.'" *Columbia Community Bank v. Newman Park LLC*, 177 Wash.2d 566, 581, 304 P.3d 472 (2013). The court held that in evaluating each case and whether to invoke the doctrine of equitable subordination, the ordinary principles of equity apply such as one "who seeks equity must do equity" and those "who come into equity must come with clean hands." *Id.* (citing cases).

In *Newman Park* the court found that while the lender failed to exercise due diligence, the borrower also had altered documents to support his loan application. *Id.* The Restatement (Third) Section 7.6 expressly lists misrepresentation, mistake, duress, undue influence, deceit or other similar imposition as situations in which equitable subrogation is warranted. *Id.* at 582. The court held that Sturtevant's deceit justified invoking equitable subrogation. *Id.*

Newman Park illustrates the extreme circumstances under which the court has reason to deviate from the established statutory framework of the Recording Act. So while the lender in *Newman Park* may have failed to exercise due diligence, that fact alone did not justify invoking equitable subrogation. It was Sturtevant's deception in tricking the lender to make the loan which justified an equitable remedy. The court held that "the fact that Sturtevant's presented forged documents to CCB, along with the fact that no prejudice to anyone will result, makes equitable subrogation particularly appropriate here. *Id.* at 582 - 583.

In the instant case none of the circumstances of Countrywide's refinance of the Knutson Mortgage Deed of Trust relate to misrepresentation, mistake, duress, undue influence or deceit. Nothing in the record indicates that any lender requested a payoff amount of the ACU revolving credit mortgage or that anyone requested cancellation of the revolving credit line. CP 108. On December 31, 2002 ACU simply received a check from Chicago Title in the sum of \$38,934.93 which was posted to the revolving credit line. CP 108. There was no request to close the credit line and ACU had no idea that the Knutson Mortgage was being refinanced. CP 108, 222. ACU was not privy to the HUD-1 Settlement Statement.

The facts and circumstances of the instant case amount to nothing more than the failure of Countrywide to exercise due diligence in refinancing the Knutson Deed of Trust. No Washington court has invoked the doctrine of equitable subrogation under such simple and ordinary circumstances.

Justice Owens dissenting in *Prestance* engaged in a similar analysis of the equities. She wrote, "a refinancing mortgagee who has actual knowledge of an intervening lien yet fails to take protective measures would be hard pressed to prove that it "reasonably expected" to assume a first priority lien position. *Bank of America v. Prestance*, 160 Wash.2d 560, 584, 160 P.3d 17 (2007). What Countrywide could reasonably expect under the circumstances of the instant case goes directly to the maxim in equity that one who comes into equity must come with clean hands. Countrywide knew of ACU's revolving credit mortgage (both by actual and constructive knowledge), failed to take reasonable steps to ensure that that line of credit was closed, and now asks this court to grant it equitable relief when there are no other intervening or extreme factors.

Countrywide seeks equitable relief based only on its own negligence. The holdings in *Prestance* and *Newman Park* simply removed a prior bar that prevented use of equitable subrogation when a refinancing lender had knowledge of intervening interest. *Prestance* and *Newman Park* do not

mandate the use of equitable subrogation in every refinance transaction where a lender is negligent. The facts of both of those case had additional elements which justified equitable relief beyond the mere negligence of a lender. There must be a reason to craft an equitable remedy and there must be no prejudice to junior lien holders. As stated in *Kim v. Lee*, supra, equitable subrogation is not an absolute right. *Kim v. Lee*, supra, at 88.

E. Equitable Subrogation Is Not Allowed If a Junior Interest Is Prejudiced.

It is well established that equitable subrogation should never be allowed if a junior interest is materially prejudiced. *Bank of America v. Prestance*, at 572 (2007); *Columbia Community Bank v. Newman Park*, at 582 (2013). This is consistent with the Restatement (Third) Section 7.6's comment d which states "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." *Restatement (Third) of Property: Mortgages § 7.6 comment d (1997)*. The rule in Washington is clear that the lender is entitled to equitable subrogation only to the extent of the first priority lien holders current obligation. *Newman Park*, at 570 (footnote 3). To allow a refinancing lender to equitably subrogate to the position of a first priority lien holder but in an amount greater than the

interest held by that first priority lien holder would prejudice all junior lien holders contrary to the doctrine.

In the present case Countrywide refinanced the Knutson loan paying Knutson \$87,255.38. CP 102. Yet Countrywide demands this court subrogate to the extent of Countrywide's entire 2006 lien in the sum of \$224,000.00 plus interest, attorney's fees and costs. *Appellant's Brief*, page 14. Countrywide cannot obtain the relief that it seeks because doing so would prejudice the rights of ACU.

Under the holdings of both *Prestance* and *Newman Park*, Countrywide can be equitable subrogated only to the amount paid on the Knutson loan (\$87,255.38). ACU is not prejudiced by equitable subrogation in the amount of \$87,255.38, because ACU was behind that amount when the revolving mortgage was opened. But any amount over \$87,255.38 puts ACU in a position it never bargained to be in. By equitable subrogation, Countrywide can stand in the shoes of Knutson Mortgage but it cannot through later granted loans, enhance the size of those shoes. Countrywide is limited to equitable subrogation only to the extent of the first priority lien holder's current obligation. *Newman Park*, at 570.

F. An Equitable Remedy Should Not Be Created If the Result is Meaningless.

Subrogation is a purely equitable doctrine. It is a fiction invented for the purpose of arriving at an obviously equitable result. *Credit Bureau Corp. v. Beckstead*, 63 Wash.2d 183, 385 P.2d 864 (1963). The doctrine, however, will not be applied if it would work injustice to the rights of those having equal or superior equities. *Id.* It would make no sense for the court to apply an equitable remedy when the resulting application of that remedy does not in any way have an effect on the parties' interests.

The real property at issue in this case was valued by the Pierce County Assessor for the tax year 2014 at \$179,600.00. CP 152. Other valuations of the property from 2013 indicate that the property was worth in excess of \$208,000.00. CP 153. The Knutson mortgage had a balance of \$87,255.38 when it was paid by the Countrywide refinance. The balance presently owed to ACU is \$38,132.25. The total of these two obligations is \$125,387.63.

If equitable subrogation were applied, the real property would have to be worth less than \$126,000.00 for imposition of the doctrine to have any practical effect. Countrywide (now Bank of America) owns all of the interests junior to ACU's revolving credit mortgage. Countrywide could stand in the shoes of Knutson Mortgage or could stand behind ACU's revolving mortgage and the result would be exactly the same. To the extent

of the Knutson Mortgage loan (\$87,255.38) which was refinanced by Countrywide, ACU is not prejudiced. But if the doctrine is not applied, ACU is also not unjustly enriched. There is simply no reason to impose an equitable remedy which deviates from an established statutory framework when the resulting outcome is no different than if the statutory framework had been followed. There is no reason to "do equity." It has already been done.

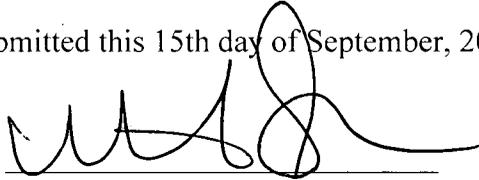
The only situation under which a party in this case would be unjustly enriched would be if Countrywide were allowed to subrogate an interest greater than that held by Knutson Mortgage. Such a situation would unjustly enrich Countrywide and would prejudice ACU.

IV. CONCLUSION

The trial court properly declined to apply the doctrine of equitable subrogation and correctly granted summary judgment in favor of ACU. The facts and circumstances do not justify imposition of equitable relief and the relief allowed by the doctrine of equitable subrogation would not have a practical affect on the rights of the parties. Under no circumstances would Countrywide be entitled to equitable subrogation to the full amount of its 2006 (\$224,000.00). Even if the trial court had elected to apply the doctrine of equitable subrogation, its application would have been limited to the

amount Countrywide paid the first lender (\$87,255.38) in accord with the holdings of *Prestance* and *Newman Park*. This court should affirm the trial courts decision.

RESPECTFULLY submitted this 15th day of September, 2014.



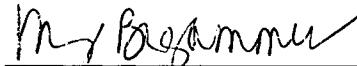
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Certificate of Mailing

The undersigned certifies under penalty of perjury under the laws of the State of Washington that on the date below, I mailed and/or caused delivery by legal messenger of a true copy of this document to:

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Dated: September 15, 2014, at Seattle, Washington.



Mary Berghammer

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