16-P-335 Appeals Court

WELLS FARGO BANK, N.A., trustee,[1] vs. NANCY P. COMEAU.

No. 16-P-335.

Essex. November 3, 2016. - November 15, 2017.

Present: Agnes, Blake, & Desmond, JJ.

Subrogation. Mortgage, Priority. Real Property, Mortgage.

Civil action commenced in the Superior Court Department on June 17, 2013.

The case was heard by Timothy Q. Feeley, J., on motions for summary judgment.

Andrew S. Lee for the plaintiff.
Gregory N. Eaton for the defendant.

AGNES, J. Where, as in this case, the doctrine of equitable subrogation is invoked by a mortgagee, it usually refers to a situation in which that party claims that because it has paid the obligation of another person or entity, it is entitled to be put into the shoes of the party it has paid in

[1] Of the WAMU Mortgage Pass Through Certificates Series 2005-PR2 Trust.

order to recover from the person or entity that had the obligation.[2] In the present case, on the other hand, the plaintiff, Wells Fargo Bank, N.A., as trustee for WAMU Mortgage Pass Through Certificates Series 2005-PR2 Trust (Wells Fargo), asks us to employ the doctrine of equitable subrogation to impose on a surviving spouse an obligation to pay the balance of a note that her deceased husband was obligated to pay when he refinanced their home in circumstances in which the surviving spouse was a party to neither the note nor the accompanying mortgage. For the reasons that follow, we reject this novel argument as fundamentally at odds with the framework established by the Supreme Judicial Court in East Boston Sav. Bank v. Ogan, 428 Mass. 327 (1998).

Background. Nancy P. Comeau (Nancy) and her husband, William L. Comeau (William),[3] owned a residence as tenants by the entirety in Groveland (locus), which, as of September 22, 2003, was encumbered by a mortgage to the Haverhill Co-Operative Bank

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[2] See Restatement (Third) of Property (Mortgages) § 7.6(a) (1997). As the Supreme Judicial Court put it in a nineteenth century case, equitable subrogation "is the substitution of one person in place of another, whether as a creditor or as the possessor of any other rightful claim, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities." Jackson Co. v. Boylston Mut. Ins. Co., 139 Mass. 508, 510 (1885).

[3] As the Comeaus share a surname, to avoid confusion we refer to them by their first names.

(Haverhill) in the amount of $150,000. Both William and Nancy were mortgagors-grantors on that mortgage to Haverhill, but Nancy was not a signatory to the note. There is no evidence that Nancy represented, directly or indirectly, that she was bound by the terms of the note. Two years later, in 2005, William refinanced the 2003 loan by executing a note in his name only to Washington Mutual Bank, F.A. (Washington Mutual), in the amount of $300,000 secured by a mortgage deed to Washington Mutual in which he (William) was the sole mortgagor-grantor. There is no reference to Nancy in the mortgage deed to Washington Mutual, and no evidence in the record of any representations made by Nancy to Washington Mutual concerning the transaction. William used a portion of the loan proceeds from the refinancing to pay off and satisfy the first mortgage to Haverhill in the amount of $142,871.51. William passed away on January 10, 2008. His undivided interest in the locus passed to Nancy by right of survivorship. At the time, a balance remained outstanding on the 2005 note to Washington Mutual.

Although Wells Fargo, as successor to Washington Mutual, holds a claim against William's estate arising from the unpaid 2005 note, it has never made a claim against William's estate and the statute of limitations has since expired. Seeking to avoid a total loss on the 2005 note, Wells Fargo filed a complaint seeking a declaratory judgment that its 2005 mortgage

must be equitably subrogated to the record position of Haverhill's 2003 mortgage, so that Wells Fargo's mortgage would also encumber Nancy's interest in the property. On cross motions for summary judgment, the judge issued a thoughtful and comprehensive memorandum and order and a declaratory judgment which denied Wells Fargo's motion for summary judgment, denied "as moot" Nancy's motion for summary judgment, and declared that "Wells Fargo is not equitably subrogated in the amount of $142,871.51 plus interest since February 9, 2005, to the record position of the mortgage from William L. Comeau and Nancy P. Comeau to Haverhill Co-Operative Bank on September 16, 2003, recorded in the Essex County Southern District Registry of Deeds in Book 21800, Page 169 against 100% fee simple interest in 2 Pond Street, Groveland, MA." Wells Fargo now appeals.

Discussion. 1. Standard of review. The judge denied Wells Fargo's motion for summary judgment and declared the rights of the parties based on his view that there were no material facts in dispute and that, as a matter of law, on the facts before the court, the remedy of subrogation was not available to Wells Fargo. In such circumstances, our review is de novo. See Merriam v. Demoulas Super Mkts., Inc., 464 Mass. 721, 726 (2013).

2. The remedy of equitable subrogation. Our analysis is guided by the decision of the Supreme Judicial Court in East

Boston Sav. Bank v. Ogan, 428 Mass. 327 (1998). There, two tenants in common purchased a condominium (property) and granted a mortgage on the property to Eastern Savings Bank (ESB) in order to finance the purchase. Thereafter, one tenant in common granted a mortgage to Ogan secured by his one-half undivided interest in the property. Id. at 328. Ogan's mortgage stated that it was subject to a first mortgage to ESB. Ibid. The tenants later sold the property to one Toner, who paid off the first mortgage to ESB with the proceeds from a new mortgage he obtained from the East Boston Savings Bank (East Boston) as well as some of his own money. Ibid. At closing, East Boston's attorney failed to discover the undischarged mortgage to Ogan with the result that East Boston's mortgage had a lower record priority than the undischarged mortgage to Ogan. Ibid.

In Ogan, the court explained that the broad power that courts of equity have over mortgages has been exercised at times to "reform mortgages, . . . to restore once-extinguished mortgages, . . . and to adjust priorities among existing mortgages." Ibid. Reasoning that the equities in that case were "substantially similar" to refinancing transactions where subrogation is applied when one mortgagee is inadvertently placed on a lower priority than another mortgagee in circumstances in which the mortgagee with the higher priority is unjustly enriched, the Ogan court concluded that subrogation

should be applied for the benefit of East Boston so as to place it in the position of ESB, whose rights were superior to Ogan's rights, but were then extinguished as a result of proceeds used by Toner and supplied by East Boston. See id. at 329, 333-334. Although East Boston made a mistake in overlooking a mortgage as to which it had constructive notice, equity demanded subrogation in order to prevent Ogan, the undischarged mortgagee, from becoming unjustly enriched with a higher priority position. Id. at 333-334.

In Ogan, the Supreme Judicial Court identified five factors that must be determined before equitable subrogation can be applied. These five factors are: "(1) the subrogee made the payment to protect his or her own interest, (2) the subrogee did not act as a volunteer, (3) the subrogee was not primarily liable for the debt paid, (4) the subrogee paid off the entire encumbrance, and (5) subrogation would not work any injustice to the rights of the junior lienholder." Id. at 330. Importantly, the court also stated that "the actions of the subrogee" must be examined. Id. at 331. "The subrogee's behavior is an important consideration that the court must balance in its equitable analysis of the interests of both mortgagees." Id. at 332.

In terms of the subrogee's conduct, courts take three main approaches. Restatement (Third) of Property (Mortgages) § 7.6 Reporters' Note, at 529-531 (1997). The majority approach

allows equitable subrogation when the subrogee had constructive knowledge of an intervening lien (i.e., it was recorded), but bars subrogation if there was actual knowledge.[4] Id. at 530. The minority approach bars equitable subrogation in all cases where the subrogee had either actual or constructive knowledge.[5] Id. at 531. A third approach, advocated by the Restatement and several jurisdictions, is that the subrogee's knowledge is not determinative of the outcome.[6] Rather, whether the doctrine of subrogation will be applied is ultimately determined by principles of equity.[7] Id. at 529. See Bank of America, N.A. v.

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[4] See, e.g., Han v. United States, 944 F.2d 526 (9th Cir. 1991) (California law); United States v. Baran, 996 F.2d 25 (2d Cir. 1993) (New York law).

[5] See, e.g., In re Gordon, 164 B.R. 706 (Bankr. S.D. Fla. 1994) (Florida law); Independence One Mort. Corp. v. Katsaros, 43 Conn. App. 71 (1996).

[6] Although Massachusetts courts have not adopted a definitive rule regarding subrogee knowledge, the Restatement approach is consistent with earlier case law. See Worcester N. Sav. Inst. v. Farwell, 292 Mass. 568, 574 (1935) ("[A]ny negligence which may be attributed to the plaintiff in failing to discover [the intervening] mortgage on the record does not bar" subrogation); North Easton Co-op. Bank v. MacLean, 300 Mass. 285, 292 (1938) ("It cannot be said as a matter of law that the omission of one to avail himself of the opportunity afforded him by the public records to become informed of . . . [a] mortgage constituted such culpable neglect as to cut him off from the relief he seeks" [quotation omitted]).

[7] See Davis v. Johnson, 241 Ga. 436, 438 (1978) (knowledge of intervening encumbrance will not alone defeat subrogation if rights of intervening party will not be prejudiced); Klotz v. Klotz, 440 N.W.2d 406, 409 (Iowa Ct. App. 1989) (subrogee had actual knowledge of intervening liens, but was granted

Diamond Financial, LLC, 88 Mass. App. Ct. 564, 571-572 (2015) (equitable subrogation employed as to portion of value of loan acquired by bank that was used to pay off a lien holder because, as result, bank succeeded to first priority without being unjustly enriched and without diminishing security interest held by others). In Ogan, the Supreme Judicial Court signaled its preference for the third approach. This view is supported by the fact that throughout the Ogan opinion, the Restatement is cited with approval. See Ogan, 428 Mass. at 330-333.

Based on the analysis developed and applied in Ogan and reflected in the Restatement, we conclude that an application of equitable considerations in the case before us leads to a result different from that in Ogan. The first factor we consider is the subrogee's actions, because the subrogee's "culpability . . . [may] negate the use of subrogation." Ogan, supra at 331-332. Thus, "[t]he subrogee's behavior is an important consideration that the court must balance in its equitable analysis of the [parties'] interests." Id. at 332. Compare Worcester N. Sav. Inst. v. Farwell, 292 Mass. 568, 574 (1935);

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subrogation "to subserve the ends of justice and do equity in the case"); Med Ctr. Bank v. Fleetwood, 854 S.W.2d 278, 285 (Tex. Ct. App. 1993) (subrogation is controlled by principles of equity, and will be granted unless equities of others will be prejudiced); Bank of America, NA v. Prestance Corp., 160 Wash. 2d 560, 577 (2007) ("[I]n the context of refinancing, where mistake is not at issue, there is no reason to consider the subrogree's [sic] knowledge" and equity should guide court's reasoning).

Davis v. Johnson, 241 Ga. 436, 440 (1978) ("The senior secured party's lack of diligence in failing to discover the existence of the intervening lien becomes material only where this has prejudiced the rights of the intervening lienor").

In the case before us, while Washington Mutual's knowledge of the interest William was granting to it with the 2005 mortgage is not material, its expectation of what interest it was receiving is a valid consideration. The Restatement suggests that since the subrogee's level of knowledge is not relevant, "[t]he question in such cases is whether the [subrogee] reasonably expected to get security with a priority equal to the mortgage being paid." Restatement, supra at § 7.6 comment e, at 520. As the motion judge noted, there are no facts in the record to support Wells Fargo's claim that Washington Mutual, its predecessor, intended to hold a mortgage on the entire property, not subject to Nancy's right of survivorship. Washington Mutual's closing instructions for the 2005 mortgage state that "[t]he Borrower [William] must hold title or acquire title consistent with the grantor recital on the Security Instrument." The security instrument (the mortgage) states that "Borrower does hereby mortgage . . . the following described property . . . . Borrower covenants that Borrower is lawfully seised of the estate hereby conveyed . . . and that the Property is unencumbered, except for encumbrances

of record." These two documents together determined what equitable title Washington Mutual intended to receive in the property. That title was William's interest in the property, subject to any encumbrances of record. Nancy's right of survivorship as a cotenant by the entirety was such an encumbrance on the property, and the 2005 mortgage was subject to that encumbrance. The law did not forbid William from mortgaging only his interest in the property, and the law did not forbid Washington Mutual from taking such an interest as security. See Coraccio v. Lowell Five Cents Sav. Bank, 415 Mass. 145, 152 (1993). Wells Fargo did not argue below that there were any mistakes or errors made in the preparation of the mortgage documents and, on appeal, it does not point to any evidence that the absence of Nancy's signature on the note was a mistake.

The second factor we consider is that "[s]ubrogation to a mortgage is usually of importance only when a subordinate lien or other junior interest exists on the real estate." Restatement, supra at § 7.6 comment a, at 509. "If no such interest existed, the subrogee could simply sue on the obligation, obtain a judgment lien against the real estate, and execute on it." Ibid. Here, although the 2005 mortgage was extinguished upon William's death, when his interest in the property passed to Nancy, Wells Fargo still held the 2005 note

secured by that mortgage. It could have made a claim against William's estate for the balance of the note, but chose not to. In our view, the law does not allow Wells Fargo to enlist the aid of the court to transfer to Nancy the obligation of William to pay the note, simply because that is Wells Fargo's only remaining avenue to recover its funds. Equitable subrogation should be granted only when the rights of other parties will not be materially affected. See Worcester N. Sav. Inst. v. Farwell, 292 Mass. at 574; North Easton Co-op. Bank v. MacLean, 300 Mass. 285, 292 (1938). Here, Nancy would be materially prejudiced if Wells Fargo were to be placed in the record position of the 2003 mortgage, because that would expose her to the risk of a foreclosure if she did not pay a debt that only her deceased husband was obligated to pay.

Ultimately, the purpose of equitable subrogation is to prevent unjust enrichment. And as the judge below stated, "Nancy may have been enriched . . . , but she was not unjustly enriched." While Nancy's interest in the property was no longer at risk of being terminated in the event of a future foreclosure relating to the 2003 mortgage, it was William's liability on the 2003 note that was extinguished by the 2005 loan, not Nancy's, because she was not liable on either note. Neither William nor Nancy engaged in any improper or deceptive acts that led to Washington Mutual releasing Nancy's interest in the property and

relying solely on William's interest for security. Therefore, we agree with the motion judge that, absent any wrongful or misleading conduct or mistake by a third party, Wells Fargo should not "now obtain exactly what its predecessor-in-interest . . . chose to forego," namely, "a right against the property that [Washington Mutual] chose not to bargain for or obtain." Thus, adhering to the principles of equity and fairness espoused in Ogan and the Restatement, we conclude that the judge was correct in declining to order that Wells Fargo be subrogated to the record position of Haverhill's 2003 mortgage.

Judgment affirmed.