COURT OF APPEALS
DECISION
DATED AND FILED

December 23, 2015

Diane M. Fremgen
Clerk of Court of Appeals

NOTICE

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. *See* WIS. STAT. § 808.10 and RULE 809.62.

Appeal No. 2015AP126 **Cir. Ct. No. 2010CV142**

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT IV

PARK BANK,

PLAINTIFF-APPELLANT,

V.

DAVID W. JACKSON,

DEFENDANT,

WACHOVIA MORTGAGE CORPORATION,

DEFENDANT-RESPONDENT.

APPEAL from a judgment of the circuit court for La Crosse County: DALE T. PASELL, Judge. *Reversed and cause remanded with directions*.

Before Kloppenburg, P.J., Lundsten and Sherman, JJ.

¶1 PER CURIAM. Park Bank appeals a judgment granted in favor of respondent Wachovia Mortgage Corporation. The issues relate to whether Wachovia is entitled to equitable subrogation, so as to place its mortgage lien in first position, despite Wachovia's failure to obtain a valid subordination agreement from the second-place lienholder, Park Bank, when Wachovia made the loan. We conclude that Wachovia is entitled to subrogation, but only in a limited amount. We reverse and remand with directions to amend the judgment to provide that limited amount.

I. BACKGROUND

¶2 This case began as a foreclosure complaint by Park Bank against defendant David Jackson. Park Bank also named Wachovia Mortgage Corporation as a defendant, as a successor in interest to World Savings Bank. Park Bank alleged that Wachovia may claim an interest in the property under a lien, but further alleged that any interest or lien by Wachovia is subsequent, subordinate, and junior to Park Bank's interest.

¶3 In Wachovia's amended answer, Wachovia denied that its interest is subordinate to Park Bank's interest; pled equitable subordination as an affirmative defense; and pled, as a counterclaim, for a declaration that Wachovia is the equitable assignee or subrogee of First National Bank of Bangor, which earlier made a loan to Jackson that was secured by a first mortgage but was paid off by Wachovia's refinancing provided to Jackson.

¶4 The circuit court granted Park Bank's motion for summary judgment, but we reversed on appeal. ***Park Bank v. Jackson***, No. 2012AP452 (Wis. Ct. App. July 3, 2013). Once back in circuit court, Wachovia moved for summary judgment on a theory of equitable subrogation. The circuit court granted

the motion, which meant that Wachovia would have a first mortgage lien of $168,613.60 that would be in a superior position to Park Bank's lien. Park Bank appeals.

¶5 Plainly stated, the theory of equitable subrogation allows a court to place a new lender into the same security position as an old lender whose loan was paid off with the new lender's loan. And, the court may do this despite flaws in the transaction that prevent this security status from being effective in the usual legal manner. In this case, Wachovia seeks equitable subrogation to place its mortgage lien in the same position as the first mortgage that was being refinanced. To maintain first-lien status, Wachovia should have obtained a subordination agreement from the holder of the second-place lien at the time of the refinance, Park Bank. However, in the absence of a legally valid and enforceable subordination agreement, Wachovia must now resort to some other theory like equitable subrogation to achieve first-lien status.

¶6 Subrogation is an equitable doctrine invoked to avoid unjust enrichment. ***Rock River Lumber Corp. v. Universal Mortg. Corp. of Wis.***, 82 Wis. 2d 235, 240, 262 N.W.2d 114 (1978). Equitable subrogation may be applied when a lender has entered into an agreement that the lender was to have security on the debt. *See* ***id.*** at 241.

> Under what is generally termed "conventional subrogation," a lender will be granted subrogation where money is advanced in reliance upon a justifiable expectation that the lender will have security equivalent to that which his advances have discharged, *see*: *Wilton v. Mayberry*, 75 Wis. 191, 43 N.W. 901 (1889), provided that no innocent third parties will suffer. *See: Union Trust Co. of Maryland v. Rodeman*, 220 Wis. 453, 264 N.W. 508 (1936). Equity will treat such a transaction as tantamount to an assignment of the original security. *See: Home Owners' Loan Corp. v. Dougherty*, 226 Wis. 8, 9, 275 N.W. 363 (1937).

> Although such conventional subrogation has been said to rest on contract, it is a doctrine of equity, and is applied or denied upon equitable principles. *American Ins. Co. v. Milwaukee*, 51 Wis. 2d 346, 351, 353, 187 N.W.2d 142 (1971). The object of subrogation is "... to do substantial justice independent of form or contract relation between the parties...." *Hughes v. Thomas*, 131 Wis. 315, 319, 111 N.W. 474 (1907).

Id. at 241-42.

II. MUST RELIANCE BE JUSTIFIABLE?

¶7 Park Bank argues that Wachovia did not justifiably rely on the subordination agreement that was faxed by Park Bank to Wachovia. As argued by Park Bank, the subordination agreement is so obviously flawed and legally ineffective that no lender could justifiably rely on it as a basis to believe that the lender would have first-lien status. Park Bank also argues that Wachovia did not, in fact, rely on that flawed subordination agreement in making its loan.

¶8 We see the concept of "reliance upon a justifiable expectation" as involving two separate questions, and Park Bank's arguments involve both of them. The first question is a factual one as to whether the lender actually made the loan in reliance on an expectation of equivalent security. The other question is whether such reliance, if it occurred, was justifiable. We address the second question in this section of the opinion.

¶9 Wachovia does not dispute that the Park Bank-provided subordination agreement was legally defective in obvious ways. Wachovia also does not claim that an expectation based on that agreement would have been justifiable. Instead, Wachovia's responses appear to break down into three strands.

¶10 First, Wachovia responds that equitable subrogation does not include a requirement of "justifiable reliance," and asserts that Park Bank has failed to cite "a single authority" for the proposition that this is an element of a claim for equitable subrogation. This is a peculiar assertion by Wachovia because Park Bank and Wachovia itself both quote the above language from ***Rock River Lumber*** stating that "reliance upon a justifiable expectation" is a component of equitable subrogation. Clearly, there is indeed some authority for this proposition.

¶11 In the second strand of its argument, Wachovia may be arguing that the existence of its loan agreement with borrower Jackson is, by itself, sufficient to establish an entitlement to equitable subrogation, assuming no third party is harmed. Wachovia asserts that its agreement with Jackson is "controlling," regardless of the alleged flaws in the Park Bank subordination agreement. Wachovia then cites to this quotation: "Thus it can be said that subrogation arises, not as a direct legal consequence of the contract of the parties, but rather as a matter of doing justice after a balancing of the equities, and that the agreement is merely a consideration—although an important consideration—in determining whether subrogation is appropriate." ***Id.*** at 242.

¶12 Wachovia's argument is not fully clear, but it appears that Wachovia wants us to take the quotation as meaning that the failed subordination agreement between the parties can be disregarded because it is "merely a consideration." However, it seems clear from the rest of the ***Rock River Lumber*** opinion that the "agreement" referred to in that passage is not a flawed subordination agreement, but is instead the agreement between the lender and *the borrower* that the lender should receive the same security as the previous lender. Thus, rather than supporting Wachovia's assertion that its own agreement with Jackson is

"controlling," this passage shows that its agreement with Jackson is "merely a consideration," although an important one.

¶13 The third strand of Wachovia's argument is to argue that its own negligence is not dispositive of whether equitable subrogation should be granted. Wachovia's argument highlights a seeming inconsistency in the case law. On one hand, case law appears to require that the lender have had a justifiable expectation of receiving equivalent security. But, on the other hand, case law also appears to grant subrogation even when the lender's expectation of equivalent security was baseless because of the lender's own negligence. It is not apparent how a negligent, baseless expectation could be described as a "justifiable" expectation. Unfortunately, neither of the parties before us directly addresses this inconsistency.

¶14 Wachovia relies primarily on ***Ocwen Loan Servicing, LLC v. Williams***, 2007 WI App 229, 305 Wis. 2d 772, 741 N.W.2d 474. In ***Ocwen***, we did not discuss whether the lender relied on a justifiable expectation of equivalent security. And, in fact, our statement of relevant law did not mention the concept of justifiable expectation at all. However, we did discuss the alleged negligence of the lender that was seeking equitable subrogation.

¶15 The financial transactions underlying ***Ocwen*** were convoluted. However, it will suffice here to say that Watson (the party opposing subrogation) argued that subrogation would be inequitable because the lender seeking subrogation was "grossly negligent in issuing the loan … because the loan closing instructions required verification that [lender] Fremont would be in a first lien position and the title company instructed Fremont to ensure that Watson's *lis*

pendens be released prior to closing," ***id.***, ¶21, which Fremont apparently did not do.

¶16 We stated that Fremont's negligence "is not dispositive" of whether equitable subrogation should be granted, and we cited case law to the effect that equitable subrogation is rarely needed unless the party seeking it has been negligent. ***Id.*** We further stated that, because this is an equitable doctrine, our focus would instead be on whether denial of subrogation would unjustly enrich the party opposing it. ***Id.***, ¶22. We went on to grant subrogation because Watson would be unjustly enriched. ***Id.***, ¶¶23-24.

¶17 In ***Ocwen***, we relied on ***Iowa County Bank v. Pittz***, 192 Wis. 83, 211 N.W. 134 (1927). The financial situation in ***Pittz*** was also convoluted. However, the court described the conduct of Pittz, who was seeking subrogation, with considerable disdain. The court noted that much authority could be found to support closing the door of a court of equity to Pittz, in light of his "gross negligence" that included "childlike confidence," "indifference to the ordinary precautions for self-protection in transactions of this kind," and "failure to ascertain that which the public records disclosed." ***Id.*** at 90-91.

¶18 The court then went on to state:

> We appreciate, however, that this equitable doctrine of subrogation is to further the ends of natural justice and that it can properly be invoked for relief against the result of the suitor's own mistakes and ignorance, for, as said in *Dixon v. Morgan* (Tenn.) 285 S.W. 558, 562, instances for the application of the rule can hardly ever exist in the absence of some negligence on the part of one seeking such relief. From the very nature of this doctrine of subrogation its mantle must many times, like the garment of charity, cover and wipe out a number of sins of omission or commission.

Id. at 91-92. The court concluded that, "even in such an extreme case as is here presented, there being no equities equal or superior to those of *Pittz*, he is entitled, except for the details hereinafter mentioned, to have preserved for him a paramount lien." ***Id.*** at 92.

¶19 We do not see an easy way to read these discussions in ***Ocwen*** and ***Pittz*** as consistent with the requirement stated in ***Rock River Lumber*** that the lender have relied on a "justifiable" expectation of equivalent security. In some situations these concepts might not be in conflict. The requirement for a justifiable expectation relates to the expectation the lender had *at the time of making the loan*. "[A] lender will be granted subrogation where *money is advanced* in reliance upon a justifiable expectation" of equivalent security. ***Rock River Lumber***, 82 Wis. 2d at 241 (emphasis added). If a lender fails to record an otherwise perfect first mortgage transaction, and thereby fails to establish a first-lien position, a court could follow ***Rock River Lumber*** and say that the lender had a justifiable expectation of being first lienholder when it advanced the money. However, the court could also follow ***Ocwen*** and ***Pittz*** and say that the lender's later negligence in failing to record the mortgage would not be a bar to equitable subrogation.

¶20 Unlike that situation, however, our current case brings both of these concepts to bear on a single act by Wachovia. In Park Bank's argument, Wachovia's negligence was in the forming of its expectation of having equivalent security. This claimed negligence closely matches the facts of ***Ocwen*** and ***Pittz***. In ***Ocwen***, the alleged negligence of lender Fremont was in failing to obtain the release of a *lis pendens* before closing, *see* ***Ocwen***, 305 Wis. 2d 772, ¶21, which is very similar to the alleged negligence of Wachovia in failing to obtain the valid

subordination of a prior creditor before closing. In ***Pittz***, the many failings of the party included things that he should have known at the time of his loan, such as the existence of a prior recorded bank mortgage. *See* ***Pittz***, 192 Wis. at 86.

¶21 In both ***Ocwen*** and ***Pittz***, the negligence of the party seeking subrogation was directly involved in that party's formation of its expectation of having a superior security position. However, in both cases the court held that such negligence is not a bar to subrogation, if the equities otherwise favor that result. We cannot easily reconcile that conclusion with a requirement that such a party's expectation of equivalent security be justifiable. However, as we read the cases, the greater weight of the authority lies in how the doctrine has actually been applied in practice, in ***Ocwen*** and ***Pittz***.

¶22 Therefore, we conclude that Wachovia's own negligence in having an erroneous expectation of first-lien status at the time it made the loan is not a significant factor in deciding whether equitable subrogation is appropriate. Instead, as in ***Ocwen***, we will focus on whether denial of subrogation to Wachovia would be a windfall to Park Bank.

III. RELIANCE IN FACT

¶23 Although we have just concluded that the lender's expectation of equivalent security need not be justifiable, we still regard *actual* reliance on such an expectation as necessary to obtain equitable subrogation. If the lender made the loan *without* relying on an expectation that it would receive equivalent security, then equitable subrogation would be a windfall to the lender because subrogation would have the effect of improving the lender's security position beyond what it expected at the time of the transaction.

¶24 Because this is a review of a summary judgment decision, and Wachovia was the prevailing movant, we frame this part of the discussion in terms of whether Wachovia has established that the only reasonable inference from the submissions is that Wachovia relied on an expectation of being in first-lien position. *See* WIS. STAT. § 802.08(2) (2013-14) (summary judgment may be granted only when there is no dispute of material fact). For the reasons that follow, we conclude that this is the only reasonable inference.

¶25 To support Wachovia's claim that it relied on an expectation that its loan to Jackson would be secured by a first mortgage, Wachovia relies mainly on the Wachovia underwriting materials and depositions of various people involved in that process. These contain the following information. When Jackson applied for the loan, he initially failed to inform Wachovia about his outstanding debt to Park Bank. Wachovia learned about the Park Bank loan from a title company. Wachovia then issued a modified loan proposal to Jackson that required a subordination of the Park Bank loan for the Wachovia loan to proceed.

¶26 A note in the Wachovia file states that the mortgage broker was then trying to obtain a subordination agreement from Park Bank. Eventually, the Wachovia underwriter for this loan was informed by a Wachovia employee in a different office that such an agreement was present in the file there. The underwriter then wrote underwriting notes for the file that stated several times that Park Bank had agreed to subordinate its loan, and Wachovia would be issuing a first mortgage loan. The transaction was eventually closed and recorded with documents stating that this would be a first mortgage.

¶27 Therefore, Wachovia made a prima facie case for summary judgment. That is, the above materials lead to a reasonable inference that

Wachovia would not have proceeded with the transaction unless the Park Bank loan was subordinated, and that Wachovia relied on the Park Bank-provided subordination agreement to expect that Wachovia would have a first mortgage to secure its loan to Jackson.

¶28 We turn our attention to the submissions of the non-moving party, Park Bank. Park Bank argues that there is also evidence from which it can reasonably be inferred that Wachovia did *not* rely on the Park Bank-provided subordination agreement to make the loan. Park Bank points to Wachovia's instructions to the closing agent. Those closing instructions directed the agent to "prepare and/or ensure execution of," and also record, a subordination agreement from Park Bank in the amount of $31,150. However, there is apparently no evidence that the closing agent either obtained or recorded such an agreement, and Wachovia does not suggest that there is.

¶29 We agree with Park Bank that these closing instructions give rise to a reasonable inference that Wachovia, despite having received the Park Bank-provided subordination agreement, nonetheless had doubts before closing about whether that agreement was sufficient to rely on. That is a reasonable explanation for why Wachovia included a request for a subordination agreement in the closing instructions.

¶30 However, even if that inference is reasonable, Park Bank must carry the argument further to prevail. The argument must proceed to a discussion of what happened next, *after* Wachovia's pre-closing concerns. That is so because the transaction did indeed close, despite any such concerns. The fact that it closed without there being a second subordination agreement obtained by the agent

appears to allow for only three possible inferences. We next consider which of those three are reasonable inferences based on the submissions.

¶31 First, it can reasonably be inferred that, although Wachovia had earlier concerns, Wachovia ultimately decided to rely on the Park Bank-provided subordination agreement as a reason to expect that Wachovia would be first lienholder. This inference remains reasonable based on the underwriting history and the fact that the transaction closed as a first mortgage, and was recorded as such.

¶32 The other two possibilities are that Wachovia closed the transaction with an affirmative belief that it was *not* going to be first lienholder, or that it closed the transaction with no expectation whatsoever in either direction about being first lienholder. But neither of these inferences can reasonably be drawn *solely* from the evidence that Wachovia asked the closing agent to obtain a subordination agreement, and that the agent did not. Beyond that evidence, Park Bank does not point to anything further that would show or imply the beliefs or expectations of Wachovia between the creation of the closing instructions and the closing itself.

¶33 In summary, the strongest reasonable inference that can be made in Park Bank's favor is that Wachovia had doubt about the reliability of the Park Bank-provided subordination agreement before closing. But Park Bank points to nothing further to reasonably show that, when the transaction ultimately closed, Wachovia was not relying on an expectation of being first lienholder based on the Park Bank-provided subordination agreement. The only reasonable inference is that Wachovia loaned the money to Jackson in reliance on an expectation that Wachovia would be first lienholder.

IV. MEASURING THE EQUITIES

¶34 As we stated, an important focus of our inquiry for equitable subrogation is whether denial of subrogation will cause a windfall to Park Bank. In addition, as we also previously explained, we must be concerned with whether there would be harm to an innocent third party. In this case, these issues largely overlap.

¶35 The parties' exchange of arguments in this respect begins with Park Bank arguing that subrogation in this case would harm an innocent third party, namely, the Small Business Administration (SBA). Park Bank asserts that the SBA insured the loan Park Bank made to Jackson. The SBA is not a party to this case, and therefore it may be questionable whether Park Bank can argue against equitable subrogation based on harm to a party not involved in the litigation. However, even if Park Bank can properly make that argument as an agent for the SBA, the argument is unpersuasive.

¶36 The claimed harm to the SBA is that equitable subrogation would deny the SBA its opportunity to review a request from Wachovia to subordinate the Park Bank/SBA loan. The argument seems to be that, if such a request had been made at the time Wachovia gave Jackson the loan, the SBA would have denied it because the SBA expected its loan to rise to first-lien status after the first mortgage was paid off.

¶37 We are unable to see what this argument achieves, in a financial sense. Even if the SBA expected to rise to first-lien status, the event that would cause that rise never occurred because Jackson never paid off a first mortgage. The SBA's denial of subordination would not, by itself, have put its loan in first place, but would merely have torpedoed Jackson's attempt to refinance his first

mortgage. This would have left Jackson stuck with the original first mortgage loan, and there is no reason to think that he would later have been more successful paying off that original loan than he was paying off the one from Wachovia.

¶38 Therefore, regardless whether the SBA did or did not approve a subordination, and regardless of its expectations about rising to first-lien status, the SBA loan would have remained stuck in second place behind an unpaid first mortgage. Accordingly, we are not persuaded that applying equitable subrogation now makes the situation worse for the SBA than if the SBA had been given a chance to review a subordination request when Wachovia made the loan to Jackson.

¶39 Turning to whether Park Bank would receive a windfall, Wachovia argues that denying Wachovia subrogation would be inequitable because that would cause a windfall to Park Bank. Wachovia argues that, without subrogation, Park Bank will have the superior lien, and this would be a windfall because, when Park Bank made its loan to Jackson, Park Bank knew that its loan would be second behind Jackson's original first mortgage. According to Wachovia, subrogation will leave Park Bank no worse off than it originally expected to be.

¶40 In reply, Park Bank appears to agree that without subrogation its lien will take a superior position. Park Bank also appears to agree that its loan was in second position when first made. Instead, Park Bank largely repeats the same argument we described above, in ¶36, substituting itself for the SBA. This argument fails for the same reasons stated above because Jackson never paid off any first mortgage. Therefore, we conclude that denial of subrogation would be a windfall because it would place Park Bank in a better position than it could reasonably expect to be.

¶41 Beyond that windfall, we also note a potential undesirable consequence if Wachovia is not able to obtain subrogation on these facts. If Park Bank is able to rise to first-lien status in part as a result of Park Bank itself having sent Wachovia a legally invalid subordination agreement, that would have the effect of encouraging other subordinating entities to deliberately issue flawed agreements in the hope that the flaw will be undiscovered by the recipient, and can later be used to challenge the recipient's claim of superior position. There is no evidence that Park Bank did so deliberately in this case, and we are not implying that it did. However, the potential for that kind of deliberate manipulation is present in this situation.

V. LIMITATION OF SUBROGATION TO $31,150

¶42 In its opening brief on appeal, Park Bank argues that the summary judgment materials show that Wachovia expected only $31,150 of Park Bank's loan to be subordinated to Wachovia's first mortgage. Park Bank draws this inference from Wachovia's instructions to the closing agent, which directed the agent to obtain a subordination from Park Bank in the amount of $31,150. According to Park Bank, although that was the amount of the loan then outstanding, its loan to Jackson was actually an open line of credit for $150,000, which he eventually drew nearly in full. Park Bank argues that if we grant subrogation to Wachovia, we should do so only in the amount of the $31,150 subordination that Wachovia expected at the time of the loan because, if such a subordination had been obtained as Wachovia requested, only that much of Wachovia's first mortgage would have had first-lien status.

¶43 Wachovia does not respond to this argument. Park Bank's argument was short, but appeared under its own labeled heading. It required a response. We

conclude that Wachovia has conceded the point by failing to respond. *See* ***Charolais Breeding Ranches, Ltd. v. FPC Sec. Corp.***, 90 Wis. 2d 97, 109, 279 N.W.2d 493 (Ct. App. 1979) (unrefuted arguments deemed conceded). We recognize that this conclusion has the effect of at least partly giving Park Bank the relief we described as a windfall in the prior section of this opinion. However, there are also other concepts at work here, such as maintaining the principle that the court will not create arguments for the parties when the parties themselves fail to do that. *See* ***State v. Pettit***, 171 Wis. 2d 627, 646-47, 492 N.W.2d 633 (Ct. App. 1992) ("We cannot serve as both advocate and judge.").

¶44 In summary, we conclude that Wachovia is entitled to equitable subrogation, but only in the amount of $31,150. On remand, the circuit court shall amend the judgment accordingly and issue any other judgments or orders that may be consistent with that result.

By the Court.—Judgment reversed and cause remanded with directions.

This opinion will not be published. *See* WIS. STAT. RULE 809.23(1)(b)5. (2013-14).