WHAT IS THE DOCTRINE OF "EQUITABLE SUBROGATION" AND WHY SHOULD I CARE?

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Equitable What? If you regularly practice in the realm of mortgages and liens, you may be familiar with this concept. (If you work for a title company, you've likely had to rely on it in the past.) If this is the case and you are intimately familiar with this doctrine and its effect on intervening liens, you may want to move along - you won't learn anything new here. If you practice in these areas or regularly record liens for judgments or materialman's liens and are unfamiliar with the concept, this might be worth a quick scan just so you know it's out there.

What is Equitable Subrogation? "Subrogation" is defined as the substitution of one party for another whose debt the party pays, entitling the paying party to the rights, remedies, or securities that would otherwise belong to the debtor.[1] This concept appears in many areas of the law, commonly with insurance policies, but is also applicable to the law of mortgages. "Conventional (as opposed to Equitable) Subrogation" is a substitution that arises by contract or agreement of the parties. "Equitable Subrogation," on the other hand, involves the substitution of one mortgageholder into the place of a prior mortgageholder, and arises by the operation of law or equity to prevent a fraud or injustice.

When might it come into play? Equitable Subrogation arises in the case where a bank or other lender advances money to discharge an existing lien or mortgage and takes a new lien for his own security, expecting to obtain the same priority position as the discharged lien. In the situation where there exists only a first mortgage at the time these funds are advanced, or if there is a first and second mortgage and the second agrees to subordinate, there is no issue and no need for concern. The problem arises when the lender is unaware of an intervening lien that prevents the new mortgage from obtaining the first position it intended to occupy. This "intervening lien" could be a judgment lien, materialman's lien, or even a second mortgage and can cause significant problems for the new mortgageholder, especially if the lienholder seeks to foreclose or execute upon its lien.

What are the requirements for effectively implementing this doctrine? In order to take advantage of the doctrine of Equitable Subrogation, a party must typically show that: 1. they advanced money to extinguish the prior encumbrance (many jurisdictions require it be completely extinguished); 2. they expected to obtain a position equal to that of the discharged lien; 3. they had no knowledge of the intervening lien at the time of recording; and 4. that application of this doctrine would not work an injustice or unduly burden the holder of the intervening lien.[2] It is typically the case that the intervening

lienholder is in no worse position after the subrogation than they were before the first mortgage was paid off, and took no action in reliance upon the satisfaction.

The most important of these requirements is typically that the party had no actual knowledge of the intervening lien. Mere constructive notice of the intervening lien arising from the recordation is typically not sufficient to defeat Equitable Subrogation. Willful ignorance or culpable negligence (such as when the lender failed to take any action to search title), often are sufficient to defeat it. The party seeking subrogation typically bears the burden of proving their lack of actual knowledge. Once shown, the burden then shifts to the opposing party to show the party's ignorance resulted from culpable negligence.

Is this something I can use to protect my client's interest? Equitable Subrogation may be something you can use in representing a lender who advanced funds to pay off a first mortgage, recorded its own mortgage expecting it to now be in first position (but without an express agreement or assignment from the first mortgageholder), and is now shocked to find out that an intervening lien has "jumped ahead" of their mortgage. In order to take advantage of this doctrine, the intervening lien must have been recorded after the first mortgage was recorded but before it was satisfied or released and the new mortgage was recorded. Your client may be reassured to learn that they may take advantage of this even if there was an error with their title search which should have detected the intervening lien or the closing agent overlooked the lien at closing.

Is it something that might be used against my client? The doctrine of Equitable Subrogation could definitely be used against your client if you represent the holder of a judgment lien, materialman or mechanic's lien, or even a second mortgageholder who recorded their lien knowing they would have to deal with a first mortgageholder in the event of default, and has now found themselves in the catbird seat and does not relinquish this position. The justification for putting the intervening lien "back in its proper place" is that the lienholder would otherwise be unjustly enriched or obtain a "windfall" to the detriment of the party that put them in this position by paying off the first mortgage.

Be aware that the party seeking subrogation will be required to meet each and every requirement of enforcing the doctrine in your jurisdiction. Thus, you may not want to roll over if you don't believe each element has been met. Also, keep in mind that this doctrine may not be allowed to relegate your client's lien if you can show your client acted to their detriment in reliance on their newfound position.

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1. Black's Law Dictionary, Seventh Edition.
2. 73 Am Jur 2d §59-60.