

Daily Development for Monday, October 29, 2012

Murphy v. Fishman (2012) 207 Md. App. 269, 52 A.3d 130
Court of Special Appeals of Maryland (September 4, 2012)

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Synopsis: Refinancing lender is denied protection of the state's recording statute where litigation over validity of mortgagor's title was pending at time mortgage was granted; refinancing lender also denied benefit of equitable subrogation to priority of paid-off mortgage.

Facts: In December 2004, Dorothy Mae Urban granted a mortgage on land in Pasadena, Maryland to CitiFinancial. On May 30, 2007, Urban purported to deed the property to her son, Robert Street, by a deed that was recorded the next day. A week later, on June 5, 2007, Urban died, and her daughter, Shelia Murphy, was appointed administrator of the Urban estate. On January 3, 2008, Murphy sued Street in circuit court (the "Estate Lawsuit") alleging lack of capacity, undue influence and fraud, and sought to: (1) impose a constructive trust on the property, (2) have the property returned to the estate; and (3) to nullify the deed.

On February 18, 2008, Street obtained a mortgage loan from 1st Chesapeake Home Mortgage in the amount of \$91,350. A portion of the loan proceeds was used to satisfy the outstanding CitiFinancial mortgage. 1st Chesapeake recorded the deed of trust (the "Street Deed of Trust") on April 2, 2008.

Meanwhile, on March 15, 2010, the circuit court issued an order (the "Estate Order") imposing a constructive trust on the property and ordering Street to execute a deed to the Urban estate. Street executed such a deed on May 25, 2010, which was recorded on June 1, 2010.

On December 1, 2010, the substitute trustees under the Street Deed of Trust instituted a foreclosure proceeding on behalf of MidFirst Bank (the assignee of the Street Deed of Trust), alleging that Street had been in monetary default under the Street Deed of Trust since May 2010. On behalf of the Urban estate, Murphy moved to stay or dismiss the foreclosure action, asserting that Street had no interest in the property by virtue of the Estate Order. Murphy argued that the filing of the Estate Lawsuit created a *lis pendens*, and that as a result the lien of the Street Deed of Trust was invalid.

MidFirst argued that the Estate Order did not declare the Urban-to-Street deed to be void, but instead imposed only a constructive trust. MidFirst thus argued that Street

retained an ownership interest in the property as of the time he executed the Street Deed of Trust. MidFirst thus claimed that as a bona fide purchaser without knowledge of the constructive trust, MidFirst was entitled to foreclose the Street Deed of Trust. Alternatively, MidFirst claimed that because the loan secured by the Street Deed of Trust refinanced the prior deed of trust granted by Urban, MidFirst was entitled to enforce its mortgage to the extent of the \$59,000 balance of that deed of trust at the time of the refinancing.

On May 19, 2011, the circuit court denied Murphy's motion to stay and dismiss, noting that even when a deed was set aside on the basis of a mortgagor's fraudulent conduct, a foreclosing mortgagee may still be entitled to protection as a bona fide purchaser if it is clear that the mortgagee acted in good faith and without notice of adverse claims on the property. The circuit court held that because there was a genuine issue of fact regarding MidFirst's good faith and whether it had actual notice of the Estate Lawsuit that would need to be resolved at trial. Murphy appealed.

Court Decision. On appeal, Murphy renewed her argument that the Estate Order rendered the Urban-to-Street deed void *ab initio*, as well as her argument that filing of the Estate Lawsuit acted as a *lis pendens* and thus provided constructive notice of the lawsuit to MidFirst, preventing it from asserting bona fide purchaser status.

MidFirst argued that because the Estate Order imposed a constructive trust (rather than declaring the Urban-to-Street deed void), the Urban estate took title to the property upon reconveyance as it was at that time – encumbered by the Street Deed of Trust – which remained on the property. Further, MidFirst argued that the Urban estate had accepted the benefit of the payoff of the prior CitiFinancial deed of trust executed by Urban, thus allowing MidFirst to foreclose from the position of that deed of trust under the equitable subrogation doctrine.

The Court of Special Appeals reversed and remanded the case to the circuit court with instructions to grant the motion to dismiss. The court held that it was irrelevant whether or not the Urban-to-Street deed was void *ab initio*. The court noted that if the deed had been merely voidable, MidFirst was not entitled to the protection of a bona fide purchaser because it had constructive notice of the Estate Lawsuit and the title issues that it raised at the time it obtained the Street Deed of Trust. The court acknowledged that prior Maryland appellate decisions had not directly addressed the question of whether a mortgage lender charged with constructive notice pursuant to *lis pendens* could qualify as a bona fide purchaser, but concluded that the notice required was "not confined to actual notice, but rather is much broader, and may encompass the constructive notice provided by *lis pendens*." By contrast, even if the deed had been void *ab initio*, MidFirst could not have qualified for the protection of the recording statute, as even a bona fide purchaser under the recording act receives no protection under a void deed.

The court also rejected MidFirst's equitable subrogation argument. Midfirst argued that equitable subrogation was appropriate based upon *G.E. Capital Mortgage Servs., Inc. v. Levenson*, 338 Md. 227, 234-37, 657 A.2d 1170 (1995), which provided:

Where a lender has advanced money for the purpose of discharging a prior encumbrance in reliance upon obtaining security equivalent to the discharged lien, and his money is so used, the majority and preferable rule is that if he did so in ignorance of junior liens or other interests he will be subrogated to the prior lien. Although stressed in some cases as an objection to relief, neither negligence nor constructive notice should be material. (Citation and internal quotation marks omitted).

Further, at the hearing on Murphy's motion to stay and dismiss, Murphy's attorney had stated "We would be willing to give to [MidFirst] the \$59,000.00 and [] we would then take the rest, the difference between fifty-nine and the sale price, because it is just inequitable in this situation at this time to do anything else[.]"

Nevertheless, the court held that *Levenson* was inapposite, because the case involved a refinancing lender that had purchased the property at foreclosure and was thus seeking to establish its priority over intervening judgment creditors. The court argued that subrogation was appropriate in *Levenson*, where the intervening creditor had knowledge of the foreclosure sale, an opportunity to bid, and an opportunity to litigate the applicability of equitable subrogation before distribution of the sale proceeds. The court thus concluded:

Read appropriately, *Levenson* applies to refinance lenders who, after a foreclosure sale, obtain a position of priority for a refinanced deed of trust over other judgment holders. *Levenson* is not dispositive where, as here, a refinance lender invokes the doctrine of equitable subrogation prior to the foreclosure sale, against a party, such as appellant, who claims to have been wrongfully deprived of title.

In a footnote, the court stated that "[e]ven if we were to find that *Levenson* applies, at a minimum, we would remand to explore [MidFirst's] knowledge of the *lis pendens*," arguing that subrogation was appropriate where the party discharging a prior lien was "excusably ignorant" of the intervening lien.

Comment 1 (Wilson Freyermuth): The court seems clearly right on the *lis pendens* point. The Estate Lawsuit to invalidate the Urban-to-Street deed was in the court docket records; under the *lis pendens* doctrine, a subsequent purchaser would take the property subject to the result of pending litigation over title to the property. Thus, it is

correct to suggest that MidFirst could not claim the position of a bona fide purchaser under the recording act.

The court's analysis of the subrogation argument, however, seems quite dubious — so much so that when I solicited Dale Whitman's point of view, I decided to share his response (which appears in Comment 2), as I could hardly improve on his comments.

Comment 2 (Dale Whitman): I think the Maryland court has blown this decision in a major way, and contradicted its own prior case law in doing so. First, I assume (and believe) that the court is right on the *lis pendens* point; the action by the Urban estate to set aside the deed was in the court docket records, and should have put the refinancing lender on notice of the action's pendency. The title company evidently simply missed it. But that is exactly the same as the situation in *Levenson* (1995). There the intervening liens were judgments, and they likewise were available in the records but missed by the title company. The court in *Levenson* characterized the refinancing lender there as being "excusably ignorant" and therefore entitled to subrogation. Why shouldn't the same characterization apply here, on essentially identical facts? Unless Chesapeake had actual knowledge of the pending litigation, it ought to be entitled to subrogation. (By the way, it's Chesapeake, the refinancing lender, and not MidFirst, its assignee, whose knowledge is important. MidFirst should have whatever rights of subrogation Chesapeake had.)

The court's point about the deed from Urban to Street possibly being void *ab initio* is a complete red herring. This isn't a recording act claim, it's a subrogation claim. It doesn't matter whether Chesapeake was a BFP for recording act purposes, or even whether it recorded its own mortgage. The court is certainly correct that the recording act won't validate a completely void deed, but that principle doesn't apply to subrogation at all. In fact, lots of cases uphold subrogation on behalf of a refinancing lender with void documents in its chain of title. See, e.g., *Ethridge v. Tierone Bank*, 2006 WL 1280957 (Mo.App.2006) (not reported in S.W.3d) (granting subrogation despite the fact that the only one spouse signed the refinancing mortgage, despite the fact that the property, as tenancy by the entirety, could be conveyed only by the joinder of both spouses); *Langston v. GMAC Mortg. Corp.*, 183 S.W.3d 479 (Tex.App. 2005) (granting subrogation despite the fact that the refinancing lender had failed to obtain the mortgagor's husband's signature on the mortgage subjecting his community property interest to the lien).

The point of subrogation is to prevent unjust enrichment, and Urban's estate (Murphy) is being unjustly enriched in an outrageous manner here. The voidness of the deed simply doesn't matter. The estate is getting free of a mortgage which legitimately encumbered its property; how can that possibly be justified? Alas, it can't.