

Daily Development for Wednesday, September 1, 2010

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MORTGAGES; SUBROGATION; "DERIVATIVE EQUITABLE SUBROGATION:" Colorado court requires that candidate for subrogation have been unaware of prior intervening lien; further holds that subrogated status cannot normally be transferred to another that has knowledge of the intervening lien.

Joohdeph v. Hicks, 235 P.3d 303 (Colo. 2010)

Hicks recorded a valid \$468,000 judgment lien against property owned by Grubbs. At the time the lien attached there were three deeds of trust against the property, with the first position held by a WaMu deed of trust. . Thereafter, Grubbs sold the property to Londres. Londres obtained a deed of trust loan from Chase, and they and Chase paid the Wamu deed of trust loan and obtained releases of the other two, leaving Chase, they thought, as a first lien lender and the Londres free of any other liens. In fact, however, their title search had not identified the Hicks lien, and it remained unpaid and still valid.

Hicks attempted to foreclose his judgment lien and Londres took the position that they and Chase should be subrogated to the first priority position of WaMu. Londres and Chase prevailed in an earlier decision affirmed by the Colorado Supreme court, and Hicks was in junior position due to equitable subrogation. .

But Londres then sold the property to Joohdeph. Joohdeph, of course, had actual knowledge of the ongoing dispute over Hicks priority and in fact got a title endorsement indemnifying Joodeph of any liability on the Hicks lien. But the title company, of course, had an interest in financing a contest between Joodeph (and Joodeph's lender) and Hicks, which was kicked off by a declaratory judgment action by Hicks.

On final appeal, the Colorado Supreme court ruled that Hicks did enjoy first lien priority. Unlike their predecessors, the court commented, Joodeph and its lender knew about Hicks' lien when they took their interest, and had no basis for equitable subrogation in Colorado, which apparently requires lack of actual notice of a claimed intervening lien in order to permit subrogation to a paid off senior lien. Londres and their lender were innocent of any knowledge of Hicks, but Joodeph and its lender knew full well about Hicks claim.

Joodeph then argued that it was entitled to "derivative equitable subrogation," since it and its lender entered into the deal expecting that the priority position of Londre and its lender would be conveyed to them. The Colorado court acknowledged that there was recent Third Circuit authority (applying New Jersey law) that recognized such a concept, but that no Colorado court had ever accepted it.

Joodeph and its lender could not succeed to the rights established by Londres subrogated position. They (and their title insurer) must deal with Hicks as a first lienholder.

Comment 1: This opinion clearly rejects the view of the Restatement of Mortgages, which would allow subrogation quite broadly, even when the subrogated party has knowledge of the prior claim at the time it pays off a higher priority lien. A number of cases have followed the Restatement down this path, but definitely not all, and clearly not Colorado.

The Restatement, to the editor's memory, does not mention "derivative" claims, but presumably it would permit them, since it recognized priority simply on the basis of paying off the prior senior debt, whether or not there is knowledge of the intervening claim. If that is a rule, why shouldn't successors have the same position? Any other rule would deprive the transferor subrogated party of the benefits of its subrogation. It must deal with the intervening lien upon resale.

Comment 2: The case is also careful to outline its view of the subrogation process. The party enjoying subrogation does not get its own lien, but rather stands in the shoes of the prior lien that it paid off. The case apparently intends that this applies to contractual provisions of the prior lien. The editor, in fact, had held the same view, but Nelson and Whitman take a very different view in their treatise and casebook, stating that the party enjoying subrogation gets its own loan agreement with the priority of the prior loan that it paid.

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