

EQUITABLE SUBROGATION' REVISTED: *Sovereign Bank v. Gillis*

Where a party supplies the funds to pay off an existing mortgage in the belief that no junior liens encumber the subject premises, and it later appears that intervening liens existed, the courts may apply the doctrine of **equitable subrogation** to avoid an unfair result. For example, assume that A holds a first mortgage on Blackacre, and that the owner ("X") seeks to refinance by obtaining a new mortgage from B. However, X had also subsequently obtained second mortgage financing from C. B advances the funds to pay off A's mortgage, believing he will have a first lien, but C's mortgage is inadvertently not paid. B could have obtained an *assignment* from A, thereby stepping into A's shoes and achieving priority over C. The Court may elect to treat the transaction as if B had in fact obtained an assignment from A. (For this reason, the concept is sometimes referred to as **equitable assignment**.) This is not unfair to C; to the contrary, C has unfairly benefitted from B's pay-off of A's mortgage. Thus, application of this doctrine merely restores the parties to the position they had bargained for. *See Weinstein on Mortgages*, §13.9 (2d Ed. 2001).

Nevertheless, courts have sometimes refused to apply this principle where the party invoking it is chargeable with actual or constructive notice of the intervening lien.. *See, e.g., First Union v. Nelkin*, 354 N.J. Super. 557 (App. Div. 2002). These holdings are contrary to the position taken by the *Restatement (Third) of*

Property: Mortgages, §7.6 (1997), which suggests that actual or constructive knowledge is "not necessarily relevant".

Sovereign Bank v. Gillis, 432 N.J. Super. 36 (App. Div. 2013) involved a priority dispute between two mortgage lenders. The junior lien was a home equity line-of-credit ["HELOC"] mortgage held by Sovereign Bank ["SB"] During a refinance of the existing first mortgage, the lender (Deutsche Bank ["DB"]) caused the HELOC to be paid, but the credit line was not closed, so that the borrower (Gillis) was able to obtain additional advances of funds. Gillis defaulted on both loans, and both lenders filed foreclosure suits; each claimed priority over the other. The Chancery Division held in favor of SB, opining that DB's actual knowledge of SB's lien precluded application of the doctrine of equitable subrogation.

The Appellate Division determined that although the Recording Act, N.J.S.A. 46:26A-1 *et seq.*, sets up a "race-notice" scheme which normally governs priority between competing interests, one who advances funds to satisfy an existing mortgage may "...inherit...the original lien position of the mortgage it paid off, even if an intervening lien [exists]...". 432 N.J. Super. at 44. Holding that the crucial issue was not DB's knowledge of SB's lien, but rather the prejudice (if any) resulting to SB, it reversed and remanded to the Chancery Division. The panel thus adopted the position taken by the *Restatement, supra*, because "to do otherwise would allow SB to reap an undeserved windfall...". *Id.* at 51.

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