

Equitable Subrogation in Real Estate

Amundsen Davis Financial Services Alert

October 27, 2017

The doctrine of conventional subrogation in real estate is familiar to most lenders: a new lender that pays the mortgage of a prior one steps into the shoes of – or is subrogated to – the prior lender’s security interest in the real estate. This principle allows new lenders to assume the “place in line” of prior lien holders and place themselves in a senior position for a lien on the real estate. This is routinely seen when a borrower refinances a mortgage on real estate, and the new lender’s loan pays the original lender. What, then, is equitable subrogation, and how does it operate?

Equitable subrogation occurs by operation of law when the court recognizes an equitable lien on real estate that is subrogated to a prior lien. Unlike conventional subrogation, the imposition of an equitable lien is a remedy for a debt that cannot be legally enforced, but which ought to be recognized. *Hargrove v. Gerill Corp.* An equitable lien can arise, despite the absence of an express agreement by the defendant, to be liable for the debt. *Id.* The typical example of an equitable lien is when one party improves real estate that belongs to another person. In order to assert an equitable lien, a plaintiff must allege a debt, duty or obligation owed to it by the defendant, and the existence of a *res* – an asset that in some way is particularly related to the debt or obligation. *Id.*, at 931.

Courts have also applied such liens in cases where fraudulent mortgage payoffs have occurred. In *CitiMortgage v. Parille*, the court dealt with a situation where a lender was attempting to foreclose on a mortgage, which had been refinanced several times. The defendants moved to dismiss the complaint because the mortgage being foreclosed was only signed by the wife, and the parties owned the property in tenancy by the entirety (both parties must sign the mortgage when the property is owned in this capacity in order to legally foreclose). The lender amended its complaint to eventually attempt to claim an equitable lien since the husband, who did not sign the most recent mortgage, had signed prior mortgages that were refinanced with funds from the mortgage being foreclosed and therefore claimed that he was liable for the full amount of the most recent debt.

The court in *Parille* eventually dismissed the case, and the appellate court affirmed the dismissal. Specifically, the appellate court noted how the bank did not even request equitable subrogation in most of its complaints, but when it finally did, it asked to be subrogated not to the older and undisputedly valid

PROFESSIONALS

Michael G. Cortina
Partner

RELATED SERVICES

Banking & Finance

Real Estate, Zoning & Public
Finance

Equitable Subrogation in Real Estate

mortgage, but to the current mortgage upon which they were attempting to foreclose. Because the lien being foreclosed could not allege any type of duty owed by the husband, since he did not sign it, the appellate court affirmed the dismissal.

Of interest in *Parille* is its citation to the case of *Shchekina v. Washington Mutual Bank*, *Shchekina* dealt with a refinance, as did *Parille*, but the difference in *Shchekina* is that the borrower demonstrated that her signature on the refinance documents were forged, and that she was out of the country when the documents were signed. It is undisputed, however, that she signed the original mortgage that was refinanced by the apparently forged refinance documents. The court allowed the plaintiff to be equitably subrogated to the last undisputed mortgage in the amount of that mortgage, because to do otherwise would be to allow the defendant a windfall by having to not pay on a mortgage that she admits she gave.

The key distinction between *Parille* and *Shchekina* is the fact that the plaintiff in *Shchekina* sought only to be subrogated to the last valid mortgage when the debtor owed a debt, and in the same amount of that last valid mortgage (which was much less than the forged refinanced mortgage). The plaintiff in *Parille*, however, sought to have the court use its power to force a debt upon the husband for the full amount owed on the most recent debt instead of only seeking the lower amount of the last mortgage that all parties agree was signed by both the husband and the wife. This distinction matters because an equitable lien requires the existence of a duty by the party to be encumbered by the lien, but the most recent mortgage was not signed by the husband in *Parille*, so he simply owed no duty to the bank regarding that particular debt.

Equitable liens can be claimed in Illinois so long as there is the existence of a debt or duty, and a res to encumber that relates to the debt or duty. *Parille* shows that a duty must exist in order to give rise to the possibility of an equitable lien; and that the plaintiff must be willing to accept less than the full amount that they are owed if they are to be subrogated to a prior lien, which is usually for a lesser amount.

It is important for lenders to know that errors in loans, or fraud in refinancing, do not necessarily mean a loss for the bank. Equitable solutions often exist for lenders in such situations, but care must be taken that the appropriate remedies are sought. As the saying goes: pigs get fat, hogs get slaughtered.