

**Inequitable subrogation: the flawed Restatement approach to equitable subrogation of  
refinance mortgages**

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*If a refinance lender (or its title insurer) fails to conduct an accurate title search, or fails to act upon information it learns in a title search, the lender may find out later that its mortgage does not have the priority position it expected because another lien—one that the refinance lender did not discover or consider—has higher priority under the state’s “first in time, first in right” recording law. When this occurs, the refinance lender may request that a court assign its mortgage the priority position of the mortgage it paid off in the refinance under the doctrine of equitable subrogation.*

*The Restatement (Third) of Property’s approach to equitable subrogation grants a refinance lender equitable subrogation nearly automatically, granting the refinance mortgage over an earlier-recorded lien regardless of whether the lender (or its title insurer) has been negligent in failing to discover or address an intervening lien. Proponents of the Restatement approach claim that it reduces or eliminates the need for title insurance on refinance transactions. However, these promises may have been overstated, and any benefits to consumers of avoiding title insurance may erode as technology is applied to the title search and examination process, making it less costly and more efficient. Furthermore, the Restatement approach often reaches an inequitable result because any benefits are merely extracted from diligent intervening lienholders. And meanwhile, the benefits of equitable subrogation mostly accrue to careless title insurers.*

*This Article proposes an alternative approach, under which a refinance mortgage would be subrogated only when truly required to avoid an injustice.*

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## I. Introduction

You are having a dream—a nightmare, really. You are second in line at the DMV, having already waited in line for a very long time. A DMV clerk becomes available and calls the person in line directly ahead of you—a banker, dressed sharply in a suit—up to the counter. Your turn is next.

But just when the next clerk becomes available, another person, also dressed in a suit and looking remarkably like the banker who is now getting helped, appears from out of nowhere and comes over and stands right in front of you in line. And to your stunned amazement, the clerk,

who has seen this banker’s brazen line-ditching, calls this second banker up to the counter to be helped while you are left to wait still longer.

You find your voice and appeal to the clerk: “Hey, when it was my turn, that banker just cut ahead of me in line! You saw it all, but you went ahead and helped the banker before me! That’s not fair!”

Coldly, the clerk replies, “Of course it’s fair. You were next up in line before this banker cut in front of you. Now, you’re still next up in line. So you’re in no worse a position than you were before. What do you have to complain about?”

Similarly, courts that adopt the Restatement View of equitable subrogation allow refinance lenders to cut in line ahead of other lienholders in terms of lien priority.<sup>2</sup> Under the Restatement View, a court will automatically demote earlier-recorded liens behind a later-recorded refinance mortgage, despite state recording statutes dictating that the earlier-recorded lien is to have higher priority.<sup>3</sup> The Restatement tells intervening lienholders that they should not complain about this demotion in priority because they are no worse off than they were before the refinance occurred.<sup>4</sup>

Courts justify the Restatement View of equitable subrogation under a theory of unjust enrichment, sometimes bolstered by policy arguments that claim a variety of economic benefits. Under the unjust enrichment theory, courts reason that an intervening lienholder receives an unearned windfall when the recording statute is applied to place a refinance mortgage behind an

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<sup>2</sup> RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 SUBROGATION (1997) [hereinafter “RESTATEMENT”].

<sup>3</sup> See RESTATEMENT, cmt. e (discussing application of the Restatement View of equitable subrogation in the context of a refinance). Lien priority is generally determined by a state’s recording statute, applying “first in time, first in right” principles from the common law. See Michael T. Madison, et al., *The Mortgage Lien in Competition With Other Encumbrances— First in Time, First in Right*, 2 LAW OF REAL ESTATE FINANCING § 12:21 (2015). While state recording statutes differ—falling into three categories (race, race-notice, and notice)—in all jurisdictions, an earlier-recorded lien generally has statutory priority over a later-recorded lien. See *Id.*

<sup>4</sup> *Id.* (stating that “[t]he holders of such intervening interests can hardly complain about” being demoted behind a later refinance mortgage).

intervening liens that was not discovered or addressed by the refinance lender during the refinance transaction.<sup>6</sup> The promised policy benefits of the Restatement View include consumer savings on the cost of title insurance due to the elimination of the need for a thorough title search and examination to find intervening liens.<sup>7</sup>

These justifications are misguided. The perceived injustice that the Restatement View seeks to remedy is non-existent. Without relief, the refinance lender—a sophisticated party that usually has been negligent<sup>8</sup>—receives a lien priority that is plainly foreseeable: the priority position set forth by the state recording laws.<sup>9</sup> In the typical case when the recording statute is applied, a diligent intervening lienholder is “enriched” only by also receiving their well-understood statutory priority position, affording them only an improved chance of recovering a debt they are owed. This result, dictated by normal application of the recording statute, is not unjust to the refinance lender or anyone else.<sup>10</sup> Perhaps deviation from the just statutory result could be excused if the Restatement approach delivered significant savings to consumers on title

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<sup>5</sup> An “intervening lien” arises most commonly occurs when a first mortgage exists on a property at the time that a second lien is created, and later, a refinance transaction occurs in which the first mortgage is paid off and released and the refinance lender takes a new mortgage. The second lien then becomes an intervening lien, and has a higher statutory priority than the new mortgage. *See* 73 Am. Jur. 2d *Subrogation* § 58 (2015).

<sup>6</sup> *See, e.g.,* Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 21–22 (Wash. 2007).

<sup>7</sup> *Id.* at 28–29.

<sup>8</sup> *See* Wells Fargo Bank, Minnesota, N.A. v. Com., Fin. & Admin., Dep’t of Revenue, 345 S.W.3d 800, 807 (Ky. 2011), *as corrected* (Aug. 25, 2011) (stating that “equity demands that sophisticated businesses, like professional mortgage lenders, should be held to a higher standard for purposes of determining whether the lender acted under a justifiable or excusable mistake of fact in failing to duly investigate prior liens.”) In the typical case, it is actually the lender’s title insurer that has been negligent, and then the title insurer should bear the loss. As the court in *Wells Fargo* explained:

[T]itle insurers are engaged in the very profitable business of assuring that their lending institution customers receive a clear title by insuring such. If the title insurer’s examiners bungle the title search, no matter how innocent the mistake might be, then the title insurers must ultimately be held liable. To parrot [another] court, ‘Either they insure or they don’t.’ Accordingly, this Court holds that the equities weigh against applying the doctrine of equitable subrogation in cases where the title insurers fail to identify properly recorded liens.  
*Id.* at 808.

<sup>9</sup> *Infra* § III(A).

<sup>10</sup> *Id.*

insurance as has sometimes been promised. But the promise of substantial title insurance savings has never been demonstrated and may not have materialized.<sup>11</sup>

This article opposes the Restatement View and promotes an alternative approach to equitable subrogation. In Section II, I will briefly review the doctrine of equitable subrogation and the various approaches courts take in applying the doctrine in disputes involving refinance mortgages. In Section III, I will critique the Restatement View, both as a matter of law and as public policy. In Section IV, I will propose an alternative approach to applying equitable subrogation that avoids the flaws in the Restatement View. Finally, I offer a few thoughts in conclusion in Section V.

## II. Equitable Subrogation and Its Various Approaches

*Subrogation* is the substitution of one person for another to allow the substitute to assert the other person's rights against a third party.<sup>12</sup> *Equitable subrogation* refers to subrogation that arises in equity to prevent fraud or injustice.<sup>13</sup> When applied in the context of mortgage refinance, equitable subrogation allows a refinance lender to assert the rights of the lender whose mortgage was paid off in the refinance transaction with funds from the refinance loan.<sup>14</sup> The effect of equitable subrogation is to place mortgages and other liens in a priority order other than the order dictated by the state's recording statutes.<sup>15</sup> Any intervening liens that have been recorded against the subject property after the prior mortgage but before the refinance mortgage

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<sup>11</sup> *Infra* § III(F).

<sup>12</sup> *US Airways, Inc. v. McCutchen*, 133 S. Ct. 1537, 1546 n. 5 (2013) (quotation omitted).

<sup>13</sup> *Subrogation*, BLACK'S LAW DICTIONARY (10th ed. 2014).

<sup>14</sup> *See* 73 AM. JUR. 2D *Subrogation* § 58.

<sup>15</sup> *Id.*

are “leap-frogged” by the refinance mortgage when equitable subrogation is applied; the refinance mortgage takes priority over the earlier-recorded intervening liens.<sup>16</sup>

The approaches to equitable subrogation fall into three major categories. The **Majority View**, a “middle ground” approach, dictates that a court should generally deny relief to a refinance lender when the refinance lender had actual knowledge of an intervening lien at the time of its mortgage, but should generally grant relief when the refinance lender had only constructive knowledge of an intervening lien—for example, when a lien was discoverable in the public records but the refinance lender failed to discover it during its title search.<sup>17</sup> The **Minority View**, the most restrictive approach, prohibits a court from granting equitable subrogation most instances, generally denying relief to a refinance lender with actual or constructive knowledge of the intervening lien.<sup>18</sup>

The **Restatement View**—the third and most expansive approach—grants equitable subrogation to refinance mortgages, regardless of actual or constructive notice of the intervening lien. <sup>19</sup> In its primary text, the Restatement provides that a refinance lender<sup>20</sup> should be entitled to be equitably subrogated to the position of the mortgage it pays off if: (1) the refinance lender paid off the mortgage at the mortgagor’s request; (2) the refinance lender was promised

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<sup>16</sup> See, e.g., *Hicks v. Londre*, 125 P.3d 452, 456 (Colo. 2005).

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> For a brief overview of the three general approaches to equitable subrogation, see *id.*, 125 P.3d at 458. Some states are hard to classify into one of the three categories because it is unclear how the state would rule in some circumstances. See, e.g., *Highmark Fed. Credit Union v. Wells Fargo Fin. S. Dakota, Inc.*, 814 N.W.2d 814 (S.D. 2012) (declining to apply equitable subrogation where a lender had actual notice of an intervening lien, but leaving open the possibility of applying equitable in other unspecified circumstances).

<sup>20</sup> For the sake of simplicity, This article refers to the holder of a refinance mortgage as the “refinance lender”; however, the actual holder of the mortgage who ends up seeking equitable subrogation in court is often a successor or assignee of the refinance lender. Also, the Restatement applies its equitable subrogation principles to others besides refinance lenders. See, e.g., RESTATEMENT, cmt. c, Ill. 19 (illustrating application of the Restatement View to a purchase transaction); see also *Sourcecorp, Inc. v. Norcutt*, 274 P.3d 1204, 1210 (Ariz. 2012), as amended on denial of reconsideration (Apr. 25, 2012) (using the Restatement rule to subrogate a purchaser to a mortgage paid off in the purchase transaction). However, this Article will focus exclusively on the Restatement View as applied to refinance mortgages.

repayment; (3) the refinance lender “reasonably expected” to get a mortgage with the priority of the mortgage it paid off; and (4) intervening lienholders will not be prejudiced.<sup>21</sup> While if taken in isolation this broad statement of the proposed rule could encompass all three general approaches to equitable subrogation, the Restatement clarifies its intended meaning of terms such as “reasonably expected” and “prejudice” in its comments, and the Restatement’s generous approach to equitable subrogation becomes clear.

Of particular importance, the Restatement reduces the word “reasonably” in the phrase “reasonably expected” to a nullity: in order to “reasonably” expect a refinance mortgage to receive priority over an intervening lien, a refinance lender must merely expect to receive that priority, and nothing more.<sup>22</sup> The only scenario under which the Restatement does not impute a reasonable expectation of priority position to a refinance mortgagee is when there is “affirmative proof that the mortgagee intended to subordinate its mortgage to the intervening interest.”<sup>23</sup> This is a meaningless test that a refinance lender would have to try very hard to fail. The only way the Restatement suggests that a lender shows an affirmative intent to not have a priority position is when it writes the words “second mortgage” on its mortgage. <sup>24</sup> Lenders that refinance first mortgages can probably manage to avoid writing “second mortgage” on their mortgage with little difficulty, and if they avoid writing those words, they are entitled to equitable subrogation under the Restatement.

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<sup>21</sup> See RESTATEMENT, § 7.6(a) (providing that “[o]ne who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment”). This article will focus on § 7.6(b)(4), which states that in order to prevent unjust enrichment, subrogation should be granted to a refinance lender who “reasonably expected to receive a security interest in the real estate with the priority of the mortgage being discharged, and if subrogation will not materially prejudice the holders of intervening interests in the real estate.”

<sup>22</sup> See *id.*, cmt. e (“The question... is whether the payor reasonably expected to get security with a priority equal to the mortgage being paid. Ordinarily lenders who provide refinancing desire and expect precisely that, even if they are aware of an intervening lien.”) (citation omitted).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*, cmt. e, illus. 27.

Without any meaningful requirement of reasonable conduct on the part of a refinance lender in order to be entitled to equitable subrogation, the Restatement approach grants equitable subrogation nearly automatically to a refinance lender that fully pays off a prior mortgage.<sup>25</sup> Subrogation as to an intervening lien is granted even if the refinance lender actually knew about the intervening lien and yet did nothing to ensure that the refinance mortgage would have priority over the earlier-recorded intervening lien.<sup>26</sup> Furthermore, when the refinance lender does not know about an intervening lien, even if the lender or its agent was negligent in conducting its title search, or did not even conduct a title search at all—thus leaving itself willfully ignorant of intervening liens—the Restatement approach still will grant the lender equitable subrogation.<sup>27</sup>

**A. Other factors may affect whether equitable subrogation is applied, including prejudice to an intervening lienholder, negligence by a refinance lender, and a refinance lender’s status as a “mere volunteer.”**

Under all of the approaches to equitable subrogation, courts may limit the application of equitable subrogation if, in the court’s view, the intervening lienholder would be materially prejudiced.<sup>28</sup> But this generally only limits equitable subrogation, rather than barring it because courts will subrogate a fictional equitable lien, which looks like the refinance mortgage stripped

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<sup>25</sup> See *Matrix Fin. Servs. Corp. v. Frazer*, 714 S.E.2d 532, 536 (S.C. 2011) (Pleicones, J., dissenting) (expressing the Restatement View that “absent material prejudice to a junior lienholder, equitable subrogation should be automatically available to a mortgage refinance who can show it expected to have first priority”).

<sup>26</sup> RESTATEMENT, cmt. e, illus. 26 (granting subrogation as to an intervening lien despite actual knowledge of the intervening lien, since the lender expected to get the priority position of the paid-off mortgage). One way a refinance lender could ensure its priority position over an intervening lien is to obtain an agreement from the intervening lienholder to subordinate the intervening lien to the refinance mortgage. See generally 68A AM. JUR. 2D *Secured Transactions* § 656 (discussing subordination agreements).

<sup>27</sup> Since constructive notice of an intervening lien is not relevant under the Restatement if the refinance lender expected to get the priority of the paid-off mortgage, it is not relevant whether the refinance lender failed to discover the intervening lien because it was negligent in conducting its title search, or whether the refinance lender failed to conduct a title search. See RESTATEMENT, cmt. e, illus. 26 (making constructive notice of the intervening interest irrelevant unless there is “affirmative proof that the mortgagee intended to subordinate its mortgage to the intervening interest.”); See also *id.*, illus. 23 (granting subrogation as to an intervening lien where a refinance lender does not conduct a title search, since the lender expected to get the priority position of the paid-off mortgage).

<sup>28</sup> RESTATEMENT § 7.6(b)(4) (stating that under the Restatement View, subrogation is only available “if subrogation will not materially prejudice the holders of intervening interests in the real estate”).

of any terms that are materially worse for intervening lienholders.<sup>29</sup> For example, courts generally recognize that an intervening lienholder is materially prejudiced when the refinance loan is at a higher interest rate than the debt that was paid off, but will still grant the refinance lender an equitable lien with priority to the extent of the interest rate of the mortgage paid off in the refinance.<sup>30</sup> Of course, most borrowers are induced to refinance by lower interest rates,<sup>31</sup> so instances where a refinance mortgage carries a higher interest rate than the prior mortgage are likely to be relatively rare. Most courts also recognize material prejudice when the principal amount of the refinance mortgage is larger than the amount of the paid off mortgage, but only to the extent of the amount that the refinance mortgage is in excess of the paid-off lien.<sup>32</sup> Courts generally do not find material prejudice when the refinance loan extends the borrower's payment schedule further into the future,<sup>33</sup> although if the refinance payment schedule drastically differs

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<sup>29</sup> See *Id.*, cmt. e (stating the Restatement View that if a refinance lender loans the borrower more money than necessary to pay off an existing mortgage, the refinance mortgage will still be subrogated “to the extent that the funds disbursed are actually applied toward payment of the prior lien,” and if the refinance loan is at a higher interest rate, the refinance mortgage will be subrogated “to the extent of the debt balance that would have existed if the interest rate had been unchanged”).

<sup>30</sup> See, e.g., *Martin v. Hickenlooper*, 59 P.2d 1139 (Utah 1936) (granting equitable subrogation to a refinance lender, but only to the extent of the same interest rate as the paid-off mortgage loan, where the refinance loan carried a greater interest rate than the paid off loan).

<sup>31</sup> HUD, *An Analysis of Mortgage Refinancing, 2001-2003*, at 3 (Nov. 2004) , <https://www.huduser.gov/Publications/pdf/MortgageRefinance03.pdf> (“The main factor driving households’ decision to refinance is the difference between the interest rate on their current mortgages and the interest rate they could obtain by refinancing.”).

<sup>32</sup> See, e.g., *Union Planters Bank, N.A. v. FT Mortgage Companies*, 794 N.E.2d 360, 366 (Ill. Ct. App. 2003) (holding that a refinance lender “can only be subrogated to the amounts of the debts extinguished in its refinancing,” and excluding closing costs and cash paid out to the borrower from the amount qualifying for subrogation).

<sup>33</sup> See, e.g., *Guleserian v. Fields*, 218 N.E.2d 397, 402 (Mass. 1966) (reasoning that junior lienholders take the risk that payment schedules of senior obligations will be extended further into the future); see also RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 7.3 REPLACEMENT AND MODIFICATION OF SENIOR MORTGAGES: EFFECT ON INTERVENING LIENS (1997) (“[A] time extension on a senior mortgage or obligation, standing alone, is not materially prejudicial to intervening interests. A finding of material prejudice is justified only in the rare situation where the time extension can fairly be said to place the junior interest in a substantially weaker position. The typical junior lienholder is normally grateful to have a time extension forestall the destruction of its lien by a senior foreclosure.”).

from the payment schedule on the borrower's prior mortgage, a court may find material prejudice.<sup>34</sup>

In some states, a refinance lender's negligence in failing to discover intervening liens matters. Some courts require a lack of negligence on the part of the refinance lender as a prerequisite to granting equitable subrogation.<sup>35</sup> In other states, a refinance lender's degree of negligence in failing to discover or address an intervening lien may determine whether a court grants or denies equitable subrogation. In these states, a refinance lender is typically denied equitable subrogation if the lender displayed a high degree of negligence such as "inexcusable negligence,"<sup>36</sup> or "culpable and inexcusable neglect."<sup>37</sup> However, even a complete failure to do any title search to discover any intervening liens is typically not considered culpable negligence in the courts that use these negligence standards.<sup>38</sup> Therefore, the outcomes of cases under these standards tend to be the same as they would be under the Restatement View: the party seeking subrogation will usually not be found culpably or inexcusably negligent, and will usually be granted equitable subrogation.<sup>39</sup>

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<sup>34</sup> See *Kim v. Lee*, 31 P.3d 665, 669, as amended (Dec. 12, 2001), opinion corrected, 43 P.3d 1222 (Wash. 2001) (finding prejudice to intervening lienholder where the term of the refinance mortgage was 30 years and the term of the mortgage it replaced was only 6 years).

<sup>35</sup> See, e.g., *Capitol Nat. Bank v. Holmes*, 43 Colo. 95 P. 314, 315 (Colo. 1908) (finding that the defendant "pursued the usual and customary method to inform himself as to the condition of the title to said premises, and adopted the usual and customary cautions in order to learn the condition of the said title, and was, in that behalf, free from negligence").

<sup>36</sup> See *Dimeo v. Gesik*, 993 P.2d 183, 185 (Or. Ct. App. 1999) (holding that equitable subrogation does not apply "unless the lender proves that it was ignorant of the existence of the intervening lien and that its ignorance was not a result of inexcusable negligence").

<sup>37</sup> See *JP Morgan Chase Bank, N.A. v. Banc of Am. Practice Solutions, Inc.*, 209 Cal. App. 4th 855, 861 (2012); *Davis v. Johnson*, 246 S.E.2d 297, 299 (Ga. 1978) (holding that equitable subrogation is available to a refinancing mortgagee absent culpable and excusable neglect; actual knowledge of an intervening lien, by itself, does not prevent application of equitable subrogation).

<sup>38</sup> See *JP Morgan Chase*, 209 Cal. App. 4th at 861 ("the failure to search the records does not itself preclude equitable subrogation").

<sup>39</sup> See *id.* at 861–62 (granting equitable subrogation irrespective of whether refinance lender's actions were reasonable); *Davis v. Johnson*, 246 S.E.2d at 300 (granting equitable subrogation to refinancing bank irrespective of bank's lack of diligence).

Neither notice nor knowledge of intervening liens is relevant under the Restatement View, and so it does not matter why a lender doesn't know about or didn't do anything to address an intervening lien. When the Restatement View is applied in its pure form, it is simply not relevant whether intervening liens are discovered or not in the first place.<sup>40</sup> Therefore, the Restatement View does not establish a negligence standard with regard to discovering intervening liens.

In a few states, equitable subrogation is denied to a refinance lender who is a "mere volunteer,"<sup>41</sup> but some confusion exists as to what constitutes a mere volunteer.<sup>42</sup> Some courts have found that a refinance lender with no pre-existing interest in the property, such as an existing lien to protect at the time of the refinance, is a mere volunteer not entitled to subrogation.<sup>43</sup> The more prevalent view is that a refinance lender who, at the request of either the borrower or an existing mortgagor, pays off an existing mortgage and takes a new mortgage of their own, is not a mere volunteer.<sup>44</sup> The Restatement View abandons any consideration of whether a party was a mere volunteer.<sup>45</sup>

### III. The flaws of the Restatement View of equitable subrogation as law and as policy

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<sup>40</sup> See RESTATEMENT, cmt. e (providing that actual or constructive notice of an intervening lien is irrelevant if the refinance lender expected to receive a priority position for its lien).

<sup>41</sup> See, e.g., *Washington Mut. Bank, F.A. v. ShoreBank Corp.*, 703 N.W.2d 486, 488, 491 (Mich. 2005) (holding that "subrogation is not available to a mere volunteer," and that therefore "the doctrine of equitable subrogation does not allow a new mortgagee to take the priority of the older mortgagee merely because the proceeds of the new mortgage were used to pay off the indebtedness secured by the old mortgage").

<sup>42</sup> See RESTATEMENT, cmt. b ("the meaning of the term 'volunteer' is highly variable and uncertain, and has engendered considerable confusion").

<sup>43</sup> See, e.g., *ShoreBank*, 703 N.W.2d at 488, 491.

<sup>44</sup> See *Merchants' & Mechanics' Bank v. Tillman*, 31 S.E. 794 (Ga. 1898) ("Albeit a person thus advancing his money at the instance of the debtor or creditor may have had no prior connection with the transaction between them, or any interest therein it may be necessary for him to protect, he is in no true sense a mere stranger and volunteer."); *Am. Gen. Fin. Services, Inc. v. Barnes*, 623 S.E.2d 617, 619 (N.C. App. 2006) (expressing same view); *Langston v. GMAC Mortg. Corp.*, 183 S.W.3d 479, 481 (Tex. Ct. App. 2005) (same).

<sup>45</sup> See RESTATEMENT, cmt. b. ("This Restatement does not adopt the 'volunteer' rule").

This section discusses how the Restatement View violates several established principles of law. As discussed in Section II, proponents of the Restatement View justify it as an equitable remedy to prevent unjust enrichment of an intervening lienholder. However because usually the intervening lienholder has done nothing wrong and is enriched only by improvement of the lienholder's chance of collecting a valid debt, the facts in the typical equitable subrogation case do not support a claim for unjust enrichment according to general unjust enrichment doctrine. The Restatement View is also inconsistent with equitable doctrine generally because it favors a negligent party over a diligent party, and it is applied in situations where simply applying the recording statute provides an adequate and just result. Finally, by negating a statute through a near-automatic grant of equitable relief to refinance lenders, the Restatement View represents significant judicial overreach, usurping the economic policy-making role properly held by legislatures.

This section also critically examines the Restatement View as policy. Proponents of the Restatement View promise a broad menu of policy benefits—lower title insurance costs, easier refinances, lessened risk of foreclosure, and even lower interest rates. But real-world evidence of these benefits is scant at best, and any benefits from avoiding the need for title searches—benefits which are more likely to accrue to title insurers, not consumers—are merely extracted from intervening lienholders who diligently followed the recording laws to preserve their interests. And any benefits from avoiding title examinations are decreasing as advances in technology make title examinations faster and cheaper. Finally because the Restatement View encourages refinance lenders to forgo a thorough title search and exam, the traditional role of the title industry as stewards of land title records withers, jeopardizing the integrity of records that serve as the foundation of real property rights.

**A. The Restatement View violates the maxim that “equity follows the law,” by granting equitable relief from the effect of a recording statute in a circumstance where an adequate and just result would be reached by following the recording statute.**

The maxim that “equity follows the law” is not meant to require the strict rule of law in every circumstance,<sup>46</sup> but rather stands for the principle that equitable relief will only be available when law is inadequate.<sup>47</sup> If “substantial justice can be accomplished by following the law, and the parties' actions are clearly governed by rules of law, equity follows the law.”<sup>48</sup>

Automatic equitable subrogation violates this maxim by applying an equitable remedy in a situation where a state’s first-in-time, first-in-right recording statute provides an adequate and just result. Lenders understand the risk presented by an undiscovered intervening lien, and are able to mitigate that risk by purchasing title insurance. When a lender’s title insurer misses a lien in its search and fails to state an exception from coverage for that lien under its policy, coverage arises under the terms of the policy.<sup>49</sup> The title insurer—the party that not only made the mistake but also assumed liability for it by express contract and received compensation to assume that liability—thus suffers the loss.<sup>50</sup> The Restatement does not say why this result, arrived at through normal application of validly enacted statutes, is unfair to a refinance lender or its title insurer.

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<sup>46</sup> See 30A C.J.S. *Equity* § 128 (“While the maxim that ‘equity follows the law’ has been frequently stated and applied, it does not always apply and is inapplicable in those matters which entitle a party to equitable relief, although the strict rule of law is to the contrary.”).

<sup>47</sup> *Id.* (“[E]quity devises means for enforcing a lawful result, when legal procedure is inadequate. In a broad sense the maxim means that equity follows the law to the extent of obeying it and conforming to its general rules and policies whether contained in the common or statute law, so that where substantial justice can be accomplished by following the law, and the parties' actions are clearly governed by rules of law, equity follows the law.”).

<sup>48</sup> *Id.*

<sup>49</sup> See AMERICAN LAND TITLE ASSOCIATION, LOAN POLICY OF TITLE INSURANCE, Conditions § 7(b) <http://www.alta.org/forms/download.cfm?formID=156&type=word> (last accessed 10/11/2015) (providing for a title insurer to satisfy a claim against the insured’s title by settling the claim with the claimant).

<sup>50</sup> See *Id.* at 1–2 (providing that the policy “insures... against loss or damage... sustained or incurred by the Insured by reason of... [t]he lack of priority of the lien of the Insured Mortgage upon the Title over any other lien or encumbrance”); see also *Landmark Bank v. Ciaravino*, 752 S.W.2d 923, 929 (Mo. Ct. App. 1988) (“The status of Chicago Title as the insurer of Landmark and its status as the ultimate beneficiary of a decree in favor of Landmark

Nevertheless, courts that declare that equity follows the law have adopted the Restatement View of equitable subrogation. In Arizona, for example, courts have explicitly stated that “equity follows the law,”<sup>51</sup> explaining that “when rights are clearly established and defined by a statute, equity has no power to change or upset such rights.”<sup>52</sup> However, those same Arizona courts have exercised the equitable power that they claim does not exist, nullifying statutory priority law through Restatement-style equitable subrogation.<sup>53</sup>

Likewise, in Washington, courts have stated that “to assert an equitable defense, the procedure prescribed by statute for the enforcement of the asserted substantive right must be inadequate or the ordinary and usual remedies unavailing.”<sup>54</sup> But when the Washington Supreme Court nullified the state recording statute as to refinance mortgages, the court made no determination that the procedure prescribed by the recording statute was inadequate.<sup>55</sup> Instead of justifying application of equity by explaining the inadequacy of the result if the relevant statute were applied, the court implied that its decision was actually consistent with the Washington recording statute and underlying “first in time, first in right” principle.<sup>56</sup> The court suggested that the recording statute and Restatement-style equitable subrogation did not conflict: “At first blush, equitable subrogation conflicts with the recording act because it is an exception to the general rule ‘first in time, first in right.’ But no new lien or interest is created; [a refinance mortgagee] simply takes over [a prior mortgagee’s] interest and that interest came first in

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is relevant. It is strange equity indeed, which would protect Chicago Title from the results of its negligence at the expense of Royal, which is totally innocent in the matter.”)

<sup>51</sup> *McDermott v. McDermott*, 129 Ariz. 76, 77, 628 P.2d 959, 960 (Ct. App. 1981) (“Whenever the rights of parties are clearly defined and established by statutory provisions, equity follows the law.”).

<sup>52</sup> *Manicom v. CitiMortgage, Inc.*, 236 Ariz. 153, 160, 336 P.3d 1274, 1281 (Ct. App. 2014), *as corrected* (Nov. 19, 2014) (quoting *Valley Drive-in Theatre Corp. v. Superior Court*, 79 Ariz. 396, 399, 291 P.2d 213, 214 (1955)).

<sup>53</sup> *See Sourcecorp, Inc. v. Norcutt*, 274 P.3d 1204, 1207, 1210 (Ariz. 2012), as amended on denial of reconsideration (Apr. 25, 2012) (acknowledging that absent equitable subrogation, the intervening lienholder’s priority position would advance under Arizona law, and then applying equitable subrogation to prevent that result).

<sup>54</sup> *Port of Longview v. Int’l Raw Materials, Ltd.*, 979 P.2d 917, 921 (Wash. Ct. App. 1999).

<sup>55</sup> *See generally Bank of Am., N.A. v. Prestance Corp.*, 160 P.3d 17 (Wash. 2007).

<sup>56</sup> *Id.*, 160 P.3d at 20.

time.”<sup>57</sup> The court made no effort to support its contention that a refinance mortgage—which involves a new mortgagee, new terms, and a new recording—is not a “new” lien.<sup>58</sup> And Washington’s recording statute does not provide for the refinance mortgagee taking over the prior mortgagee’s interest; the “first blush” conflict appears to remain on second blush.<sup>59</sup>

**B. The Restatement View of equitable subrogation violates the principle that “equity aids the vigilant, not those who slumber on their rights,” by favoring a negligent refinance lender over a diligent intervening lienholder.**

The Restatement View also violates the maxim that “equity aids the vigilant, not those who slumber on their rights.”<sup>60</sup> This maxim stands for the principle that “equity will protect one who by superior diligence has obtained a legal advantage and will deny relief to one whose danger was created by one's own neglect.”<sup>61</sup> Under this principle, “a party seeking equitable relief must take reasonable action to protect his or her own interests.”<sup>62</sup> Equitable relief is not available where a party’s “negligence, or delay, has caused, occasioned, or contributed to, the injury, or where the aid of equity becomes necessary through a party's own fault, or inaction.”<sup>63</sup> Equitable subrogation, as an equitable doctrine, should follow these principles, and should not be used to favor a negligent party over a vigilant party.<sup>64</sup>

The Restatement View, however, favors a negligent party over a vigilant one, violating this maxim. Under the Restatement approach, equitable subrogation is granted to a refinance

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<sup>57</sup> *Id.*

<sup>58</sup> *See generally id.* at 17.

<sup>59</sup> See WASH. REV. CODE ANN. § 65.08.070 (West 2012) (providing that a subsequent conveyance is void as against a conveyance “first duly recorded,” without any exception for refinance mortgages).

<sup>60</sup> 30A C.J.S. *Equity* § 125 (2015).

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *See Wells Fargo Bank, Minnesota, N.A. v. Com., Fin. & Admin., Dep't of Revenue*, 345 S.W.3d 800, 807 (Ky. 2011), *as corrected* (Aug. 25, 2011) (“It is axiomatic that as an equitable doctrine, subrogation aids the vigilant, and not the negligent.”).

lender or title insurer that has neglected to protect its interest by conducting a sloppy or incomplete title search that increases the risk that it will fail to discover an intervening lien.<sup>65</sup> The Restatement approach grants equitable relief even if a refinance lender or title insurer failed to do any title search at all, and thus did absolutely nothing to ensure the legal priority of its mortgage.<sup>66</sup> No equitable principle indicates that a party should get relief from the consequences of a risk it has negligently caused. Thus, courts should deny a neglectful lender equitable relief.

The Minority View is far more consistent with this equitable principle, denying relief to a refinance lender that has neglectfully conducted its title search--instead favoring an intervening lienholder who has been vigilant in preserving his legal right by validly recording his interest.<sup>67</sup> By denying equitable relief and following the lien priority rules in the recording statute, equity is simply following the law to protect a party who by superior diligence has obtained a legal advantage.

**C. The Restatement View's equitable foundation—the purported unjust enrichment of an intervening lienholder if it is not applied—is exceedingly weak, even when the refinance lender's negligence is not taken into account.**

The Restatement View also misapplies its equitable justification—unjust enrichment. The Restatement View focuses on the fact that the intervening lienholder, having done nothing, has received a promotion in priority over a mortgage debt that it had been behind, making its lien more valuable. This, according to the Restatement View, is an unearned windfall, and it would

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<sup>65</sup> This is because under the Restatement View constructive notice of intervening liens is irrelevant. *See* RESTATEMENT, cmt. e.

<sup>66</sup> *Id.*

<sup>67</sup> *See Wells Fargo*, 345 S.W.3d at 807–09 (holding that the Minority View best balances the equities between a lender that has missed a lien and an intervening lienholder).

be unjust under the circumstances to allow the intervening lienholder to retain the benefit of its unearned boost in priority at the expense of the refinance lender.<sup>68</sup>

But this theory of unjust enrichment fails under general principles of unjust enrichment as stated by the same courts that have adopted the Restatement View because even though the intervening lienholder is enriched, there is nothing unjust about the enrichment. For example, in Washington, unjust enrichment requires, unsurprisingly, that a party not only be enriched, but that the party's enrichment be *unjust*.<sup>69</sup> According to the Washington Supreme Court, “the mere fact that a person benefits another is not sufficient to require the other to make restitution.”<sup>70</sup> Unjust enrichment only occurs, according to the court, “where money or property has been placed in a party's possession such that in equity and good conscience the party should not retain it.”<sup>71</sup> Neither the Restatement nor the Washington Supreme Court's equitable subrogation jurisprudence make any effort to say why an intervening lienholder should not be able to retain an improved lien position in good conscience, when all that the improved lien position affords the lienholder is a better chance at collecting the debt underlying its valid lien.

To the contrary, the Washington Supreme Court has held that when a party receives a benefit that “simply reflects the amount owed” to it—for instance when a party gets paid off on a valid debt it would not otherwise have recovered but for a benefit conferred by another—it is only receiving a benefit it is entitled to, and no unjust enrichment occurs.<sup>72</sup> When a refinance mortgagee fails to protect its mortgage priority position, and an intervening lienholder gets a priority boost over it, the intervening lienholder receives *even less* than full payment on its

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<sup>68</sup> RESTATEMENT, cmt. a (“If there were no subrogation, such junior interests would be promoted in priority, giving them an unwarranted and unjust windfall.”).

<sup>69</sup> *Lynch v. Deaconess Med. Ctr.*, 776 P.2d 681, 683 (Wash. 1989) (holding that for a plaintiff to recover under a theory of unjust enrichment, “enrichment of the defendant must be unjust”).

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

debt—it only receives an improved chance to eventually recover on the debt, attributable to its improved priority position. If the general unjust enrichment rule were applied, the intervening lienholder’s receipt of this lesser benefit, without more, would not qualify as unjust enrichment. But the Washington Supreme Court side-stepped this problem when it adopted the Restatement View of equitable subrogation by failing to analyze the issue under the rules expressed in its previous unjust enrichment jurisprudence. Rather, it just stated in conclusory fashion that “the junior interest will be unjustly enriched because he will be given a higher priority merely because the debtor refinanced.”<sup>73</sup> Plainly, the purported “unjust enrichment” of the intervening lienholder that serves as the equitable underpinning of the Restatement View is merely “enrichment,” an insufficient basis for equitable relief.

**D. The Restatement View of equitable subrogation unjustifiably allocates a contractual risk to third parties.**

Basic principles of mistake and contract principles fairly allocate the risk of failure to discover an intervening lien to the party that failed to discover it. A refinance lender knows that there is a risk that intervening liens may have been recorded after the mortgage to be paid off but prior to the recording of the refinance mortgage. According to the Restatement (Second) of Contracts, a refinance lender should bear the risk of its mistaken belief<sup>74</sup> about the existence of intervening liens if it only has limited knowledge relating to any intervening liens, but treats that limited knowledge as sufficient.<sup>75</sup> The mistaken lender should bear the risk of loss whether its

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<sup>73</sup> Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 23 (Wash. 2007).

<sup>74</sup> RESTATEMENT (SECOND) OF CONTRACTS § 151 (1981) (“A mistake is a belief that is not in accord with the facts.”).

<sup>75</sup> *Id.* § 154 (1981) (“A party bears the risk of a mistake when (a) the risk is allocated to him by agreement of the parties, or (b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient.”).

limited knowledge results from its failure to adequately search the relevant property records for liens affecting its interest, or its failure to search the record at all.<sup>76</sup>

Normally, the lender will obtain title insurance for its mortgage. A title insurance policy enumerates the events for which coverage is provided—typically including the event that an intervening lien causes the lender to not have the lien priority that they expected.<sup>77</sup> When parties allocate risk by contract, the Restatement (Second) of Contracts states that the risk should be borne by the party that agrees to assume the risk.<sup>78</sup> So when a refinance lender purchases title insurance for its refinance mortgage, the title insurer should pay the lender’s loss arising from an intervening lien because the lender has paid the title insurer in exchange for the title insurer’s agreement to bear the risk of an intervening lien. For example, if the title insurer fails to discover an intervening lien because of its limited knowledge of liens due to its failure to conduct an adequate title search, the title insurer should pay a claim for the lender’s loss because it assumed the risk of an undiscovered intervening lien by agreement.<sup>79</sup> Or, if the title insurer discovers an intervening lien but does not take action that preserves the priority position expected by the refinance lender, once again the title insurer should bear the risk because the title insurance policy allocates that risk to the insurer.

The Restatement View of subrogation takes the inherent risk in a refinance transaction that, under the law, should be borne by the lender or its title insurer and assigns it to third parties—the intervening lienholders, who are placed behind a lien that did not exist when they took their interest. The Restatement justifies the allocation of the contractual risk of an

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<sup>76</sup> *Id.* § 151 (1981), cmt. a. (“An erroneous belief, whether articulated or not, is a mistake, and includes facts that a party has merely assumed.”).

<sup>77</sup> See ALTA LOAN POLICY, *supra* note 43.

<sup>78</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 154(a) (1981).

<sup>79</sup> Title insurance policies also generally allow the insurer the option of fixing the title defect caused by the intervening lien instead of paying a cash claim to a lender for its loss. See ALTA LOAN POLICY, *supra* note 43, Conditions § 7(b) (giving the insurer the option of settling a claim with the claimant).

intervening lien to the intervening lienholder on two related grounds. First, the Restatement says that “the holders of intervening interests can hardly complain about this result, for they are no worse off than before the senior obligation was discharged.”<sup>80</sup> Second, the Restatement says that “if there were no subrogation, such junior interests would be promoted in priority, giving them an unwarranted and unjust windfall.”<sup>81</sup>

But it can just as easily be said that the refinance lender is unjustly enriched when the Restatement approach is applied because the refinance mortgage leapfrogs the intervening lien even if the refinance lender could have protected its priority position but instead did nothing.<sup>82</sup> And meanwhile, it can just as easily be said that the intervening lienholder is made worse off by the demotion to a priority position behind the later-recorded refinance mortgage, even though the intervening lienholder did everything it could to protect its statutory position.<sup>83</sup>

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<sup>80</sup> RESTATEMENT, cmt. e.

<sup>81</sup> *Id.*; *see also* Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 24 (Wash. 2007) (stating that the purpose of the Restatement View of equitable subrogation is “to prevent an unjustified and unwarranted windfall on behalf of the intervening lien holder.”).

<sup>82</sup> *See* Countrywide Home Loans, Inc. v. First Nat. Bank of Steamboat Springs, N.A., 144 P.3d 1224, 1228-29 (Wyo. 2006) (quoting trial court’s view that a refinance lender would be unjustly enriched by an equitable promotion in priority under the restatement view, where the refinance lender merely expected to have a priority position without actually taking any of the steps it could have taken to ensure that position).

<sup>83</sup> *See id.* In the case, the refinance lender, Countrywide, had knowledge of First National Bank’s intervening lien, but took no action to address that intervening lien in order to protect its refinance mortgage. The trial court aptly pointed out that the Restatement View regarding unjust enrichment can be turned on its head in this circumstance, i.e. applying equitable subrogation unjustly enriches the refinance lender:

[Countrywide] could have asked for a subordination agreement or an assignment of the AWL mortgage; it did neither of these things and now seeks to rely upon the concept that it “expected” to step into AWL’s priority without anything more. The argument goes that, in recognizing the doctrine of equitable subrogation, [First National Bank] is not prejudiced and “loses nothing” because it remains second in priority (before it was behind AWL; now it would be behind [Countrywide] ). But, this Court believes equity requires looking at things from a different perspective: [Countrywide] entered into the third mortgage on the property with knowledge of [First National Bank’s] prior loan to Ketcham. Why should [Countrywide] get the benefit (and be unjustly enriched) by leaping over [First National Bank] to assume AWL’s priority status. [Countrywide] has done nothing to deserve this advantage. *Countrywide Home Loans, Inc. v. First Nat. Bank of Steamboat Springs, N.A.*, 144 P.3d at 1228-29.

Also, if the statutory priority order is honored, an intervening lienholder has leverage in a refinance to make demands or have their lien satisfied. Some courts have suggested that an intervening lienholder who is not considered by the refinance lender during a refinance is materially prejudiced by the fact that it is denied the opportunity to get something of value in return for a subordination agreement—a contract between the intervening lienholder and the refinance lender to allow the refinance mortgage to give the refinance mortgage priority over the intervening lien.<sup>84</sup> The Restatement View says that equitable subrogation will only be granted “if subrogation will not materially prejudice the holders of intervening interests in the real estate,” but it does not consider the possibility that material prejudice to intervening lienholders always occurs when refinance lenders do not have to obtain subordination agreements from intervening lienholders in circumstances where they would otherwise need to do so.<sup>85</sup>

**E. Restatement-style “equitable” subrogation, justified through promised economic benefits to homeowners, is an improper overreach by the courts, implementing the court’s economic theories by vitiating duly enacted recording statutes.**

In other contexts, the judicial practice of avoiding validly-enacted statutes to further judges’ economic policy views has been discredited. At the turn of the 20<sup>th</sup> century, the great jurist Oliver Wendell Holmes, believing that judges had misjudged their role in weighing social and economic policy, warned judges not to nullify statutes on belief that some public economic

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<sup>84</sup> See Hugh B. Lambe, *Enforceability of Subordination Agreements*, 19 REAL PROP. PROB. & TR. J. 631, 632 (1984) (“A subordination agreement is simply an agreement that alters what would otherwise be the legal priority of liens, mortgages, or other encumbrances on property. Parties, otherwise entitled to a certain priority by the operation of law, consent in some manner to alter the order of priority so that one party’s potentially superior encumbrance is subordinate to, or ranks for purposes of security after, the other party’s encumbrance.”); see also *Citizens State Bank v. Raven Trading Partners, Inc.*, 786 N.W.2d 274, 284 (Minn. 2010) (declining to equitably subrogate a bank’s mortgage because a “bank’s failure to consider the intervening liens and obtain subordination agreements cannot be deemed justifiable as an excusable mistake.” (quotation omitted)); *MB Fin. Bank, N.A. v. Thorn*, No. 306672, 2012 WL 4093617, at \*3 (Mich. Ct. App. Sept. 18, 2012) (finding material prejudice where the holders of an intervening interest did not receive things of value they would have received in return for their agreement to subordinate their intervening interest).

<sup>85</sup> RESTATEMENT § 7.6(b)(4).

benefit would be gained.<sup>86</sup> Rather than deferring to the economic policy judgments of popularly-elected legislatures, courts of Holmes' era actively promoted *laissez faire* capitalism over other economic schools of thought, often by striking down statutes that infringed on private contracts.<sup>87</sup> Courts justified wiping out validly-enacted laws regulating contractual capacity by holding that these laws interfered with a right to contract guaranteed by the Due Process clause of the Constitution.<sup>88</sup> Holmes generally opposed these actions; in his view, the economic principles being advanced by the courts were far from indisputable, and he cautioned judges that they should be far less certain of the correctness of their own policy views.<sup>89</sup> Holmes stated:

“I cannot but believe that if the training of lawyers led them habitually to consider more definitely and explicitly the social advantage on which the rule they lay down must be justified, they sometimes would hesitate where now they are confident, and see that really they were taking sides upon debatable and often burning questions.”<sup>90</sup>

Soon after Holmes joined the Supreme Court, he expressed his view that the courts should be reluctant to invalidate statutes for perceived public economic benefit in his famous dissent in *Lochner v. New York*.<sup>91</sup> In *Lochner*, the majority held that “limiting the hours in which grown and intelligent men may labor to earn their living, are mere meddlesome interferences with the rights of the individual.”<sup>92</sup> To Holmes, the majority was once again improperly implementing its own economic views over those of the legislature. In his dissent, Holmes argued that whether a judge agreed with the statute at issue should be irrelevant, stating that “agreement or disagreement has nothing to do with the right of a majority to embody their

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<sup>86</sup> Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 467 (1897) (stating that courts of the day had “failed adequately to recognize their duty of weighing considerations of social advantage”).

<sup>87</sup> See BERNARD SCHWARTZ, A HISTORY OF THE SUPREME COURT 179–82 (1993).

<sup>88</sup> See, e.g., *Allgeyer v. State of La.*, 165 U.S. 578, 589 (1897) (holding that the word *liberty* in the Fourteenth Amendment includes a right “to enter into all contracts which may be proper, necessary, and essential” to other rights inherent in the term *liberty*, such the right to earn a livelihood).

<sup>89</sup> Holmes, *supra* note 81, at 467-68.

<sup>90</sup> *Id.*

<sup>91</sup> 198 U.S. 45 (1905).

<sup>92</sup> *Id.* at 61.

opinions in law.”<sup>93</sup> Holmes indicated that the law should have been upheld despite the majority’s belief that it was unwise; “state laws may regulate life in many ways which we [judges] as legislators might think as injudicious.”<sup>94</sup>

Holmes’ view eventually became the prevailing view. A half-century later, the Supreme Court, in declining to invalidate a state law even though the Court saw a strong argument that striking down the law would advance a better social policy, stated that

such arguments are properly addressed to the legislature, not to us. We refuse to sit as a superlegislature to weigh the wisdom of legislation, and we emphatically refuse to go back to the time when courts used the Due Process Clause to strike down state laws, regulatory of business and industrial conditions because they may be unwise, improvident, or out of harmony with a particular school of thought.<sup>95</sup>

The Restatement’s approach encroaches on the policy-making prerogative of legislatures and hearkens back to the discredited overreaches of the *Lochner* era courts. Courts that allow themselves permission to ignore recording statutes via wholesale application of equitable subrogation to refinance mortgages are mirroring the Court in *Lochner*: nullifying a validly-enacted statute in furtherance of their own preferred economic policy, substituting equity for the Constitution as the vehicle for the overreach.

For example, when the Washington Supreme Court adopted the Restatement approach to equitable subrogation in *Bank of America, N.A. v. Prestance Corp.*, it justified nullifying the state’s recording statute by asserting that the court’s decision “helps stem the threat of foreclosure” and “affords enormous financial benefits for many homeowners.”<sup>96</sup> Adoption of the Restatement View, according to the Washington Supreme Court, would “save billions of dollars by reducing title insurance premiums” because “when a jurisdiction adopts the liberal view of

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<sup>93</sup> *Id.* at 75 (Holmes, J., dissenting).

<sup>94</sup> *Id.*

<sup>95</sup> *Ferguson v. Skrupa*, 372 U.S. 726, 731-32 (1963).

<sup>96</sup> *Bank of Am., N.A. v. Prestance Corp.*, 160 P.3d 17, 28 (Wash. 2007).

equitable subrogation, the insurance premium is greatly reduced.”<sup>97</sup> The court in *Prestance* was doing exactly what a legislature would do: it implemented an economic policy in the belief that doing so achieved a better economic result for society generally. Instead, the court should have done what courts are supposed to do: apply equity only to prevent an unjust result in a particular case.

When legislatures consider Restatement-style subrogation of refinance mortgages as a matter of policy, they do not necessarily come to the same policy conclusions that the Washington Supreme Court did. In Ohio, for instance, the legislature rejected a bill that would have made subrogation of refinance mortgages automatic.<sup>98</sup> The bill expressly provided that a refinance mortgage would be subrogated regardless of whether the refinance mortgagee had actual or constructive notice of intervening liens or whether the refinance mortgagee or a third party committed a mistake or was negligent, or whether the mortgagee had title insurance.<sup>99</sup> This bill, introduced in 2013,<sup>100</sup> was passed by the Ohio House of Representatives.<sup>101</sup> But after an Ohio Senate committee held a hearing on the bill,<sup>102</sup> it removed the mortgage subrogation provisions from it.<sup>103</sup>

This illustrates that courts that dabble in economic policy-making, whether through blanket application of “equity” or through other means, aren’t just enacting undeniably proper policies that legislatures would enact if only they had thought of them. Thus, the venture into

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<sup>97</sup> *Id.*

<sup>98</sup> Ohio Legislative Service Commission, Bill Analysis (HB 201), <http://www.lsc.ohio.gov/analyses130/h0201-i-130.pdf>.

<sup>99</sup> 130th General Assembly Regular Session 2013-2014, H. B. No. 201 (As Introduced), [http://archives.legislature.state.oh.us/bills.cfm?ID=130\\_HB\\_201\\_I](http://archives.legislature.state.oh.us/bills.cfm?ID=130_HB_201_I).

<sup>100</sup> Status Report of Legislation, 130th General Assembly - House Bills (HB 201), <http://lsc.state.oh.us/coderev/hou130.nsf/House+Bill+Number/0201?OpenDocument>.

<sup>101</sup> 130th General Assembly Regular Session 2013-2014, H. B. No. 201 (as Passed by House) [http://archives.legislature.state.oh.us/bills.cfm?ID=130\\_HB\\_201\\_PH](http://archives.legislature.state.oh.us/bills.cfm?ID=130_HB_201_PH).

<sup>102</sup> Alexandra Villarreal, *Ohio Senate holds hearing on mortgage subrogation bill*, BANK CREDIT NEWS, Apr. 4, 2014, <http://bankcreditnews.com/legislation/ohio-senate-holds-hearing-mortgage-subrogation-bill/>.

<sup>103</sup> See Ohio Legislative Service Commission, Synopsis of Senate Committee Amendments (HB 201), <http://www.lsc.ohio.gov/synopsis130/h0201-130.pdf>.

economic policy-making that accompanies the Restatement View is not only an improper infringement upon the policy-making prerogative of the legislature; it is a material infringement as well.

**F. Even if it were proper for courts to ignore recording statutes in order to impose their economic policy views, courts should not adopt the Restatement View because it doesn't appear to deliver on its policy promises.**

Courts applying the Restatement View have justified it through promised economic benefits to society: reduced threat of foreclosure, facilitation of refinances, and billions of dollars of savings on title insurance, flowing back into the pocket of the consumer.<sup>104</sup> Aside from the fact that it is not proper for a court to impose its economic views in derogation of a validly enacted statute, it is far from clear that application of the Restatement View of equitable subrogation actually achieves any of these policy objectives. Notably, no court appears to have cited any empirical evidence to back these promises, perhaps because there is no convincing evidence that the Restatement approach actually does reduce title insurance rates.<sup>105</sup> And if there are not any title insurance savings, it would seem doubtful that refinances have been facilitated.<sup>106</sup>

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<sup>104</sup> *Bank of Am., N.A. v. Prestance Corp.*, 160 P.3d 17, 28 (Wash. 2007); *Sovereign Bank v. Gillis*, 74 A.3d 1, 8 (N.J. App. Div. 2013) (finding that the Restatement approach has several advantages, including “facilitating more refinancing that can help stem the threat of foreclosure” and “saving homeowners billions of dollars by reducing title insurance premiums” by reducing a title insurer's risks).

<sup>105</sup> I cannot find any statistical analysis of the Restatement View's effect on title insurance rates to support the claims of Restatement View proponents that adoption of the Restatement View dramatically lowers title insurance rates. *Cf.* Nelson R. Lipshutz, *The Importance of the Doctrine of Equitable Subrogation to the Nevada Economy*, at 9 (January 24, 2011), [http://www.regulatoryresearch.com/wp-content/uploads/2015/08/Importance\\_of\\_Doctrine\\_of\\_Equitable\\_Subrogation\\_to\\_Nevada\\_Economy\\_Jan24\\_2011.pdf](http://www.regulatoryresearch.com/wp-content/uploads/2015/08/Importance_of_Doctrine_of_Equitable_Subrogation_to_Nevada_Economy_Jan24_2011.pdf) (making a claim that title insurance rates for commercial loans would be driven “inexorably upward” if equitable subrogation defenses were denied but supporting this assertion with only unspecified discussions with a title insurance company's underwriting counsel).

<sup>106</sup> Even if refinances were facilitated by the Restatement policy view, it is not clear whether easier refinancing reduces the threat of foreclosure. The Washington Supreme Court just accepted looser refinance credit as a worthy policy objective, but consider that refinance mortgage volume reached an all-time record of \$2.5 trillion in 2003, but by 2007, foreclosure rates were skyrocketing as the nation descended into a historic foreclosure crisis. *See* FDIC,

Table 1 below shows a comparison of title insurance rates for a typical transaction in selected states. Statistical analysis of the Restatement View’s effect on title insurance rates. Anecdotally, however, adoption of the Restatement View certainly does not appear to have achieved the promised effect of billions in consumer savings in Washington: title insurance rates on Washington refinances have actually increased since the Washington Supreme Court adopted the Restatement View.<sup>107</sup> While the Washington Supreme Court has never mentioned this inconvenient fact, it admitted in 2013 that “[m]aybe the effect of liberalizing equitable subrogation on [stemming the threat of foreclosure and saving billions in title insurance premiums] was overstated.”<sup>108</sup> However, it did not provide any support for the claim that liberalizing equitable subrogation by adopting the Restatement View had any favorable policy effect at all, as it “explicitly adopted” the Restatement View “in full.”<sup>109</sup>

**Table 1: The cost of a First American<sup>110</sup> lender’s title insurance policy on a \$130,000 refinance mortgage in 2006 and 2015.**

State	2006 premium <sup>111</sup>	2015 premium <sup>112</sup>	Subrogation approach
Arizona (Maricopa Co.)	\$541	\$450	Restatement <sup>113</sup>

FDIC Outlook, [https://www.fdic.gov/bank/analytical/regional/ro20044q/na/2004winter\\_03.html](https://www.fdic.gov/bank/analytical/regional/ro20044q/na/2004winter_03.html) (accessed 8-15) (noting that Mortgage Bankers Association Mortgage Refinance Index climbed to all-time records in 2001, 2002, and 2003); Alex Viega, *Foreclosure filings up sharply over a year ago*, HOUSTON CHRON., August 22, 2007, <http://www.chron.com/business/article/Foreclosure-filings-up-sharply-over-a-year-ago-1840527.php> (noting that the number of foreclosure filings reported in the U.S. in July 2007 had jumped 93 percent from the same month in the prior year). If refinances were such an indisputably good thing for reducing foreclosures, why did a historic foreclosure crisis occur so soon after an unprecedented refinance boom?

<sup>107</sup> See Table 1, *supra*.

<sup>108</sup> Columbia Cmty. Bank v. Newman Park, LLC, 304 P.3d 472, 479 (Wash. 2013).

<sup>109</sup> The Washington Supreme Court concluded that the Restatement View “is the more simple and clear approach,” that it “is most consistent with our recent prior case law,” and that it “would be wise to follow [the trend of courts adopting the Restatement View].” *Id.* at 478-79.

<sup>110</sup> First American Title Insurance Company is the largest single title insurer in the United States, with a 24.8% market share as of Q3 2015. See AMERICAN LAND TITLE ASSOCIATION, Comparative Nine Month (2015 vs. 2014) Family/Company Summary, [http://www.alta.org/industry/15-03/Comparative\\_NineMonth\\_2015vs2014\\_Family-Company\\_Summary.xls](http://www.alta.org/industry/15-03/Comparative_NineMonth_2015vs2014_Family-Company_Summary.xls) (last accessed Feb. 23, 2016).

<sup>111</sup> See Grant S. Nelson & Dale A. Whitman, *Adopting Restatement Mortgage Subrogation Principles: Saving Billions of Dollars for Refinancing Homeowners*, 2006 B.Y.U. L. REV. 305, 310 n. 27 (2006).

<sup>112</sup> FIRST AMERICAN TITLE, FEE CALCULATOR, <http://facc.firstam.com/> (last accessed Aug. 11, 2015).

<sup>113</sup> See *Lamb Excavation, Inc. v. Chase Manhattan Mortgage Corp.*, 95 P.3d 542, 546 (Ariz. Ct. App. 2004) (“Arizona’s approach to equitable subrogation appears consistent with the Restatement.”); see also *Sourcecorp, Inc. v. Norcutt*, 274 P.3d 1204, 1209 (Ariz. 2012), *as amended on denial of reconsideration* (Apr. 25, 2012) (“We adopt the Restatement approach and reject any requirement of an “agreement” as a condition for equitable subrogation.”).

California (Los Angeles Co.)	\$360	\$380	Majority View <sup>114</sup>
Illinois (Cook Co.)	\$330	\$450	Majority View <sup>115</sup>
Michigan (Wayne Co.)	\$337	\$520.35	Minority View <sup>116</sup>
New York (Westchester Co.)	\$382	\$344	Majority View <sup>117</sup>
Nevada (Clark Co.)	\$279	\$395.75	Restatement <sup>118</sup>
Oregon (Multnomah Co.)	\$689	\$783	Majority View <sup>119</sup>
Utah (Salt Lake Co.)	\$471	\$468	Majority View <sup>120</sup>
Washington (King Co.)	\$313	\$329	Restatement <sup>121</sup>

Several factors might explain why application of the Restatement approach might not reduce title insurance premiums to the extent that its proponents might have thought. One likely factor is that title insurance markets are not subject to normal competitive market pricing forces. The title insurance market is affected by a phenomenon known as “reverse competition”—a market situation that occurs when a product for sale is marketed to someone other than the buyer.<sup>122</sup> Title insurance premiums are paid by borrowers, but since the cost of title insurance is such a small percentage of the finance transaction and borrowers generally know little about title insurance, borrowers generally do not actively shop for title insurance, and usually just accept whatever title insurer is chosen for them.<sup>123</sup> So title insurance is marketed to those responsible

<sup>114</sup> See *JP Morgan Chase Bank, N.A. v. Banc of Am. Practice Solutions, Inc.*, 209 Cal. App. 4th 855, 861, 147 Cal. Rptr. 3d 287, 290 (2012) (holding that “constructive notice, as opposed to actual notice, does not forestall application of equitable subrogation”).

<sup>115</sup> See *United Cmty. Bank v. Prairie State Bank & Trust*, 972 N.E.2d 324, 339 (Ill. Ct. App. 2012).

<sup>116</sup> See *Washington Mut. Bank, F.A. v. ShoreBank Corp.*, 703 N.W.2d 486, 491 (Mich. Ct. App. 2005) (rejecting application of the doctrine of equitable subrogation to a “mere volunteer,” and holding that “the doctrine of equitable subrogation does not allow a new mortgagee to take the priority of the older mortgagee merely because the proceeds of the new mortgage were used to pay off the indebtedness secured by the old mortgage.”).

<sup>117</sup> See *King v. Pelkofski*, 229 N.E.2d 435, 439 (N.Y. 1967) (applying equitable subrogation when the refinance lender does not have actual notice of an intervening lien).

<sup>118</sup> See *Houston v. Bank of Am. Fed. Sav. Bank*, 78 P.3d 71, 74 (Nev. 2003) (explicitly adopting the Restatement View).

<sup>119</sup> See *Rusher v. Bunker*, 782 P.2d 170 (Or. 1989) (stating that equitable subrogation is to be applied where the lender was ignorant of an intervening lien); *Dimeo v. Gesik*, 993 P.2d 183, 185 (Or. 1999) (holding that a lender must be ignorant of the intervening lien for equitable subrogation to apply).

<sup>120</sup> See *Homeside Lending, Inc. v. Miller*, 31 P.3d 607, 612 (Utah Ct. App. 2001) (requiring a mistake of fact in order for the doctrine of equitable subrogation to apply).

<sup>121</sup> See *Bank of Am., N.A. v. Prestance Corp.*, 160 P.3d 17 (Wash. 2007).

<sup>122</sup> J. ROBERT HUNTER, TESTIMONY BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY: TITLE INSURANCE COST AND COMPETITION (Apr. 26, 2006), [http://www.consumerfed.org/pdfs/Title\\_Insurance\\_Testimony042606.pdf](http://www.consumerfed.org/pdfs/Title_Insurance_Testimony042606.pdf).

<sup>123</sup> *Id.*

for choosing the insurer: in a refinance transaction, the lender.<sup>124</sup> Title insurers compete for business referrals by providing lenders various forms of quasi-kickbacks, driving up costs.<sup>125</sup> In sum, the title insurer has little incentive to please the borrower by lowering the borrower's premiums; it is the lender that the title insurer typically must please in a refinance transaction.

Another likely factor involves the unique characteristics of title insurance which make it distinct from virtually all other type of insurance. Title insurance is unlike other forms of insurance in that title insurance is based on a concept of risk elimination rather than risk assumption.<sup>126</sup> Unlike other types of insurers, the primary expenses of a title insurer are expenses involved in discovering and eliminating risks of claims before they occur, by conducting a title search and exam to identify encumbrances or title defects and either eliminating (“curing”) the encumbrance or title defect or by writing an exception from coverage for the encumbrance or defect into the terms of the eventual title insurance policy.<sup>127</sup> By doing so, title insurers eliminate most title problems that could cause a loss—such as an intervening lien—before the title policy is even issued.<sup>128</sup> By contrast, the primary expenses of other types of insurers are payments of claims to policy holders who have suffered a covered loss.<sup>129</sup>

Restatement-style equitable subrogation does not eliminate the need for this curative work. Even if a title insurer decides that it does not have to discover intervening liens when insuring the lender in a refinance transaction because it will have priority over those liens, the insurer is still exposed to other kinds of claims if it fails to search the public record and cure title

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<sup>124</sup> *See id.*

<sup>125</sup> *See id.*

<sup>126</sup> Joyce D. Palomar, TITLE INSURANCE LAW § 1:15 (2016).

<sup>127</sup> *Id.*; *see also* The American Land Title Association, *How Title Insurance Differs from Other Lines of Insurance*, TITLE NEWS (Jul./Aug. 2000), [https://www.alta.org/publications/titlenews/00/0004\\_05.cfm](https://www.alta.org/publications/titlenews/00/0004_05.cfm) (explaining why title insurance, unlike other types of insurance, usually has higher loss prevention and underwriting expenses than loss-related expenses).

<sup>128</sup> *Id.* (stating that title insurers exert a great deal of control over underwriting risks, and can almost eliminate the risk of a missed lien).

<sup>129</sup> *Id.*

defects. For example, if the insurer fails to verify, through a search of the land records, that title to the property is still vested in the person who purports to be the homeowner, the refinance mortgage may be issued in the name of a person who no longer has an interest in the property, or the lender may fail to get a signature of a spouse or co-owner on the mortgage, likely giving rise to a claim against the title insurance policy.<sup>130</sup>

**G. The Restatement View’s primary benefit of reducing or eliminating the need for title searches is becoming less and less important because automation of the title search process is reducing the time and cost of title searches.**

As discussed in the prior section, title insurance is different from other types of insurance in that a title insurer takes affirmative steps to eliminate risks before issuing a policy, namely, a title search and examination.<sup>131</sup> Traditionally, title insurers “insure over” only minor risks of title defects.<sup>132</sup> Title insurers’ emphasis on eliminating risks of title defects in advance of issuing policies “benefits not only the insurer but also the insured and society as a whole because land may be invested in, developed, or otherwise improved with less risk that the title will later be challenged by a superior claimant.”<sup>133</sup> To preserve the benefit of certainty in title to land that is afforded by the traditional title search and examination process, many states legislatures have mandated that a title search must be performed by a title insurer before it may issue title

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<sup>130</sup> See Slade Smith, *Bank of America sues First American for Over \$500 Million*, SOURCE OF TITLE (Mar. 17, 2010), <http://www.sourceoftitle.com/article.aspx?uniq=6116> (describing a \$500 million lawsuit brought by a mortgage lender against its title insurer, which had issued title insurance policies on certain types of mortgages without doing title searches, leading to thousands of claims for not only lien priority problems, but also problems with vesting and legal descriptions on the mortgages); see also Complaint at 27–29, *Bank of Am., N.A. v. United Gen. Tit. Ins. Co.*, No. 10CV55415, Mecklenburg Co. N.C. Super. Ct. (Mar. 5, 2010), <http://www.sourceoftitle.com/pdf/BofA.pdf> (a copy of Bank of America’s complaint in the case, showing the allegations of losses based on vesting and legal description problems).

<sup>131</sup> PALOMAR, *supra* note 126, at § 1:15.

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

insurance.<sup>134</sup> As a result of the emphasis on risk avoidance, the major portion of the cost of a title insurance policy goes toward the title search and examination process rather than toward paying claims after the policy is issued.<sup>135</sup>

Despite the importance and cost of title searches and examinations, the title insurance industry was slow to adopt technology to aid that process.<sup>136</sup> According to one industry executive at the turn of the twenty-first century, most title searches and examinations at that time were done the same way they were done a hundred years prior.<sup>137</sup> Part of the problem was that the county land records on which title searches and examinations were based were not quickly converted to digital systems. While some records offices had adopted computer technology, many searches were performed by poring over paper records or microfilm.<sup>138</sup> Ten years ago, most title searches were still performed by a title searcher working at the courthouse.<sup>139</sup>

Today, computer technology is finally being widely adopted to the title search and examination process. A vital prerequisite to this process has been the widespread adoption of digital imaging and computer indexing by county land record offices. While ledgerbooks and handwritten or typewritten paper documents and obsolete technologies such as microfilm are still in use in some jurisdictions today, many county recorders are now scanning incoming documents and creating an electronic copy of them.<sup>140</sup> In many of these jurisdictions, e-recording technology has been adopted, allowing title companies and others who submit land title

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<sup>134</sup> *See id.*

<sup>135</sup> *See id.*

<sup>136</sup> James B. Frantz, *Title Industry Goes Tech*, NATIONAL REAL ESTATE INVESTOR, Sept. 1, 1999, [http://nreionline.com/mag/real\\_estate\\_title\\_industry\\_goes](http://nreionline.com/mag/real_estate_title_industry_goes).

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> JOSEPH EATON & DAVID EATON, THE AMERICAN TITLE INSURANCE INDUSTRY: HOW A CARTEL FLEECES THE AMERICAN CONSUMER 48 (2007).

<sup>140</sup> Property Records Industry Association, Access to and Sale in Bulk of Land Records, at 3 (2011), [http://www.pria.us/files/public/Committees/Records\\_Access/Bulk\\_Records\\_Access/Bulk\\_Records\\_Adoption\\_Final.pdf](http://www.pria.us/files/public/Committees/Records_Access/Bulk_Records_Access/Bulk_Records_Adoption_Final.pdf) (hereinafter “Bulk Sale of Land Records”).

documents for recording to do so over the internet—allowing recorders to receive documents for recording digitally.<sup>141</sup>

In addition, most jurisdictions that record and store their land records using computer technology also will sell the land records in bulk to private buyers.<sup>142</sup> At little cost, county recorders can copy thousands of scanned land title documents or an entire index of records in a database from its server hard drive to another medium such as a DVD, an FTP server, or an external hard drive, and give all that data to the private buyer.<sup>143</sup> Where laws or practices have not allowed private buyers to obtain land records in bulk at low cost, they have at times resorted to the courts to attempt to gain such access.<sup>144</sup>

This low-cost access to entire stores of land records has allowed private entities such as title insurance companies to create their own versions of county land records, known as “title plants.”<sup>145</sup> In many jurisdictions, especially the larger urban ones, title companies have created their own electronic title plants to facilitate their searches.<sup>146</sup> Once they have obtained the land title records in bulk and have imported the data into their title plant, these title companies can then do searches in-house and no longer depend on physical or even electronic access to the county recorder’s office.<sup>147</sup> To make title searches and examinations more efficient, title companies have added their own proprietary indexes or other enhancements to their title plants.<sup>148</sup> Such enhancements include the use of standardized indexes across multiple counties; the addition or enhancement of geographic indexing to ensure that all documents affecting title to

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<sup>141</sup> See generally Danny Byrnes, *Nationwide Title Clearing, The Evolution of eRecording from the County Recorder’s Perspective* (2016), [http://info.nwtc.com/county\\_recorder\\_white\\_paper](http://info.nwtc.com/county_recorder_white_paper).

<sup>142</sup> See generally Bulk Sale of Land Records, *supra* note 140.

<sup>143</sup> *Id.* at 20.

<sup>144</sup> See Jarrod A. Clabaugh, *Lawsuit Debates County's Control of Public Record Access*, SOURCE OF TITLE, Jan. 10 2006, <http://www.sourceoftitle.com/article.aspx?uniq=881&page=1>.

<sup>145</sup> See Bulk Sale of Land Records, *supra* note 140, at 6.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

a particular parcel are located; and integration with the title company's other systems, including software designed to simplify the title search process.<sup>149</sup>

Despite the increased adoption of computer technology, the title insurance production process is still infected with inefficiencies such as manual and redundant steps, multiple handoffs of work, non-integration of multiple, complex computer systems, and the perpetuation of low-value processes.<sup>150</sup> Eighty to ninety percent of the steps in the title search process are either done manually or require manual intervention.<sup>151</sup> However, using increasingly sophisticated title plants, some companies have taken additional steps to actually automate the title searching and examination process. For example, NextAce, Inc., founded in 2003, has developed a system that automates all functions in the title searching and examination process over a coverage area that encompasses over ninety percent of the U.S. population.<sup>152</sup> NextAce claims that its system, which uses standard technologies such as optical character recognition in concert with its own proprietary technologies such as patterned data extraction,<sup>153</sup> can complete even very complex title searches and examinations in five minutes<sup>154</sup>—a far cry from the traditional half-day excursions to the courthouse just to retrieve the relevant documents. While NextAce's system still requires human validation—only eight-seven percent of fields extracted from documents do not require human intervention to make corrections, and even NextAce characterizes its automated process as only “one heck of a start” toward delivering a completed title product<sup>155</sup>—automated title search and examination systems such as NextAce's are likely to considerably

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<sup>149</sup> *Id.*

<sup>150</sup> Accenture & RedVision, Key insights on true title origination costs and what title companies can do about them, <http://www.redvision.com/uploads/pdfs/RedVisionAccentureTitleIndustryBenchmarkStudy.pdf>.

<sup>151</sup> *Id.*

<sup>152</sup> NextAce, Title Automation at 3 (2014), <http://nextace.com/pdf/NextAce%20-%20Title%20Automation%20White%20Paper.pdf>.

<sup>153</sup> *Id.* at 6.

<sup>154</sup> *Id.* at 3.

<sup>155</sup> *Id.* at 8.

reduce the time and expense involved in delivering title insurance. Declining costs in producing title insurance will likely reduce the Restatement View's promised benefit from reducing or eliminating the need for title insurance in refinance transactions.

#### **H. The Restatement View may have other hidden policy pitfalls.**

Even though the Restatement view does not eliminate all of the risks that a title search is designed to discover, adoption of the Restatement View may encourage title insurers to be less thorough in their title searches, which would tend to increase the number of certain types of claims. Since title insurance covers only events that have already occurred, it is theoretically possible for a title insurer to eliminate every possibility of a loss. However because the careful and thorough title searches required to approach this theoretical ideal represent increased costs to the title insurer, title insurers are likely to balance the benefits and costs when deciding how careful and thorough their title searches ought to be.<sup>156</sup> If a title insurer has a lower chance of a claim because a state has adopted the Restatement View and has thereby reduced or eliminated a title insurer's risk of loss from failing to discover a lien in a title search, the benefit of a thorough title search is reduced, and the title insurer has an incentive to be less careful and thorough in its search. Some title insurers may be persuaded to skip the traditional prerequisite of a title search altogether.<sup>157</sup> While this may benefit the title insurer overall if the insurer has predicted its

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<sup>156</sup> See Fitch Ratings, Review and Outlook 2007-2008, U.S. Title Insurance, at 3 (Nov. 20, 2007), [http://www.altal.org/indynews/2007/Fitch\\_Rpt\\_11-20-07.pdf](http://www.altal.org/indynews/2007/Fitch_Rpt_11-20-07.pdf) (explaining that title insurance has a theoretical minimum loss ratio of zero, but cost constraints on the title search dictate that some encumbrances will be missed by title searches).

<sup>157</sup> See Smith, *supra* note 130 (describing lawsuit alleging thousands of title claims, many involving title issues other than lien priority, where the title insurer purposely did not perform title searches).

benefits and costs correctly, it will likely increase the frequency of title claims not relating to lien priority.<sup>158</sup>

Skipping the title search and related curative work in refinance transactions may have other unintended consequences.<sup>159</sup> For example, if title insurers are less careful or thorough in their title searches or omit title searches altogether in refinance transactions, one possible negative side effect is a loss of integrity in land title records.<sup>160</sup> In the traditional title insurance process involved in a refinance, when a title insurer discovers a defect in the land records during its search, it corrects the defect. If this process is not undertaken, the defects will remain in the land records to crop up later. This likely means that more defects will remain to be discovered and fixed in future purchase transactions, increasing the cost of clearing title and increasing the risk of delay and complication in these transactions.<sup>161</sup> The American Land Title Association, the dominant trade association for the title insurance industry, has warned that insuring titles without conducting title searches will harm the integrity of title records.<sup>162</sup>

#### **IV. A better approach to equitable subrogation would apply equitable relief only when equities actually favor the refinance lender.**

I propose that the guiding principles of the doctrine of equitable subrogation should be the same principles that guide the application of equity generally. That is, the presumptive

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<sup>158</sup> *Id.*

<sup>159</sup> *See generally* The American Land Title Association, Analysis of Consumer Issues Pertaining to the RLP (Aug 12, 2002), <https://www.alta.org/mortgage/ALTARLPAnalysis.doc> (describing the dangers of Radian Lien Protection product, a title insurance substitute—not underpinned by a title search—that insured refinance lenders for certain risks that would impair the priority of their mortgage).

<sup>160</sup> *Id.* at 10.

<sup>161</sup> *Id.*

<sup>162</sup> *See* American Land Title Association, ALTA Files Lawsuit in California Against Property and Casualty Insurers for Illegally Issuing Title Insurance, 87 TITLE NEWS 4, at 6 (2008) (quoting ALTA's then-CEO, Kurt Pfothenhauer, in reference to insurance of titles without a title search: “[B]ecause no title search or corrective is performed, it threatens the integrity of public land records—the bedrock upon which real estate ownership in this country is built”).

outcome should be the normal application of recording statutes and “first in time, first in right” lien priority. The burden should be on the party seeking equitable subrogation to show that an injustice will occur unless the court departs from this default outcome.

The degree of negligence of the lender or its title insurer in failing to discover an intervening lien should weigh against it, and the intervening lienholder’s diligence in protecting its interest by recording it should weigh in its favor. Thus, a party seeking equitable subrogation should generally have to establish that it had at most a low degree of culpability in its failure to discover an intervening lien in a refinance transaction. Parties that fail to discover liens because they purposely chose not to conduct a title search should be barred from relief under the doctrine of equitable subrogation. The same can be said for parties that purposely cut corners in their title searches and fail to discover liens because they failed to search relevant portions of public records.

Before a court grants equitable subrogation, a party should have to show that it had a *reasonable* expectation that its lien had the priority position into which the party asks the court to place it. A reasonable expectation of lien priority should minimally require that the party seeking subrogation took reasonable steps designed to discover an intervening lien. If the party cannot establish that it failed to discover an intervening lien despite reasonable efforts designed to discover it, equitable subrogation should be denied. Or if the party discovered an intervening lien but did not take steps to protect its interests under circumstances in which it reasonably should have done so, equitable subrogation should be denied.

Even if a party can show that it missed an intervening lien through an “innocent mistake,” such as when a party can show that it searched the relevant records but simply overlooked an intervening lien through human error, a strong argument can be made that equitable subrogation

should be denied. When a refinance lender fails to discover an intervening lien when it issues its mortgage, an intervening lienholder loses leverage it would have in the refinance transaction—to either force the borrower to satisfy the lien or pay the lienholder for a subordination agreement. Granting equitable subrogation in this circumstance materially prejudices the intervening lienholder by nullifying this leverage, and materially benefits the party that has made a mistake by allowing them to avoid dealing with the intervening lienholder. Furthermore, the loss is often incurred by a title insurer that has not only made the mistake, but has also accepted a premium to pay the loss in this situation.

The best view, however, would at least allow for the possibility of equitable subrogation when the lender undertook a search that was reasonably calculated to discover an intervening lien, but the refinance lender missed the lien or did not address the lien due to “a justifiable or excusable mistake of fact.”<sup>163</sup> In this circumstance, the refinance lender’s level of culpability may be low, and the consequences are often harsh—often, a loss of the entire amount of the intervening lien. In this circumstance, the lender at least arguably has the reasonable expectation of the priority position of the prior mortgage that the primary text of the Restatement View requires. In other words, I am not advocating that courts adopt a zero-tolerance requirement for any mistake made by the party seeking subrogation. The precise dividing line where the balance tips to one side or the other will depend on the facts.

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<sup>163</sup> *Citizens State Bank v. Raven Trading Partners, Inc.*, 786 N.W.2d 274, 280 (Minn. 2010) (quoting *Emmert v. Thompson*, 52 N.W. 31, 32 (Minn. 1892)). I believe that this language from the Minnesota Supreme Court accurately expresses the circumstances when equitable subrogation should be generally available to a party seeking equitable subrogation. While I disagree with some of the circumstances the Minnesota Supreme Court has found to be justifiable and excusable, the Court applied this standard as I would propose in *Carl H. Peterson Co. v. Zero Estates*, 261 N.W.2d 346, 348 (Minn. 1977), where the court distinguishes between an “unsophisticated individual” and a “professional lender” for purposes of deciding what constitutes an excusable mistake, and finds that the mistake of a professional lender was not justifiable or excusable when the lender should have known that intervening mechanics liens likely existed but “fail[ed] to consider potential priority conflicts and to obtain subordination agreements from them.”

However, equitable subrogation should be applied only when there is equitable cause to apply it.<sup>164</sup> The mere fact that the refinance lender, or its title insurer failed to discover or address the intervening lien, without more, should not entitle the refinance lender to avoid the effect of a recording statute through equitable subrogation.<sup>165</sup>

Contrary to the Majority View, the refinancing party's actual knowledge of the intervening lien should not conclusively bar equitable subrogation, however. The party's level of culpability in not addressing the lien—not whether the party technically had actual notice of the lien—should be the primary factor in whether equitable subrogation is available. It is conceivable that a party with actual knowledge of a lien could be less culpable in its failure to address an intervening lien than a party that has only constructive knowledge. For example, when a party discovers a lien but can show that its failure to act on its knowledge was a justifiable or excusable mistake of fact under the circumstances, equitable subrogation should be available. When a party did not have actual knowledge of a lien because it simply did not take the steps necessary to find the lien, equitable subrogation should not be available.

The equitable doctrine of unjust enrichment should not be used to justify equitable subrogation in the usual case where the intervening lienholder would otherwise receive nothing more than its statutory lien position for its valid lien. It is axiomatic that unjust enrichment requires that the enriched party be enriched *unjustly*. Here, the enriched party is entirely without fault and receives nothing more than a better chance of recovering a valid debt owed to it. There is nothing unjust about the intervening lienholder's enrichment in this circumstance. Equitable

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<sup>164</sup> E. Sav. Bank, FSB v. CACH, LLC, 124 A.3d 585, 592 (Del. 2015) (“Equitable subrogation has never been used to undercut the authority of a Delaware statute without equitable cause.”).

<sup>165</sup> See *id.* at 592–93. The Delaware Supreme Court expresses a view of equitable subrogation that matches the principles that I advocate here: it recognizes the remedy as an equitable one, and then applies equitable principles to deny a refinance lender equitable subrogation where applying the recording statute did not leave the refinance lender without a remedy at law; it could simply pursue a claim against its title insurer that had missed the intervening lien. See *id.* at 593 (quoting *Chavin v. H.H. Rosin & Co.*, 246 A.2d 921, 922 (Del. 1968) (“It is, of course, axiomatic that Equity has no jurisdiction over a controversy for which there is a complete and adequate remedy at law.”)).

subrogation should thus usually require an injustice to the party seeking subrogation, independent from any benefit received by the intervening lienholder.

Finally, when applying equitable subrogation, courts should not base their decisions on their economic policy views. While I do not believe that courts should be entirely blind to economic policy considerations, courts should concentrate on delivering justice to the parties. Economic policy arguments should only be used to reinforce decisions that would be sound without those policy arguments. And when courts use economic policy arguments, those arguments should have a sound basis; courts should not make economic pronouncements on thin evidence and incomplete understanding, as appears to have been the case with the Restatement View of equitable subrogation. The economics of mortgage finance and the title insurance industry are not amenable to easy analysis. Even if the economic truths were more certain than they are, courts should refrain from using equity to further an economic policy view.

## **V. Conclusion**

In arguing that refinance lenders should not be automatically given a free pass to the front of the priority line, I am simply advocating for a view of subrogation that considers the equities of all lienholders, not just the refinance lender. The Restatement View exalts the refinance lender and treats the intervening lienholder shabbily. I merely call for equal treatment.

I believe that courts should keep in mind that the Restatement View became widely adopted not long before the events that gave rise to the recent mortgage crisis, and view it with appropriate suspicion as policy. The practices that preceded and accompanied the housing bubble are well-documented, and I will not recount them here; I think it is fair to say that in that era, inflated expectations of the benefits of expanded mortgage credit abounded and that these misguided expectations led to a wide variety of unsound practices related to mortgage finance.

As a creature of that over-exuberant time, the Restatement View should not escape reevaluation as policy where it has been adopted. For example, perhaps the time-tested practice of searching and examining title should not be put on the scrap heap. Perhaps instead, new and improved methods of searching and examining title, using innovative technologies, will deliver reliable title to real property more quickly and inexpensively than ever imagined.

Finally, though I recognize the legislature as the proper forum for considering the policy issue of whether refinance mortgages should be automatically subrogated, I would caution legislatures against statutory adoption of automatic subrogation without very careful analysis. The soundness of relieving a refinance lender from the responsibility of considering intervening liens should be evaluated based on the benefits it actually delivers, rather than what someone thought it would deliver ten or twenty years ago.