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## What Happened to the Equity in Equitable Subrogation

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Smith: Smith: What Happened to the Equity in Equitable Subrogation

# What Happened to the Equity in Equitable Subrogation?

*Metmor Financial, Inc. v. Landoll Corp.*<sup>1</sup>

## I. INTRODUCTION

The doctrine of equitable subrogation provides courts with a vehicle to allow a lending institution that has paid off an existing loan to take the original lending institution's place in priority status.<sup>2</sup> While the doctrine appears quite simple, courts have been remarkably inconsistent in their approaches to allowing equitable subrogation claims. This Note discusses the various approaches taken by courts today, and more importantly, analyzes Missouri's current approach as affirmed most recently in *Metmor Financial, Inc. v. Landoll Corporation*.<sup>3</sup>

## II. FACTS AND HOLDING

In April of 1995, Vickie Lynn Beck and Melvin Scott Beck (hereinafter "the Becks") sought to purchase a piece of real property from Howard and Virginia Johnson (hereinafter "the Johnsons").<sup>4</sup> The Johnsons, however, had a pre-existing mortgage on their property with Sterling National Bank.<sup>5</sup> On April 9, 1995, the Becks began discussions with Metmor Financial (hereinafter "Metmor") about financing their prospective purchase from the Johnsons.<sup>6</sup> Metmor approved the Becks' financing only after the Becks agreed that Metmor would obtain first-lien status on its mortgage.<sup>7</sup>

In early May of 1995, Chicago Title Company (hereinafter "Chicago Title") was asked to examine the title and conduct the closing.<sup>8</sup> Meanwhile, on May 15, 1995, unknown to Metmor and the Becks, Landoll Corporation (hereinafter "Landoll") obtained and filed a judgment against the Johnsons and their wholly owned corporation.<sup>9</sup> On May 16, 1995, a Chicago Title employee conducted a judgment search of the records to determine if any intervening judgments had been filed against the Johnsons.<sup>10</sup> The employee failed to locate the then existing

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1. 976 S.W.2d 454 (Mo. Ct. App. 1998).

2. See generally GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 10.6 (3d ed. 1994).

3. 976 S.W.2d 454 (Mo. Ct. App. 1998).

4. *Id.* at 456.

5. *Id.*

6. *Id.*

7. *Id.*

8. *Metmor Fin., Inc. v. Landoll Corp.*, 976 S.W.2d 454 (Mo. Ct. App. 1998).

9. *Id.* at 457. The court does not provide any further specifics as to the judgment filed by Landoll, other than to assert its validity as against the Johnsons and their wholly owned corporation.

10. *Id.*

lien against the Johnsons and reported to Chicago Title that no outstanding judgments existed against the Johnsons.<sup>11</sup> Chicago Title then promptly recorded the Deed of Trust and Missouri Warranty Deed relating to the sale of the property from the Johnsons to the Becks.<sup>12</sup> Following that, Chicago Title, at the request of the Becks, then disbursed the loan proceeds received from Metmor to Sterling National Bank in payment of the Johnsons' pre-existing loan.<sup>13</sup>

On July 25, 1995, Landoll initiated execution proceedings to recover its previously recorded judgment against the Johnsons.<sup>14</sup> Landoll sought to levy the property by a judicial sale scheduled for September 12, 1995.<sup>15</sup> Metmor and the Becks responded by filing a petition requesting declaratory and injunctive relief against Landoll.<sup>16</sup>

The trial court temporarily enjoined the judicial sale of the property on September 12, 1995.<sup>17</sup> Metmor filed an amended petition on November 16, 1995, seeking permanent injunctive relief and a declaratory judgment under the theory of equitable subrogation.<sup>18</sup> On October 7, 1996, the trial court dissolved the temporary injunction and denied Metmor's request for a permanent injunction based on equitable subrogation.<sup>19</sup>

On appeal, Metmor argued that relief based on equitable subrogation was appropriate because (1) Metmor had paid the Sterling lien obligation at the request of the Becks; (2) Metmor intended to obtain first-lien status; and (3) Landoll would not be prejudiced because Landoll would retain the same lien status it would have had if Metmor had not paid off the previously existing Sterling loan.<sup>20</sup>

The Missouri Court of Appeals for the Western District of Missouri disagreed. The court held that even when a lender shows that an intervening

11. *Id.* The Chicago Title employee was unable to locate any existing judgments against the Johnsons because she failed to properly conduct her search. *Id.* While the employee typed in "Howard Johnson" and "Virginia Johnson," these locators were unsuccessful in locating the Landoll judgment. *Id.* The court suggests that the judgment was not revealed because the judgment index required the input of different data when the lawsuit involves multiple parties. *Id.* Hence, the employee would have needed to type "Johnson, et al." in order to locate the Landoll judgment. *Id.*

12. *Id.*

13. *Metmor Fin., Inc. v. Landoll Corp.*, 976 S.W.2d 454, 457 (Mo. Ct. App. 1998).

14. *Id.* at 458.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Metmor Fin., Inc. v. Landoll Corp.*, 976 S.W.2d 454, 458 (Mo. Ct. App. 1998). The Becks also filed an amended petition previously on October 18, 1995, requesting declaratory relief against Landoll alleging that Landoll had failed to give proper notice of the judicial sale. *Id.* The trial court, however, denied the Becks relief on that ground. *Id.*

19. *Id.*

20. *Id.* at 461.

judgment holder would be no worse off than it would have been had the lender never paid off the existing mortgage, and even when a lender intends to obtain first-lien status, if that lender had constructive notice of the previously recorded judgment, application of equitable subrogation is inappropriate in the absence of any complicity by the intervening judgment holder.<sup>21</sup> Shortly thereafter, on April 28, 1998, the Missouri Supreme Court denied Metmor's motion for rehearing.<sup>22</sup>

### III. LEGAL BACKGROUND

Subrogation can be properly classified as either conventional subrogation or equitable subrogation.<sup>23</sup> Conventional subrogation arises from an *express* agreement among the parties that the person or entity discharging the prior lien will be substituted to the priority of the prior lienee.<sup>24</sup> Equitable subrogation, however, arises when the subrogating intent is *implied* by operation of law.<sup>25</sup> While courts have been largely consistent in their application of conventional subrogation, the same is not true of their application of equitable subrogation.<sup>26</sup> Generally speaking, courts agree that mortgagees asserting equitable subrogation must show that they *intended* to assume first priority and that the intervening judgment holder is not prejudiced by allowing the mortgagee to "jump" in priority.<sup>27</sup> The divergence among the courts occurs when deciding whether actual or constructive notice of an intervening lien will preclude a lender from claiming application of the doctrine of equitable subrogation. The following section seeks to address the various approaches taken and the asserted reasons behind each of them.

#### A. Missouri Case Law

The doctrine of equitable subrogation has existed in Missouri for over a century.<sup>28</sup> In Missouri's first known equitable subrogation case, *Bunn v. Lindsay*,<sup>29</sup> the Missouri Supreme Court specifically held that the failure of a mortgagee seeking subrogation to locate a recorded intervening judgment will

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21. *Id.* at 461-62.

22. *Id.* at 454. The case was ultimately retransferred on October 20, 1998, and readopted by the Court of Appeals on October 26, 1998. *Id.*

23. See Carol Vento, Annotation, *Discharge of Mortgage and Taking Back of New Mortgage as Affecting Lien Intervening Between Old and New Mortgages*, 43 A.L.R.5th 519 (1996).

24. *Id.*

25. *Id.*

26. *Id.*

27. See RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

28. See *Bunn v. Lindsay*, 7 S.W. 473 (Mo. 1888).

29. *Id.*

bar that mortgagee from asserting a subrogation right.<sup>30</sup> In *Bunn*, the plaintiff mortgagee requested that the court grant him subrogation to the original mortgage because he not only had intended to have such priority status, but also had failed to obtain actual notice of the recorded intervening judgment.<sup>31</sup> The *Bunn* court, however, held that when a lien is recorded, the “judgment [becomes] spread upon the public records in order that all who might deal with the property might know of its existence.”<sup>32</sup> As such, any failure to locate that lien would come as a result of the mortgagee’s own negligence, for which he has no one to blame but himself.<sup>33</sup> Under such circumstances, the *Bunn* court stated that it would not, through the use of equity, relieve the mortgagee “by interfering with the legal rights of others who are without fault.”<sup>34</sup>

Since *Bunn*, Missouri courts have consistently refused to allow subrogation claims where the mortgagee seeking subrogation received constructive notice, via recording, of the intervening judgment.<sup>35</sup> The courts have essentially determined that a mortgagee’s failure to locate a recorded intervening lien is a result of that mortgagee’s own negligence, and therefore should appropriately bar equitable subrogation claims.<sup>36</sup>

For example, in *Landmark Bank v. J.V. Ciaravino*,<sup>37</sup> plaintiff Landmark Bank employed a title company to conduct a title search and facilitate the closing.<sup>38</sup> However, the title company negligently failed to locate an existing lien.<sup>39</sup> Landmark then took the deed of trust.<sup>40</sup> Shortly thereafter, the existing

30. *Id.* at 476. Missouri’s current recording statute provides that documents filed for record with the recorder shall “impart notice to all persons of the contents thereof and all subsequent purchasers and mortgagees shall be deemed, in law and equity, to purchase with notice.” MO. REV. STAT. § 442.390 (1994) (emphasis added).

31. *See Bunn*, 7 S.W. at 475-76.

32. *Id.* at 476. The *Bunn* court denied equitable subrogation despite the fact that the intervening lienor had sustained no diminution in the value of his lien.

33. *Bunn v. Lindsay*, 7 S.W. 473, 476 (Mo. 1888).

34. *Id.*

35. *See infra* notes 37-44 and accompanying text.

36. *See infra* notes 37-44 and accompanying text.

37. 752 S.W.2d 923 (Mo. Ct. App. 1988).

38. *Id.* at 924-25.

39. There were actually a series of recorded deeds of trust on the property. The third deed of trust, held by lienholder Royal Bank, was the deed of trust which Landmark was unaware of, and against which it was seeking subrogation rights against. *Id.* Landmark believed that it was being issued the third deed of trust, and that the majority of the money it was loaning to the borrower was being used to pay off the second deed of trust. *Id.* Hence, Landmark believed that it would be holding a second deed of trust in the real estate. *Id.* In fact, the deed of trust expressly recited, “subject to a first deed of trust.” *Id.* However, while the money was used to pay off the second deed of trust, there was in fact an additional prior recorded deed of trust, that held by Royal Bank. *Id.*

40. *Id.*

lienholder asserted its priority status against Landmark.<sup>41</sup> At trial, Landmark requested that the court grant subrogation rights against the prior recorded lienholder.<sup>42</sup> The court suggested that allowing subrogation where constructive notice was present “would be nothing less than a judicial repeal of [Missouri’s Recording Statute] and would place the lending of money secured by real estate at great risk and insecurity.”<sup>43</sup> The court concluded that equitable subrogation would not be granted to a lender “if [that lender] has been placed into the position in which [that lender] finds [it]self because of [its own] culpable and inexcusable neglect.”<sup>44</sup>

Missouri courts, however, have allowed equitable subrogation claims in rare and extreme cases “bordering on if not reaching the level of fraud.”<sup>45</sup> This was the case in *State Savings Trust Co. v. Spencer*,<sup>46</sup> where the borrower came to the plaintiff seeking a loan to pay off his first deed of trust, which was being threatened by foreclosure.<sup>47</sup> The plaintiff agreed to give the borrower a loan, provided that it would be granted the first deed of trust’s position in terms of priority.<sup>48</sup> While the borrower was successful in gaining subordination of the second deed of trust holder, the borrower did not obtain such subordination from the third deed of trust holder.<sup>49</sup> Instead, the borrower forged an instrument which purported to give plaintiff the subordination of the third deed of trust holder to advance ahead of him in priority status.<sup>50</sup> Because the instrument was forged, the subordination was held not legally valid.<sup>51</sup> As such, the plaintiff was forced to seek *equitable* subrogation against the third deed of trust holder.<sup>52</sup> Under these limited circumstances, where criminal conduct was employed to cover up an existing valid lien,<sup>53</sup> and where the existing lienholder would be in no worse position than it would have been had the original lien not been paid off,<sup>54</sup> the *Spencer* court allowed the plaintiff his equitable subrogation claim.<sup>55</sup> The *Spencer* case appears to be the only Missouri case that has allowed an equitable subrogation claim to survive in the face of constructive notice.

Missouri’s case law concerning equitable subrogation over the past century has been largely consistent. In short, Missouri’s case law stands for the

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41. *Id.* at 925.

42. *Landmark Bank v. J.V. Ciaravino*, 752 S.W.2d 923, 925 (Mo. Ct. App. 1988).

43. *Id.* at 928.

44. *Id.* See also *Baker v. Farmer’s Bank*, 279 S.W. 428 (Mo. Ct. App. 1926).

45. *Landmark Bank*, 752 S.W.2d at 928.

46. 201 S.W. 967 (Mo. Ct. App. 1918).

47. *Id.* at 968.

48. *Id.*

49. *Id.*

50. *Id.*

51. *State Sav. Trust Co. v. Spencer*, 201 S.W. 967, 970 (Mo. Ct. App. 1918).

52. *Id.*

53. *Id.*

54. *Id.* at 971.

55. *Id.*

proposition that, except in instances bordering on fraud, *any* notice, either actual or constructive, is enough to defeat a claim for equitable subrogation.<sup>56</sup>

### *B. Other Jurisdictions Following Missouri's Approach*

While the approach taken by Missouri's courts represents a distinct minority in the country, there are several cases outside of Missouri holding that not only actual, but also constructive notice, is enough to defeat a claim for equitable subrogation.<sup>57</sup>

In *Belcher v. Belcher*,<sup>58</sup> for example, the court determined that where upon the exercise of reasonable diligence by examination of public records the mortgagee could have obtained notice of intervening judgments, that mortgagee shall not be given the right of equitable subrogation.<sup>59</sup> Such a rule, the *Belcher* court suggested, "makes it incumbent upon a purchaser to consult available records in regard to contemplated real property transactions,"<sup>60</sup> and at the same time, "minimizes, as to those transactions, the effect of any uncertainty of representation between vendor and vendee concerning encumbrances of record."<sup>61</sup> A handful of other cases have agreed with the analysis of *Belcher*, and have reached similar conclusions.<sup>62</sup>

### *C. Majority Approach*

In contrast to Missouri's line of cases, the majority of jurisdictions today hold that while actual notice of an intervening judgment will defeat a claim for equitable subrogation, constructive notice will not.<sup>63</sup>

In *Rusher v. Bunker*,<sup>64</sup> the Oregon Court of Appeals provided an excellent synopsis of the rationale behind this approach. The court granted subrogation to a lender who failed to obtain actual notice of a prior recorded lien,<sup>65</sup> holding that "record notice does not, in itself, defeat the ability of a lender to become

56. See *supra* notes 30-55 and accompanying text; *infra* notes 57-59 and accompanying text.

57. See RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

58. 87 P.2d 762 (Or. 1939).

59. *Id.* at 764.

60. *Id.* at 765.

61. *Id.*

62. See *In re Gordon*, 164 B.R. 706, 708 (Bankr. S.D. Fla. 1994) (stating constructive knowledge of lien enough to preclude entitlement to equitable subrogation); *Independence One Mortgage Corp. v. Katsaros*, 681 A.2d 1005 (Conn. App. Ct. 1996); *Heiber v. Florida Nat'l Bank*, 522 So. 2d 878 (Fla. Dist. Ct. App. 1988).

63. See RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

64. 782 P.2d 170 (Or. Ct. App. 1989).

65. *Id.* at 174.

equitably subrogated to a senior encumbrance that the lender discharges.”<sup>66</sup> The court further stated that constructive notice should be disregarded, as “[i]t can have no relevancy on the question [of] whether the lender actually expected to get priority of security in the property because that can be inferred only from his [or her] actual knowledge.”<sup>67</sup> The *Rusher* court concluded that “[i]nsofar as it implies that there is culpability in the lender,” such negligence should not bar an equitable subrogation claim by allowing the intervening judgment holder to be “enriched fortuitously,” provided of course that the intervening judgment holder has not been misled or harmed.<sup>68</sup>

This approach certainly appears to be the commanding one among jurisdictions today.<sup>69</sup> For example, courts applying Alabama,<sup>70</sup> California,<sup>71</sup> New Jersey,<sup>72</sup> New York,<sup>73</sup> and South Carolina<sup>74</sup> law are among the many refusing to allow constructive notice of intervening judgments to defeat an otherwise successful equitable subrogation claim.

#### *D. The Restatement Approach*

The *Restatement (Third) of Property (Mortgages)* takes an even more liberal approach. Under the *Restatement*, subrogation can be granted even if the mortgagee seeking subrogation had actual knowledge of the intervening interest.<sup>75</sup> As such, the mortgagee’s notice, either actual or constructive, is completely irrelevant.<sup>76</sup> The only relevant queries under this approach are (1) whether the mortgagee reasonably expected to get security with a priority equal

66. *Id.* at 172.

67. *Id.*

68. *Id.*

69. See RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

70. *Mutual Life Ins. Co. v. Grissett*, 500 F. Supp. 159, 164 (M.D. Ala. 1980) (“[M]ere constructive notice imputed from the existence of recordation is not sufficient to preclude . . . the doctrine of equitable subrogation.”).

71. *Han v. United States*, 944 F.2d 526, 530 (9th Cir. 1991) (“[T]he fact that the junior encumbrance was recorded will not by itself bar equitable subrogation.”).

72. *Metrobank v. National Community Bank*, 620 A.2d 433, 438 (N.J. Super. Ct. App. Div. 1993) (“[S]ubrogation is effective only where the new mortgagee is without actual knowledge of the existence of junior encumbrances.”).

73. *United States v. Baran*, 996 F.2d 25, 29 (2d Cir. 1993) (“[S]ubrogation erases the lender’s mistake in failing to discover intervening liens, and grants him the benefit of having obtained an assignment of the senior lien that he caused to be discharged.”) (applying New York law).

74. *Enterprise Bank v. Federal Land Bank*, 138 S.E. 146, 148-50 (S.C. 1927) (stating only actual knowledge of an intervening creditor will defeat a claim for equitable subrogation).

75. See RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

76. See *East Boston Sav. Bank v. Ogan*, 701 N.E.2d 331, 335 (Mass. 1998); RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

to the mortgage being paid; and (2) whether the intervening judgment holder would be prejudiced by allowing the subrogation.<sup>77</sup>

This approach, most recently advocated by the American Law Institute, has also been employed in a relatively small number of cases in Iowa,<sup>78</sup> Massachusetts,<sup>79</sup> New Jersey,<sup>80</sup> and Texas.<sup>81</sup>

#### IV. INSTANT DECISION

In *Metmor Financial, Inc. v. Landoll Corp.*,<sup>82</sup> the Missouri Court of Appeals for the Western District of Missouri recognized that Metmor had successfully shown that Landoll would be no worse off than it would have been had Metmor never paid off the existing mortgage,<sup>83</sup> and that Metmor had intended to obtain first lien status. Still though, the court held that because Metmor was provided with constructive notice of Landoll's previously recorded judgment, and because Landoll was completely innocent of any complicity or fraud, Metmor could not successfully bring an equitable subrogation claim.<sup>84</sup>

The court first examined the propriety of allowing Metmor an equitable subrogation claim when Landoll's intervening judgment lien was properly recorded.<sup>85</sup> The court cited *Bunn v. Lindsay*,<sup>86</sup> where the court refused to allow an equitable subrogation claim when an intervening judgment was recorded in the public records and the debtor failed to search the public records and locate

77. See RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

78. *Klotz v. Klotz*, 440 N.W.2d 406, 409-10 (Iowa Ct. App. 1989) (justifying such an approach because it gives an incentive to parties to advance sums of money in order to help a property owner avoid forfeiture).

79. *East Boston Sav.*, 701 N.E.2d at 335. In *East Boston Savings*, the court stated: We are persuaded by the reasoning of the courts that not only allow subrogation where the subrogee has actual or constructive knowledge of the intervening mortgage, but also look to equity to decide if subrogation is inappropriate . . . Knowledge is not necessarily fatal to the grantee's claim of subrogation, if equity would nonetheless dictate the recognition of subrogation.

*Id.*

80. *Trus Joist Corp. v. National Union Fire Ins. Co.*, 462 A.2d 603, 608 (N.J. Super. Ct. App. Div. 1983), *rev'd sub nom. Trus Joint Corp. v. Treetop Assocs., Inc.*, 477 A.2d 817 (N.J. 1989).

81. *Providence Inst. for Sav. v. Sims*, 441 S.W.2d 516, 520 (Tex. 1969) ("We hold that under these circumstances neither actual nor constructive notice knowledge of the intervening lien will defeat the right of subrogation . . .").

82. 976 S.W.2d 454 (Mo. Ct. App. 1998).

83. Metmor could not bring a successful equitable subrogation claim. *Id.* at 461-62.

84. *Id.*

85. *Id.* at 461.

86. 7 S.W. 473 (Mo. 1888).

the judgment. The court also referenced *Landmark Bank v. Ciaravino*,<sup>87</sup> where the court held that equitable subrogation was not available when a title company failed to locate existing intervening liens when conducting its title search.<sup>88</sup> Finally, the court cited Missouri's recording statute,<sup>89</sup> stating that, in Missouri, lenders are charged with constructive notice of properly recorded judgments despite the lender's failure to locate such judgments.<sup>90</sup> The court concluded that *Metmor* should be charged with constructive notice of the *Landoll* judgment, and therefore, equitable subrogation was unavailable.<sup>91</sup> To hold otherwise, the court noted, "would place in jeopardy the whole system [of] prioritizing liens in Missouri."<sup>92</sup>

Recognizing the potential for exceptions, the *Metmor* court mentioned *State Savings Trust Co. v. Spencer*,<sup>93</sup> where the court held that equitable subrogation was appropriate, notwithstanding constructive notice, when a borrower obtains money from a lender through the use of a forged instrument, provided that the superior lienholders were no worse off than they were before the subsequent lender advanced his money to retire the senior loan.<sup>94</sup> The *Metmor* court, however, quickly distinguished its facts by noting that *Landoll* was "totally innocent of any complicity in *Metmor*'s loan to the Johnsons."<sup>95</sup> Therefore, because not a single Missouri case existed that allowed a lender to advance ahead of a recorded lienholder in the absence of complicity by the superior lienholder in obtaining the loan,<sup>96</sup> the *Metmor* court refused to allow *Metmor* to so advance.

The court next examined the propriety of allowing *Metmor* equitable subrogation merely upon a showing that *Landoll* would be no worse off if subrogation were granted than it would have been had *Metmor* never paid off the

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87. 752 S.W.2d 923 (Mo. Ct. App. 1988).

88. *Id.* at 924-25.

89. MO. REV. STAT. § 442.390 (1994).

90. *Metmor Fin., Inc. v. London Corp.*, 976 S.W.2d 454, 462 (Mo. Ct. App. 1998).

91. *Id.*

92. *Id.*

93. 201 S.W. 967 (Mo. Ct. App. 1918).

94. *Id.* at 971.

95. *Metmor Fin., Inc. v. London Corp.*, 976 S.W.2d 454, 462 (Mo. Ct. App. 1998).

96. *Id.* at 460-62. The *Metmor* court's assertion that the existent complicity or fraud must be by the superior lienholder is questionable. Both the *Metmor* and *Landmark* courts base their position on the principal case, *State Savings Trust v. Spencer*, 201 S.W. 967 (Mo. Ct. App. 1918). However, in *Spencer*, it was the borrower who acted fraudulently, not the superior lienholder. *Id.* Because the *Spencer* court allowed the equitable subrogation claim, the *Metmor* and *Landmark* courts have arguably misconstrued the exception to include only cases where the fraudulent actor is the superior lienholder. Clearly such a position cannot be logically taken from a fair reading of the *Spencer* case.

Sterling loan obligation.<sup>97</sup> The court again relied on *Landmark v. Ciaravino*,<sup>98</sup> reasoning that “more is required to support an equitable subrogation [claim] than that the superior liens are no worse off than they were before the subsequent lender advanced his money to retire the senior loan.”<sup>99</sup> Hence, the court determined that *Metmor* failed to establish sufficient facts to warrant application of equitable subrogation.<sup>100</sup>

## V. COMMENT

Concededly, the court’s decision in *Metmor* fits well within the confines of existing Missouri case law. The *Metmor* court’s decision literally shadows the century-old *Bunn v. Lindsay*<sup>101</sup> decision, which held that constructive notice alone is enough to defeat a claim for equitable subrogation.

The court properly emphasized the importance of respecting Missouri’s recording statute. Further, the court suggested that to allow equitable subrogation in the face of such a statute “would place in jeopardy the whole system of prioritizing liens in Missouri.”<sup>102</sup> Perhaps though, the court overstates its position. That is, equitable subrogation does not undermine a state’s recording system (as suggested by the *Metmor* court).<sup>103</sup> Instead, equitable subrogation reinforces the importance of a recording system by not allowing equitable subrogation claims against intervening lienholders who rely to their detriment on the soundness of their recorded judgments.<sup>104</sup>

Despite this, the *Metmor* court asserts that both constructive and actual notice by the lender should effectively bar equitable subrogation claims.<sup>105</sup> The premise behind this position is that lenders take a high level of responsibility for their actions. As one scholar suggested, “Banks ought to look after their own financial dealings very carefully, and [therefore] we should [be able] to assume that any actions they take reflect judgments that have [been] made based upon

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97. *Metmor*, 976 S.W.2d at 460-62.

98. 752 S.W.2d 923 (Mo. Ct. App. 1988).

99. *Metmor*, 976 S.W.2d at 462.

100. *Metmor Fin., Inc. v. London Corp.*, 976 S.W.2d 454, 462 (Mo. Ct. App. 1998).

101. 7 S.W. 473 (Mo. 1888).

102. *Metmor*, 976 S.W.2d at 462.

103. *East Boston Sav. Bank v. Ogan*, 701 N.E.2d 331, 336 (Mass. 1998).

104. *Id.*

105. *Metmor Fin., Inc. v. London Corp.*, 976 S.W.2d 454, 462 (Mo. Ct. App. 1998).

the record."<sup>106</sup> Thus, lenders should not later be able to come into court and claim ignorance of readily discoverable facts.<sup>107</sup>

The *Metmor* court, however, appears to have completely disregarded the competing policies involved in making its determination. For example, the court failed to consider that such a rule confers a huge windfall to the intervening judgment holder at the expense of the lender's completely justifiable expectations. The intervening judgment holder, when recording its lien subject to an existing lien, could not have reasonably expected to suddenly gain first priority status due to an early payoff of the first lien. Quite the contrary, the intervening judgment holder knowingly accepts the inherent risks involved in a second priority status security.<sup>108</sup> Alternatively, the lender who actually does provide the funds to pay off the first lien certainly has a justifiable expectation that it will step into the shoes of the first lienholder.

Additionally, the *Metmor* court (and likewise, the Missouri approach) fails to consider a strong public policy argument against disqualifying lenders from equitable subrogation claims based on constructive *or* actual notice. Because in nearly all modern transactions involving payment by a lender of a prior debt the paying lender will obtain title insurance, "quibbles over the lender's degree of negligence or notice really come down to a decision whether to cast the loss on the title insurance underwriter."<sup>109</sup> While title companies certainly should bear losses that *directly* result from their negligent searches, "it is hard to see why they should be compelled to pay merely to promote the priority of an intervening lienor who has suffered no loss and who has no reason to expect or claim such a promotion."<sup>110</sup> Such a rule has "the long-run effect of raising title insurance costs [at the expense of the general public] in order to give windfalls to a few lienholders."<sup>111</sup> The general public should not be forced to pay for such unjustified windfalls indirectly through higher title insurance costs.

While a majority of courts today agree that constructive notice should not bar an equitable subrogation claim, most of these very same courts still bar such claims in the face of actual notice.<sup>112</sup> These courts first suggest that the existence of a lender's actual notice of an intervening lienholder allows the inference that the lender did not actually *expect* or *intend* to get priority of security as against

106. Patrick Randolph, *Mortgages: Bank Loses Equitable Subrogation Request - Man Bites Dog* (visited Feb. 9, 1996) <<http://cctr.umkc.edu/dept/dirt/dd98/dd042298.htm>>.

107. *Id.*

108. *East Boston Sav. Bank v. Ogan*, 701 N.E.2d 331, 335 (Mass. 1998). These risks include both renewals and extensions of time for payment on the original mortgage. *Id.* These actions are not considered prejudicial to the intervening judgment holder because they do not require the lienholder's approval. *Id.*

109. NELSON & WHITMAN, *supra* note 2, § 10.6, at 15.

110. NELSON & WHITMAN, *supra* note 2, § 10.6, at 15.

111. NELSON & WHITMAN, *supra* note 2, § 10.6, at 15.

112. *See supra* notes 74-81 and accompanying text.

the intervening lienholder.<sup>113</sup> However, such an inference is entirely unnecessary under the *Restatement* approach. Instead, under the *Restatement*, the lender itself must prove that it indeed did intend to get priority. This approach makes more sense because instead of binding a lender by arbitrary inferences made about its intentions, the *Restatement* provides a lender with the opportunity to come forth with real evidence to illustrate its actual intentions.

The second major rationale behind the majority approach appears to be that if indeed the lender had actual notice of the intervening lienholder, and intended to gain first priority status, then the lender should have taken the appropriate steps to effectuate its intentions. However, such a rationale incorrectly assumes that every lender has a complete and sophisticated understanding of the intricacies of mortgage law. Quite simply, the average lender is probably *not* aware of the limited technical devices<sup>114</sup> that may be used to properly subrogate itself to the priority of an original lienholder. It seems unjust to penalize those lending institutions that do not have sophisticated real estate attorneys who are aware of such devices. Penalizing these lending institutions in effect places the sophisticated lender's intentions at a higher status than those of the unsophisticated lender.

The best approach, that taken by the *Restatement*,<sup>115</sup> is that where the junior lienor is not prejudiced by allowing equitable subrogation,<sup>116</sup> and where the lender intended to take first-lien status, the subrogation claim should be allowed. The lender has "superior equities" to those of the junior lienor, who will lose nothing as a result of subrogation.<sup>117</sup>

The *Restatement* approach can be analogized to ordinary tort law. For example, in a simple negligence claim, a negligent tortfeasor cannot be compelled to pay damages unless she causes harm to someone. The mere fact that a tortfeasor is negligent does not, by itself, give rise to a negligence cause of action. Conventional wisdom suggests such a cause of action would provide an unjustified windfall to the plaintiff.

113. See *Rusher v. Bunker*, 782 P.2d 170, 172 (Or. Ct. App. 1988).

114. See Dale Whitman, *Equitable Subrogation for "Non-Innocent" Lenders*, (visited Feb. 9, 1996) <<http://cctr.umkc.edu/dept/dirt/dd98/dd050798.htm>>. For example, the lender can enter into an *express* agreement with the original lender that it will gain the priority of the mortgage it is paying. The intervening lienor need not be involved in the agreement at all. If such an agreement is in writing, then provided that the intervening lienor is not prejudiced, most courts will enforce it under "conventional subrogation" theory. Alternatively, the lender can insist that the initial lender give it an assignment of the initial mortgage, instead of releasing the mortgage. That assignment can subsequently be recorded, thus making it clear on the records that the refinancing lender has the original lender's priority.

115. RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.6 cmt. e (1996).

116. That is, no prejudice is present where the junior lienor occupies the same position as before the prior lien was paid and discharged.

117. See Theodore R. Vogt, Note, *Mortgages — Subrogation of One Whose Loan is Used to Pay a Senior Mortgage*, 36 MICH. L. REV. 151, 153-54 (1937).  
<https://scholarship.law.missouri.edu/mlr/vol64/iss2/7>

The same arguably should hold true in mortgage law. A lender's negligence in failing to locate a recorded intervening judgment should not automatically disqualify the lender from an equitable subrogation claim. Rather, the law should require an intervening judgment holder to show that it was somehow "harmed" or "prejudiced" by the lender's negligence. Only then should a lender be disqualified from an equitable subrogation claim.

In short, the *Restatement* approach appears to best implement the principles involved in equitable subrogation. Its approach provides a result that best coincides with both the lender's and the intervening lienholder's expectations. Additionally, this approach eliminates unjustified windfalls by allowing a lender to advance in priority if no intervening lienholder would otherwise be prejudiced. The absence of such windfalls, at the expense of title companies, ultimately results in more affordable title insurance fees for the general public.

## VI. CONCLUSION

While no one can seriously doubt that the decision in *Metmor* falls within the boundaries of Missouri's equitable subrogation case law, that alone should not insulate the decision from criticism. The current approach in Missouri, as employed by the *Metmor* court, is that constructive notice (as well as actual notice) should disqualify a lender from an equitable subrogation claim. Nearly all courts in the nation today have realized the *inequities* involved in such a result. In Missouri, however, lenders and title companies must continue to ask, "What happened to the *equity* in equitable subrogation?"

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