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Voided Reverse Mortgage Grants Windfall To Disabled Borrower.

By: Thomas C. Valkenet

Lien priority disputes in Maryland courts are often resolved with the almost automatic application of equitable subrogation- where a lender pays off prior liens but fails to record a new lien it will be granted the prior lien status. This operates to defeat intervening liens, including federal tax liens, other mortgage liens and judgment liens. It is predicated on fairness. The property owner is encumbered by no greater lien than he had before, and the intervening lien holders do not receive a windfall because of another's mistake.

Our appellate courts have said that negligence on the part of the lender or settlement company in conducting a title search will not bar application of equitable subrogation. Some lawyers in our office joke that the bar is low enough that settlement companies could send a blind pig to conduct a title search and the lender would still prevail over intervening liens by the application of equitable subrogation.

And so the September 30, 2015 Nutter v. Black opinion by the Maryland Court of Special Appeals arrived on my desk like a cup of black triple espresso- I was wide awake even at page thirty-five, where the court slaughtered the blind pig. Where I fully expected equitable subrogation to save the lender, the appellate court declared "no." Most surprising was that the lender in this decision paid off a prior mortgage lien, gave the borrower cash, promptly recorded its own lien and then lost it all.

James B. Nutter & Co. gave Mrs. Black a reverse mortgage. But whomever searched title failed to pick up that Mrs. Black was the subject of a guardianship dating from 1989. Not only did the title search miss the guardianship in the court dockets, but it missed reference to the guardianship in a deed and deed of trust granted by Mrs. Black's guardian to the prior lender.

Mrs. Black's court appointed guardian found out about the reverse mortgage by accident- he received notice from Bank of America of the payoff. The guardian then discovered the reverse mortgage, and found further that over $57,000 in cash had been deposited in Mrs. Black's personal accounts.

The resulting circuit court conflict between the reverse mortgage lender and Mrs. Black's guardian centered on Mrs. Black's capacity to make a mortgage. The lender took the position that Mrs. Black may have been incompetent but that it was the guardian's duty to promptly ratify or avoid the deal. The lender argued that the guardian waited over a year, to the great prejudice of the lender. After all, the prior mortgage was paid, its lien was released, and Mrs. Black received a lot of cash.

The guardian held firm that because Mrs. Black had been adjudicated disabled she thus had no ability to make any agreements with the lender. He refused to ratify the reverse mortgage or to even return money paid by the reverse mortgage lender to payoff the Bank of America lien. And he demanded that the lien be declared void.

As a back up legal position the lender requested application of equitable subrogation. This would have given the lender the same lien position held by the bank paid off by the reverse mortgage. And it would have left Mrs. Black in no worse position- she had a mortgage before, and she would have a mortgage after.

The trial court and the appellate court began their analysis at the same legal point. Both started with an examination of Mrs. Black's status as a legally disabled person. Surprisingly, Maryland has very little precedent discussing whether contracts with incompetent persons are "void" (like it never happened) or "voidable" at the election of the disabled person or the guardian. In fact, we have to search back to 1926 to find another similar case. But once this appellate panel answered the question, the remaining issues fell against the lender.

This opinion makes clear that once a disabled person is adjudicated incompetent, and awarded a guardian of person and property, then a contract to make a loan in exchange for a mortgage lien is void. It is a non-event. The documents have absolutely no legal value, and the lender who mistakenly contracted for the loan has nothing to enforce against the borrower or the property.

The position follows a simple declaration contained within the Maryland Estates & Trusts Code that upon adjudication all property of the disabled person vests in the guardian. And so, in this case Mrs. Black was deemed not to have any property rights at the time she contracted for the loan. Having no property rights, she was without any ability to pledge the real property as security for the reverse mortgage.

At this point within the appellate court's analysis a title lawyer would reasonably expect application of equitable subrogation to salvage a partial victory for the lender- the court should have awarded a partial lien for the money loaned at least to the extent of the prior payoff. The apparent negligence exhibited by the lender in not finding guardianship records, or even the signatures of the guardian on the prior lien documents, should not have barred application of equitable subrogation.

So were my expectations as I turned to page 23 of the opinion, where I fully expected the warm blanket of equitable subrogation to safely swaddle the lender.

But this appellate panel determined the lender had no rights to receive anything in exchange for paying off the prior Bank of America loan. Quoting prior cases, the panel explained that:
It is undisputed that once properly yoked with the label of "mere volunteer" or "officious payor," a plaintiff is prohibited from recovering under theories of unjust enrichment or subrogation. It is less clear, however, precisely when a plaintiff's payment to a third party satisfying the liability of the defendant renders a plaintiff a volunteer and casts him or her "into legal outer darkness."

Once again, it was Mrs. Black's status as a legally adjudicated disabled person that drove the court to cast the lender "into legal outer darkness." Having no property rights, herself, Mrs. Black was not obligated to any lender. Only her guardian had any rights to contract, and thus only he had legal obligations relating to Mrs. Black's property.

The lender argued for application of equitable subrogation, saying that it had committed a reasonable mistake, even though the court records and title documents identified the guardianship. To this the panel said:
Because a disabled person lacks the capacity to enter into contracts and cannot encumber property...no mortgage lender exercising even an iota of diligence and prudence would extend a loan to an adjudicated disabled person.

And there it is- the three judge panel drop their microphones and exit, stage right, leaving the lender with no loan, no lien, and no cash.

There is expectation that this case will go to the Maryland Court of Appeals on a petition for writ of certiorari (a permissive appeal to the highest appellate court on matters of public policy), and there is additional

expectation in this office that the case will be reversed and remanded at least on the equitable subrogation issue.

Several Maryland appellate decisions have recited that the neglect of a lender will not prevent equitable subrogation from saving at least a partial lien to the extent of the payoff to the prior lender. And within the last year a federal appellate court interpreting Maryland law correctly noted that equitable subrogation operates automatically, as a matter of law, at the very moment of payment. The lack of diligence or prudence of the lender is not the determining factor.

We will be keeping one eye open for further developments in this case. And if it remains the law of the land, we expect ongoing efforts by intervening lien holders to chip away at the automatic application of equitable subrogation by urging courts to more closely examine the relative lack of diligence or prudence of the lender.

Mr. Valkenet is a 29 year veteran of Maryland and the District of Columbia trial and appellate courts, where he focuses on title insurance and related property and construction claims. Representative clients include First American Title Insurance Company, Investor's Title Insurance Company, North American Title Insurance Company, Old Republic Title Insurance Company, Title Resources Guaranty Company. He can be reached at tcv@youngandvalkenet.com .