Superior Court of Connecticut, Judicial District of Windham.

Eastern Savings Bank v. John W. Chiavarini, Sr. et al.

CV156009439

Decided: May 9, 2016

MEMORANDUM OF DECISION ON MOTION TO DETERMINE PRIORITIES

Before the court in this foreclosure action is a pendente lite motion for determination of priorities. Plaintiff, Eastern Savings Bank ("Eastern"), holds a mortgage that John Chiavarini, Sr., and Dixie Chiavarini issued to it in 2006, and which was recorded in the Sterling land records on February 15 of that year. Defendant Jewett City Savings Bank ("JCSB"), holds a mortgage upon the same property which the Chiavarinis issued in 2007, and which was recorded on September 5 of that year. JCSB's answer to the complaint denies the priority of the 2006 instrument over its 2007 mortgage. Eastern responded by filing the instant motion, on which the court has conducted a full evidentiary hearing with both banks actively participating. JCSB invokes the doctrine of equitable subrogation in support of its position. Although Eastern is the moving party, JCSB concedes that it has the burden of proof on this issue. Both banks submitted prehearing memoranda of law, as well as post-hearing memoranda requested by the court.

"In mortgage law, '[a] fundamental principle is that a mortgage that is recorded first is entitled to priority over subsequently recorded mortgages provided that every grantee has a reasonable time to get his deed recorded.' This principle is referred to as the first in time, first in right rule"; AJJ Enterprises, LLP v. Herns Jean–Charles, 160 Conn.App. 375, 395 (2015) (Citations omitted). The court continues:

[t]he doctrine of equitable subrogation provides an exception to [that] rule . Subrogation is a doctrine which equity borrowed from the civil law and administers so as to secure justice without regard to form or mere technicality . It is broad enough to include every instance in which one party pays a debt for which another is primarily answerable, and which, in equity and good conscience, should have been discharged by the latter. It is a legal fiction through which one who, not as a volunteer or in his own wrong and where there are no outstanding and superior equities, pays the debt of another, is substituted to all the rights and remedies of the other, and the debt is treated in equity as still existing for his benefit.

In numerous cases it has been held that one who advances money to discharge a prior lien on real or personal property and takes a new mortgage as security is entitled to be subrogated to the rights under the prior lien against the holder of an intervening lien of which he was ignorant . The intention of the parties to the transaction is the controlling consideration . Ultimately, as our Supreme Court has noted, "[t]he object of [legal or equitable] subrogation is the prevention of injustice."

160 Conn.App. 375, 395–6 (Citations omitted; internal quotation marks omitted.) "The determination of what equity requires in a particular case, the balancing of the equities, is a matter for the discretion of the trial court;" Independence One Mortgage Corp. v. Katsaros, 43 Conn.App. 71, 76 (1996). In the exercise of that discretion, "because a mortgage foreclosure is an equitable proceeding, the trial court may consider all relevant circumstances to ensure that complete justice is done;" id., at 75. Earlier, the Supreme Court indicated in Home Owners' Loan Corp. v. Sears, Roebuck & Co., 123 Conn. 232, 242 (1937), that an equitable result "depends to a large extent upon the circumstances of the particular case."

AJJ Investments ' summary of prior case law defining equitable subrogation outlines essentially a two-pronged test: 1) did the new party "pay a debt for which another is primarily answerable . not as a volunteer or in his own wrong?" and 2) if so, did that event, "in equity and good conscience" create a duty on the part of its adversary to release its earlier encumbrance?

As far as is pertinent to this action, the Chiavarinis' involvement with either of the two banks began in 2005 when Eastern loaned them the funds they used to purchase their Sterling home. The mortgage they gave then to secure those funds is the primary subject of the foreclosure complaint and there is no issue as to its priority. The present controversy evolved in four steps beginning in February of 2006. The parties don't so much contest what actually happened, and so arriving at an affirmative answer to the first of the two questions posed is not difficult. As to the second, the antagonists are sharply divided.

The first of those steps occurred on February 9, 2006, when Eastern closed with the Chiavarinis on a $50,000 home equity line of credit ("HELOC") loan. In the course of that proceeding, they tendered to Eastern their "Open End Mortgage" which was duly recorded, as indicated, on February 15. Eastern assigned the loan account number * * * * * *4074. This loan allowed the borrowers over a defined "draw period" to issue checks against that account, up to the full amount secured. The Chiavarinis immediately drew down the full $50,000 authorized, and over the ensuing seventeen months made payments each month of interest only, as allowed.

Step two occurred on July 2, 2007, when the Chiavarinis exercised a "conversion option" made available to them as part of the HELOC transaction. By their exercise of this option, they obligated themselves to make monthly payments of both principal and interest, with interest at a fixed rate, rather than, as under the HELOC terms, varying with market conditions. The monthly payments were calculated in an amount aimed at amortizing the debt fully over 180 months. Eastern assigned a new account number to this file—* * * * * *4827. This and account * * * * * *4074 were then aggregated as components of a so-called "master line" which was assigned number * * * * * *4801. The conversion did not obligate Eastern to release the 2006 mortgage, and it did not do so. The Chiavarinis made the first required payment on this loan on August 5.

Step three had begun a week earlier, when the Chiavarinis applied to JCSB for a new loan. Their application identified Eastern's 2006 loan as one of their liabilities, listing it under the * * * * * *4827 account number, and indicating that "paying off" this "second mortgage" was one of the principal objectives in taking on the new loan. JCSB obtained a credit report, which identified the Eastern account as bearing number * * * * * *167. Throughout the hearing, Eastern continuously highlighted JCSB's failure to note the discrepancy between this and any of the three numbers it had assigned to its Chiavarini accounts. The number on the credit report precisely matches the first six digits of the HELOC (2006) account number, however, and so the discrepancy presented by the remaining digits has little impact upon the equities here.

Communications between the banks and the borrowers over the next several weeks are critical. As a condition of approval of the new loan, JCSB informed the borrowers on August 14 that it would require a second mortgage on their Sterling residence, and that the HELOC loan at Eastern would have to be closed out completely. Via a fax on August 15, Eastern informed JCSB that the "Chiavarini payoff" as of two days hence was $50,281.80, and included a per diem interest figure for payments received thereafter. By a letter addressed directly to the borrowers with a copy attached to its fax to JCSB, Eastern indicated that "we have a general policy of delivering a release for a mortgage only after receipt of the proper payoff funds," and that "all payments must be in the form of a bank check" (subject to exceptions not pertinent hereto). On August 24, JCSB closed the new loan. After the rescission period expired on August 30, JCSB transmitted a bank check in the amount of $50,590.10 (the updated payoff figure) directly to Eastern. Simultaneously, the Chiavarinis delivered a letter to Eastern on JCSB letterhead signed on August 24 containing a "request" that "the above home equity line of credit be terminated." In all of the correspondence described in this paragraph, all parties identified the loan being paid off as bearing account number * * * * * *4827. On September 5, JCSB caused the August 24 mortgage to be recorded, but deferred to the Chiavarinis to obtain and record the release of the Eastern mortgage. Eastern has never provided the release of the 2006 mortgage.

Step four began eight months later. On May 12, 2008, the Chiavarinis returned to Eastern and were able to access new funds amounting to $5000, charged to their HELOC account * * * * * *4074, which had shown a zero balance since August of 2007. Over the course of the next five years, they ran the account

balance up close to the authorized $50,000 limit, all the while making regular payments of interest only, and presumably maintaining a satisfactory payment schedule on the JCSB loan as well. This did not endure. The HELOC loan, at least, went into default in 2014. The borrowers sought the protection of the bankruptcy court. Eastern commenced this foreclosure of its first mortgage, naming itself as the first of the junior encumbrancers by virtue of the 2006 mortgage. JCSB, described in the complaint as the holder of a third mortgage, both denied the validity of the 2006 mortgage, and alleged in its answer that if Eastern has a mortgage, it must be accorded a priority junior to that which JCSB holds. Although this court heard no evidence as to the precise amount of any of the outstanding debts, nor as to the value of the mortgaged premises, the parties represented that if any there is any surplus in value exceeding the first mortgage debt it would not be sufficient to satisfy any creditor beyond that standing in second place. No suggestion has been made that the Chiavarinis proceeded to build up their HELOC account as a result of any fraudulent intent, and apparently the bankruptcy court has discharged them from personal accountability for any unsecured portion of their debts.

On the first prong mentioned above, the court finds that JCSB paid a debt for which the Chiavarinis were primarily answerable, not as a volunteer or in its own wrong.

Proceeding to the equitable issues involved here, it is notable that the fact pattern exhibited here bears only a passing resemblance to those reported in any of the appellate authorities cited by the parties. The Supreme Court cases have generally yielded results sympathetic to lenders invoking equitable subrogation. In the Home Owners' Loan case, the Court upheld a trial court decision allowing a lender priority over a party with an earlier-recorded attachment later turned into a judgment lien, after the lender had released a previous encumbrance but failed to obtain a release of the intervening instrument. In Lomas & Nettleton Company v. Isacs, 101 Conn. 614 (1924), the Court reversed as an abuse of discretion a decision refusing equitable relief to a lender who had advanced new funds in substitution of an earlier mortgage. And in Connecticut National Bank v. Chapman, 153 Conn. 393 (1966), the Court affirmed a trial court ruling recognizing the priority of a later-in-time mortgage, when to disallow that result would result in a windfall to mortgagees whose real interest in the subject property was the same, in light of that reordering of priorities, as it would have been had no new mortgage been issued. That case involved, evidently, a stark mistake in the title search preliminary to issuance of the new mortgage, yet that error was not viewed as preclusive of an equitable subrogation.

On the other hand, a trio of Appellate Court decisions affirmed trial court denials of quests for priority made by refinancing lenders whose title searchers had failed to discover a validly recorded inferior mortgage which became, by virtue of the refinance and release of a previous first mortgage, the new first upon the subject premises. These are Independence One Mortgage Corp. v. Katsaros, 43 Conn.App. 71 (1996), Equicredit Corp. of Connecticut v. Kasper, 122 Conn.App. 94, cert. denied, 298 Conn. 916 (2010), and Deutsche Bank National Trust Co. v. DelMastro, 133 Conn.App. 669, cert. denied, 304 Conn. 917 (2012). All three opinions affirmed trial courts which had exercised their discretion in favor of the party whose encumbrance was missed, in part, at least, because none of those mortgagees had done any wrong or received any payment upon the transaction. But see, Rosenblitt v. Williams, 57 Conn.App. 788, cert. denied, 254 Conn. 906 (2000), in which the court affirmed a trial decision allowing a 1995 lender to be subrogated to the position of a 1990 mortgage holder, after concluding that one of the borrowers had fraudulently pocketed the new lender's mortgage funds which had been intended to pay off that earlier lender.

As Eastern would have it, it acted within its rights in failing to release the 2006 mortgage and in then later extending new money to the Chiavarinis with its mortgage security unimpaired. The court notes that the Eastern mortgage is captioned “Open End Mortgage,” and paragraph 17 of the recorded instrument, titled “Future Advances,” provides that “Bank is agreeing to make future advances . under circumstances and subject to the limitations contained in the Agreement, and such future advances . will be secured by this instrument. Advances under the Agreement may be repaid in whole or in part from time to time . and any amount repaid will . then be available for future advances up to the credit limit. Notwithstanding the fact that the balance of the Account may from time to time be equal to zero, unless and until the Account

is cancelled in accordance with the terms of the Agreement, the Account will remain open for future advances, and this Mortgage will remain in full force and effect as security for all future advances."

To that mortgage is appended a copy of the note the Chiavarinis issued in 2006. The note contains language narrowing the seemingly inextinguishable encumbrance contemplated by paragraph 17, specifically Subsections IV(2) and (8). Subsection (2) provides that ". if you plan to refinance this Account [and] if we receive notice regarding such a . refinance, we will make arrangements to suspend borrowing privileges and have your Account paid off at the . refinance closing. After the . refinance, your right to use the Plan will be cancelled." Subsection (8) provides that if "any or all of you wish to terminate the Account, let us know. Before we will release the Mortgage, you must have paid all amounts owing . " (Capitals in original, passim.)

Eastern justifies its failure to provide the release to the borrowers and JCSB to their utilization of the * * * * * *4827 account number on the payoff check and other correspondence. It denies that its agents had any duty to assume that a payoff of "* * * * * *4827" was intended to be applied to "* * * * * *4074," and blames the current standoff on JCSB's negligence in failing to learn the correct number, and in failing to police the receipt of the release during the months between September of 2007 and May of 2008. Those failures, according to the testimony of JCSB's agents, resulted in part from relying upon the data given it by the borrowers and the credit reporting agency with respect to the account number, and, in part, from its then policy when closing what it called a "quick close loan," of deferring to the borrowers the task of securing the release of any mortgage being paid off by the proceeds of that new loan.

But negligence is not a per se bar to a party's successful invocation of equitable subrogation. As the Court pointed out in Home Owners ' Loan, supra, at 242, the circumstances of the particular case largely direct "[w]hether or not a [party] will be barred of remedy in equity against the effect of a mistake because of his negligence." In Lomas & Nettleton, supra at 620, the Court noted that it had "upheld the power of a court of equity to grant relief from the consequences of an innocent mistake, although the mistake was not unmixed with negligence." The age of those cases does not undercut their authority; the same principle undergirds the appellate court's 2000 decision in Rosenblitt.

If JCSB was casually indifferent to these details, Eastern, likewise, was casually indifferent to its duty in light of the obvious intentions of JCSB and the Chiavarinis with respect to the 2007 transaction. Its witness maintained that when the check and correspondence arrived bearing the number of the conversion loan account, its agents could simply apply the proceeds as directed and ignore the remainder of the letter's contents. Yet when Eastern faxed a "payoff" figure to JCSB on August 14, it must have known that "payoff"—defined in Black's Law Dictionary, 10th. Ed. as "a reckoning or settlement"—signified an intention on the borrowers' part to conclude the HELOC arrangement. When Eastern received and negotiated payment in full in the form of a JCSB bank check within two weeks accompanied by a written directive from its customers "terminating" their account, no reasonable conclusion could have been reached other than that the Chiavarinis had refinanced their second mortgage. Under subsection IV(2) of the note the borrowers had signed, Eastern was obliged to release its mortgage when it recognized that a refinancing had taken place. Furthermore, its letter transmitted to JCSB stating its policy that delivery of a release would be withheld until a bank check was received must be separately deemed to imply that when such a check was received, the release would in fact be forthcoming. Eastern's argument that the proceeds were rightfully applied to account "* * * * * *4827" instead of "* * * * * *4074" is disingenuous in light of the context in which the payment occurred.

Additionally, it is a long-recognized aspect of the doctrine of equitable subrogation that the result ordered by a court must effectuate the intention of the parties to the transaction. Eastern argues that it made no bargain with JCSB, and so whatever intention that bank had in dealing with the Chiavarinis is immaterial. Its transmission of the payoff letter and acceptance of the payoff proceeds, albeit a limited transaction, reflects an intention between the two banks that upon payment of the borrowers' loan by the latter it would be entitled to a release of the mortgage of the former. But even if those communications had not taken place, "[t]here is no more reason to deny that the person claiming subrogation should have the benefit of

the securities because there is not an agreement to that effect than there would be in the absence of some agreement for equity to refuse to enforce a constructive trust or to deny the right of the assignee of a debt to have the benefit of the security given for it;" Home Owners' Loan, supra, at 239.

Eastern also maintains that the Chiavarini letter of August 24 is meaningless as a directive to close the HELOC account, since it did not purport to close account number "* * * * * *4074." That letter succinctly expressed their desire that their "home equity line of credit be terminated" (emphasis added), thus making express what the other correspondence and payment necessarily imply. That letter triggered Subsection IV(8)'s provision allowing a borrower to terminate the HELOC account, as nothing was left owing on the HELOC loan and the Chiavarinis had therefore satisfied all of Eastern's conditions for that termination. If Eastern had any honest doubt as to its borrowers' intentions, it owed them and JCSB a duty to inquire about the discrepancies it now relies upon—discrepancies, incidentally, which arose solely due to its decision to assign the converted loan a new account number in the interests of its administrative convenience. Under these circumstances, the preparation and delivery of a release was a ministerial duty which Eastern did not have the discretion to refuse.

In determining the equities here, the trial court decision in Interstate Advisor, LLC v. McCalla, Superior Court, judicial district of Hartford, HHD CV10 6014396 (November 1, 2012; Vacchelli, J.), presents this court with the closest analogue to the matter before it. That court reversed priorities of an unreleased mortgage first in time in the land records (coincidentally issued in 2006, and coincidentally a home equity loan), and two subsequently recorded mortgages (coincidentally issued in 2007). The court found that the 2006 mortgage secured a note which allowed, as does Eastern's mortgage, the drawdown of funds over an extended period of time. When the 2007 mortgages were issued and a part of their proceeds used to pay the equity loan down to zero, the new lender expected that it would be in first position (and second, as the loan structure included two separate but simultaneous loans). The McCallas, however, in contrast to the Chiavarinis, asked the equity lender not to cancel their line of credit, and so it did not do so. Like the Chiavarinis, however, those borrowers in time went back to the home equity lender and drew down new funds, thereafter defaulting and ultimately achieving a discharge in bankruptcy. Holding that the 2006 lender had reneged on the agreement to provide a release in consideration of its receipt of the mortgage payoff, the court permitted the 2007 lender to move into first place in spite of the sequence of recording of the various mortgages, because, heeding Home Owners' Loan, it recognized that "[e]quitable subrogation . is broad enough to include every instance in which one party pays a debt for which another is primarily answerable, and which, in equity and good conscience, should have been discharged by the latter."

The fact that the McCallas' inducement to the home equity lender to keep its loan account open was apparently instantaneous, whereas the Chiavarinis directed to the contrary and did not reverse themselves for eight months, is a distinction of no benefit to Eastern. Throughout that entire period, the only reason the home equity account was not terminated, notwithstanding the Chiavarinis' clear directions to that effect, was Eastern's decision to ignore their communication because it bore the so-called wrong account number. Thus, Eastern possessed but squandered the opportunity to avoid the eventual disbursements to the Chiavarinis that created the present dispute.

In light of the foregoing, this court concludes that JCSB has succeeded in proving that equity and good conscience warrant its mortgage being accorded second place in priority, immediately following Eastern's 2005 purchase money mortgage. Upon the motion for determination of priorities, it is, therefore ORDERED that the 2007 mortgage held by JCSB shall have priority over the 2006 mortgage held by plaintiff.

By the court

Boland, J.

Boland, John D., S.J.