Is Equitable Subrogat Lenders and Insurers

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Overview

This article discusses the recent abandonment of the equitable subrogation doctrine as a remedy in Missouri for lenders and how this withdrawal also affects the remedy's availability to insurers. The article also maps the definitive features of the remedy by synthesizing notable cases that alternately developed and then nearly destroyed the doctrine in Missouri. These cases also project how future courts may rule on future equitable subrogation cases in Missouri.

Introduction

A recent unsuccessful attempt by an insurance company to use the equitable subrogation doctrine in Missouri punctuated a recent, dramatic decline of the doctrine. The 2009 case of *St. Paul Surplus Lines Insurance Company v. Remley*[2] demonstrated how far out of favor equitable subrogation has fallen in relation to its treatment by Missouri courts as early as 50 years ago. The doctrine degenerated over the last half century, though, and, in June 2007, the Supreme Court of Missouri deemed it a "drastic" and "harsh" remedy.[3] Since 1841,[4] Missouri courts' attitudes towards the doctrine have shifted dramatically, and a plot of the courts' equitable subrogation decisions shows a distinct birth, growth and death life cycle. Remarkably, the doctrine's fall from grace as a lender's remedy has been so precipitous as to jeopardize the availability of the remedy for insurers as well.

The Meaning of Equitable Subrogation

In short, lender's equitable subrogation is a tool by which real property lenders, or lienors, may replace the prior, senior lien position of an earlier in time lender by paying off that prior lender's loan.[5] This result could soften the blow dealt by Missouri's notice-based recording statutes or the impropriety of deceitful borrowers or other lenders.[6] A lender could seek equitable subrogation in many different circumstances, but always due to one of two possible scenarios: either the new lender was mistaken as to the intended collateral's title;[7] or the new lender was tricked into thinking it would hold a first priority lien.[8]

Likewise, Missouri courts, in determining whether to apply the doctrine, historically chose one of two policy perspectives: either that the new lender should have known better as to previous lienors' interests and thus equitable subrogation is denied; or that the new lender gave value with an expectation and inherits the same position as the prior, satisfied lender, so long as no junior lender suffers. Missouri's current approach,[9] though, adopts the former position to limit the remedy to only those instances where a lender or insurer falls prey to egregious fraud.[10]

Insurers, too, once relied on the doctrine for relief when an insured compromised or destroyed the insurer's right to recover a policy loss from a tortfeasor.[11]

ion Dead for in Missouri?

[T]he broad doctrine, *as a doctrine of equity*, that so far as an innocent purchaser for a valuable consideration without notice of any infirmity . . . has . . . added to the permanent value of the estate, he is entitled to a full remuneration. . . This is the clear result of the Roman law; and it has the most persuasive equity, and, I may add, common sense and common justice, for its foundation.[24]

The standard definition or understanding of subrogation (often found in lender/borrower or insurer/insured relationships) arises when one party pays an obligation or incurs debt that should be borne by another. It is, then, a principle of equity that an insurer, upon payment of the loss, acquires the legal right to be subrogated *pro tanto* "to the assured's right of action against the person responsible for the loss."[12] The conventional legal wisdom was that the payor could recover from the beneficiary of the satisfied debt as a matter of equity. This logic was often reduced to contractual terms and thus became what could be described as "conventional" or "legal" subrogation. Historically, when no such contract right existed, but the circumstances were such as to warrant subrogation, courts would use "equitable" subrogation in lieu of a contractual subrogation right.[13]

Development of the Remedy for Lenders

The First 100 Years: From Reluctance to Acceptance

Missouri's early 19th century cases[14] looked critically at the new lender's motivation to pay another's debt, despite early legal scholars' advocacy for the broad use of equitable subrogation in a great variety of circumstances.[15] These cases sought to limit equity's ability to compromise prior creditors' *legal* rights.

Vallé's Heirs – Missouri's First Equitable Subrogation Case

In Missouri's first reported case of equitable subrogation, *Vallé's Heirs v. Fleming's Heirs*,[16] the Supreme Court of Missouri looked abroad for guidance on the novel remedy. In *Vallé's Heirs,* a decedent's heirs wished to reclaim property sold at a statutorily botched estate sale – despite the fact that its liens were satisfied by virtue of the sale proceeds.[17] The equitable subrogation doctrine preserved the purchasers' interest from the risk of losing their money and collateral due to a statutory technicality.[18] The Court thought it unjust for the heirs to take clear title to the property but then deny the purchasers' interest simply because of technical non-compliance[19] — thereby creating a windfall. *Vallé's Heirs* referenced Maine's warm introduction of the doctrine to American in *Bright v. Boyd.*[20]

In *Bright v. Boyd,* like *Vallé's Heirs,* an invalid estate sale prompted a purchaser to extend new funds to retire pre-existing liens.[21] Yet in *Bright* the subsequent purchaser sued for a refund after his substantial improvements created equity. Maine's Judge Story first balked at the idea of applying equity to a case where the new purchaser volunteered to pay off existing creditors.[22] But after examining ancient European legal traditions, Judge Story imported the doctrine as "founded in the clearest natural equity."[23] *Vallé's Heirs* echoed Judge Story's opinion:

Discounting the Remedy Absent Wrongdoing and the Volunteerism Bar

After a strong start in Missouri, the Supreme Court of Missouri and lower state courts dealt equitable subrogation a series of setbacks in cases that all involved mishandled estates or judicial sales. In the 1879 case of *Wooldridge v. Scott*,[25] unlike *Vallé's Heirs*, the Court denied the plaintiff estate's equitable subrogation plea because the loan transaction between the senior lender and borrower failed to satisfy the statute of frauds. Thus, the prior loan at issue which the plaintiff retired was unperfected, unattached and immune to subrogation.[26]

The *Wooldridge* Court, as opposed to *Vallé's Heirs*, saw technicality as precluding the equitable remedy, not justifying it. This pensive approach to novel remedy, disfavored those who make legal, technical mistakes and became a recurrent theme in Missouri. *Wooldridge*'s lasting legacy, though, is found in the sentence: "[i]f the vendee had . . . a fraudulent purpose . . . we might be disposed to afford relief."[27] *Wooldridge*'s clairvoyance came to fruition in later Missouri decisions and became the standard for the doctrine's use.

Equitable subrogation's tribulations continued in early 19th century estate cases where Missouri courts limited or restricted the use of equitable subrogation for thematic reasons. One such theme was volunteerism, as espoused in *Norton*

v. Highleyman,[28] where the Court denied a misinformed plaintiff equitable subrogation after trying to purchase property at a postponed estate sale.[29] The Court held that "[a] mere mistake in a matter purely of law does not afford any ground for relief in a court of equity. … In making this payment plaintiff was a mere volunteer."[30]

Norton saw mistakes of fact as operative in determining whether to apply equitable subrogation. The *Norton* Court also established a firm limitation:

> [B]efore a third party, making payment of a debt secured by mortgage, can be subrogated to the rights of the mortgagee, he must show either that he made the payment at the request of the mortgagor, or to protect some interest he had of his own . . .[31]

Norton recognized *Wooldridge*'s limitation that equity will not rectify mistakes of law absent misdeeds, and yet another estate sale case, *Bunn v. Lindsay,*[32] refused to consider mistaken volunteers as candidates for equitable subrogation altogether. The *Bunn* Court denied equitable subrogation to its plaintiff, who paid off a debtor's lien only after a third party recorded a judgment against the debtor.[33] Since the plaintiff had no legal interest in the property, he, like the plaintiff in *Norton*, was "a stranger to any interest in the land up to the time he voluntarily made the payment."[34] A new lender's failure to consult land records in *Oldham v. Wade*[35] also precluded subrogation. Together, these early Supreme Court cases created a precedent which enforced Missouri's recording statutes, but did not prevent unjust enrichment.

Berry v. Stigall – Debtors' Opportunism Triggers Equitable Subrogation

It took another estate sale case, *Berry v. Stigall*,[36] to finally laud the doctrine's ability to thwart unjust enrichment of opportunistic borrowers. *Berry* involved debtors who both consciously allowed a new but technically unauthorized mortgage to satisfy prior liens, but then sought to enjoy their resultant unencumbered property free of an unauthorized mortgage that they later self-servingly rebuked.[37] The Court likened the plaintiffs' situation to that of the heirs in *Vallé's Heirs* and *Boyd,* who sought to void a subsequent purchaser's interest but still retain the benefits thereof. The complicit "approval of [Plaintiffs'] silence" irked the Court,[38] and this complicity tipped the chancery scales in favor of equitable subrogation.

State Savings Expands the Doctrine

State Savings Trust Co. v. Spencer[39] provided an opportunity to examine equitable subrogation in relation to a non-negligent lender who loaned funds to a debtor with a *contractual* expectation of senior priority. In *State Savings Trust*, a lender agreed to satisfy the borrower's three pre-existing loans to succeed to a first lien position.[40] The borrower's forgery of the promised lien subordination prompted litigation, though.

State Savings Trust contained the essential elements that warranted equitable subrogation[41] and pitted seemingly equally innocent parties against each other in a priority dispute created by a fraudulent borrower. The plaintiff sought to preserve a promised expectation, while the prior lienor sought the legal fruit of the superior interests' release.

Unlike previous Missouri cases protecting first-in-time lenders, the creditor in *State Savings Trust* displayed neither negligence nor altruism, but simply fell victim to fraud. *State Savings Trust* found in favor of the *new* lender, though, in part because the junior lienor would enjoy the same collateral position as if no funds had been extended.[42] *State Savings Trust* held that the unaffected "status" of a lienholder, though, would never dispositively "entitle [one]…to be subrogated."[43]

The facts of *State Savings Trust* aligned with the intended purpose of equitable subrogation and helped present the doctrine in a new light, apart from strict Supreme Court holdings,[44] and presented a glowing review of the doctrine, especially when no junior lienors did not suffer.[45] Yet another 1918 Missouri case, *Holland Banking Company v. Spencer,*[46] codified the doctrine's elements and Missouri's highest court validated *State Savings Trust* as a "wholesome"[47] doctrine 37 years later in *Anison v. Rice.*[48] However, one feature of the *State Savings Trust* decision – the borrower's complicit fraud on the part of the borrower – provided a platform for future courts to marginalize the doctrine's applicability.

The year 1918 also saw *Frazier v. Crook*[49] use equitable subrogation to prevent the defendant's windfall when the plaintiff wrongfully inserted a post-execution insurance clause, which, it was held, voided the *instrument*, but did not vitiate the *lien* in equity.[50] In *Frazier*, all parties intended for the plaintiff to hold a first-priority lien, so the lien's preservation harmed no one. So preventing the borrower's unjust enrichment trumped the rules of construction-based technicality.

The 1926 case of *Baker v. Farmers' Bank of Conway*[51] further endorsed *State Savings Trust*'s view of equitable subrogation when lenders have senior-lien intent, but no "culpable and inexcusable neglect."[52] The *Baker* court held that lending funds to satisfy preexisting liens at the borrower's contractual behest is non-voluntary for subrogation purposes and thus protectable.[53]

Anison v. Rice and Validation of the Supreme Court of Missouri

The Supreme Court of Missouri revisited the substantially matured doctrine in *Anison v. Rice*;[54] increased the doctrine's reach, and discounted some of its technicality-based detractors. *Anison* discussed the prototypical subrogation scenario – a lender's expectation of seniority upon a debtor's solicitation – as

well as a potentially fatal reliance on an oral promise.[55]

In *Anison,* two joint tenants asked a new lender to satisfy their foreclosing creditor in exchange for a new note and new deed of trust, ostensibly to replace the to-be-foreclosed first. *Anison*'s plaintiff advanced funds to retire the default loan, but never received his promised collateral interest.

The Supreme Court ruled that equitable subrogation entitled the plaintiff to the secured lien position formerly held by the foreclosing creditor, despite a failure to observe the formalities at which *Wooldridge* balked.[56] *Anison* drew extensively from earlier Missouri cases and national treatises to present a comprehensive and positive review of the merits of equitable subrogation.[57] *Anison*'s extensive analysis, reasoning and historical treatment of the doctrine emphatically established the validity of equitable subrogation in Missouri.

Seceding Appellate Courts and a Fraud-Based Limitation

Three decades after *Anison*, an attempted exploitation of equitable subrogation's capability prompted an appellate court's abandonment of the doctrine. An over-aggressive perversion of the doctrine led the appellate courts to apply equitable subrogation only so as to punish wrongdoing, not to prevent unjust enrichment. These appellate decisions trended away from equitable subrogation until the 2007 landmark case of *Ethridge v. Tierone.*[58]

Sage, Landmark Bank, Metmor, and *Thompson* Vault Wrongdoing Over Unjust Enrichment

Frago v. Sage[59] introduced a renewed distrust of equitable subrogation because the party *seeking* subrogation stood to reap a windfall. In *Frago*, the plaintiffs paid off their own senior debt to avoid foreclosure, but then boldly sought subrogation as to their own junior debt. *Frago*'s plaintiffs sought to appoint themselves, like Napoleon's self-anointment as emperor, as first priority lienors as to their own collateral.

This potential exploitation of the doctrine drew the ire of the court, which even cited insurance-based conventional subrogation standards to limit the doctrine's future application.[60] In *Frago,* "[t]he burden [was] placed upon the party seeking subrogation to substantiate by clear and convincing evidence that . . . the other party, in equity, should endure the loss."[61]

In *Landmark Bank v. Ciaravino,*[62] the Eastern District continued its anti-equitable subrogation crusade and resuscitated the line of cases hostile to equitable subrogation, such as *Bunn*, which limited the doctrine to "only in extreme cases bordering on if not reaching the level of fraud."[63] The *Landmark Bank* decision entirely overlooked the unjust enrichment prevention goals of *State Savings Trust* and *Anison* and regressed to *Bunn*'s harsh reliance on Missouri's recording statutes.

In *Landmark Bank,*[64] the plaintiff sought subrogation as to a discoverable senior lien, but the court opined that the lien's detectability imputed negligence and precluded equity. This sentiment was quickly echoed in *Gateway Centers Building Investors, Ltd.,*[65] where the court held that only Missouri's recording statutes act to protect new lenders. Most importantly, though, *Landmark Bank* conclusively held that fraud – not unjust enrichment – is the true condition precedent to equitable subrogation which applied "only in extreme cases bordering on . . . fraud."[66] Only *Landmark Bank*'s *Anison*-based dissent recognized the doctrine's utility to prevent such egregious unjust enrichment.[67]

The courts' focus on fraud became acute in *Metmor v. Landoll,*[68] where a recorder of deeds did not reflect a prior lienor's interest, but electronic recordation made the instrument *theoretically* discoverable. According to the Western District court, only the "nuances of the Platte County recording system" kept plaintiff from discovering it.[69] Despite the court's concession that the new lender *could not have possibly discovered the senior lien*, it held that, absent fraud, equitable subrogation was unavailable.[70] *Metmor* and *Gateway Center* now subverted *Anison*'s policy that technical mistakes should not yield windfalls at a lender's expense; instead, the courts ironically used technicalities to justify the denial of equitable subrogation.

Thompson v. Chase[71] continued Missouri's purge of equitable subrogation despite the presence of each of the doctrine's requisite elements. In *Thompson*, the plaintiff quitclaimed her marital interest to facilitate her ex-husband's refinancing of their marital property and pay her divorce award. But once the new lender's funds satisfied the lion's share of her judgment, she sought to attach and levy the property to satisfy the remaining balance of her first-in-time judgment. The defendant lender now faced foreclosure and the extinguishment of its interest, and sought subrogation as a defense to the plaintiff's execution. *Thompson*, then, presented a mirrored image of *Frago.*

Even Missouri's anti-equitable subrogation courts could justify the doctrine based on *Thompson*'s facts. A court seeking to prevent windfalls per *Frago* could validate equitable subrogation since the plaintiff would hold property worth twice as much as the balance of her judgment lien. The *Thompson* court, however, read *Frago* to mean that windfalls are discouraged only if the *lender* benefits and embraced the contra-positive, that equitable subrogation should be denied if the remedy would *prevent* the borrower's windfall.

Thompson's other available justification for equitable subrogation involved the plaintiff's complicity per *Landmark Bank*. *Thompson*'s plaintiff also induced the new lender's refinance loan by waiving her interest in the property to allow first lien priority. However, despite the holdings of *State Savings Trust*, *Anison*, *Holland* and *Frasier,* the *Thompson* court found no

indicia of the now-imperative fraud and thus refused to prevent the plaintiff's self -preserved windfall.

The decisions in *Thompson* and *Frago* display an untenable position as to equitable subrogation. The ruling in *Thompson* denied equitable subrogation even though the debtor stood to gain a windfall while the potential windfall to the *creditor*, in the *Frago* court's view, precluded equitable subrogation. These irreconcilable decisions contradict earlier Missouri equitable subrogation cases,[72] which sought to avoid unjust enrichment and instead suggest that the courts will protect borrowers at lenders' expense.

The Supreme Court Completes the Cycle in *Ethridge*

In 2006, the Missouri Court of Appeals-Southern District heard an equitable subrogation case replete with equitable subrogation's hallmark features: technicalities, mistakes and unjust enrichment. In *Ethridge v. Tierone,*[73] a widow sought to void her husband's refinance of their marital property because the deed of trust included only the husband as "borrower" and failed to recite her marital interest.[74]

The lender sought reformation to reflect both parties as the borrowers, since both benefitted from the refinance loan and the attendant satisfaction of the prior deed of trust.[75] Alternatively, the widow's potential windfall supported a claim for equitable subrogation. The Southern District, per *Anison*, ruled that Mrs. Ethridge benefitted from the earlier lien's discharge and equitable subrogation would rightfully prevent a windfall at the lender's expense.

However, the Supreme Court of Missouri, on review of the Southern District's *Ethridge* decision, abandoned its prior holdings in favor of the new equitable subrogation modes created by the Eastern and Western Districts. Favoring *Metmor* and *Thomson*, the Court noted the "extreme" nature of equitable subrogation and brandishing the doctrine to cases involving fraud,[76] holding that Mrs. Ethridge "must" have acted in fraud for equitable subrogation to apply.[77] The Supreme Court of Missouri became an adherent to the appellate courts' revisionist approach to equitable subrogation, and *Ethridge* finalized this new fraud-based paradigm.

Equitable Subrogation for Insurers

Fraud is not a prerequisite for equitable subrogation for the benefit of lenders only, though. In a recent Missouri case where an insurer sought equitable subrogation, the court actually cited to the above lender-specific cases to deny the "drastic remedy."[78] This is despite the broad and supportive treatment that the insurance version of the doctrine received in its early debuts in Missouri courts as "principles of equity."[79]

The treatment of equitable subrogation for insurers in Missouri followed a downward slope similar to its lenders' counterpart, but one which accelerated much more rapidly. To be sure, the acceleration of the doctrine's demise for *insurers* correlated to its disintegration as to *lenders*. The accelerated disintegration seems all the more severe considering how favorably courts treated equitable subrogation in its infancy.

A Bright Beginning for Insurers' Equitable Subrogation

By the early 20th century, Missouri courts treated equitable subrogation as a natural byproduct of the contractually-oriented conventional subrogation. "[C]onventional subrogation" allowed insurers to stand in the shoes of their insured and recover losses paid out on policies which were, in turn, recoverable via actions against third party tortfeasors or other faulty parties.[80] One such case resembled several lender-themed cases where the insured stood to collect on his injuries from *both* his insurer and the responsible party.[81]

The court in *The Home Insurance Company of New York v. Smith*[82] used the doctrine of subrogation as an equitable remedy to prevent the unjust enrichment of the insured at the expense of the insurer. In fact, the perfect equity sought by the court was only that the insurer should be entitled to subrogation as to the amount it paid *pro tanto* on its insured's behalf as to any payments received from the actual harmful actor. The insured in *The Home Insurance Company of New York* unintentionally prevented the insurer's conventional subrogation rights by settling and releasing the responsible party. This potential contractual failure invoked the court's equitable powers and utilized equitable subrogation – even, as the court specifically noted, without the specter of fraud.[83]

Equitable subrogation for insuers, then, arose when, for whatever reason, the contractual subrogation policies failed, but in equity the insurers should stand in the insured's shoes for recompense.[84] In *Knight v. Calvert Fire Insurance Company*, subrogation was implied as a matter of equity when an insurance policy failed to include a subrogation clause altogether.[85] The court deemed the right of subrogation appropriate to protect the insurer as a matter of equity since the insured sought to compromise the insurer's normal subrogation by releasing the tortfeasor.[86]

One familiar reason for invoking the equitable cousin of conventional subrogation involved the insured acting to prejudice the insurer.[87] For instance, if an insured settled his claim with a tortfeasor and thereby released him from liability, the insurer lost its right to proceed against the actual guilty party.[88] Equitable subrogation, then, would entitle the insurer to collect those amounts received by the insured *pro tanto* the amounts paid by the insurer. This is precisely the type of unjust enrichment avoidance that early Missouri courts utilized in dealing with lender-based equitable subrogation claims.

Essentially, the release of a tortfeasor or guilty third party equivocates the mis-

feasance or malfeasance that courts once looked for in evoking equitable subrogation as to lenders.[89] The insurer (or lender) lost its ability to recoup its loss against the true wrongdoer, so it should be permitted to recoup its loss (or collateral) from the insured (or borrower). Thus, equitable subrogation protected when contract provisions failed.

Just as early Missouri courts looked for the presence of unjust enrichment when deciding to award equitable subrogation, insurers could also employ the doctrine when their insured stood to recover from the insurer under a policy *and* the guilty party in tort or settlement.[90] In this situation, courts would direct that recovery should be diverted, in equity, to the proper parties.[91] However, the unjust enrichment policy also quickly devolved to a more severe and limited remedy.

The Need for Fraud Now Applies to All Types of Equitable Subrogation

Another reason courts would use to justify equitable subrogation involved the presence of fraud chargeable to the insured.[92] Any type of collusion or wrongful maneuver by the insured to the detriment of the insurer would call for the employment of equitable subrogation. Over the latter half of the 20th century and culminating only recently, insurers seeking equitable subrogation faced a familiar gauntlet that tightened the standards and limited the scenarios in which the doctrine would be utilized.

First, the court in *Street v. Lincoln National Life Insurance Company*[93] established that, in an insurance context, the doctrine might allow for subrogation as between the insurer and insured, but it would never provide a stand-alone cause of action as to a third party, regardless of the amount of wrongdoing. This case dealt with a life insurance policy, and the court held that the intended beneficiary could not subrogate to the actual payee under the policy's terms. Rather, it was the proponent's duty to show by clear and convincing evidence that equity should be invoked on the subrogee's behalf. This "clear and convincing" standard was, as noted earlier, identified by the court in *Frago* to justify limiting the doctrine's applicability.

Then, in the 1960s, it became abundantly clear that the doctrine would face another severe limitation – Missouri's public policy against the assignment of personal causes of action, including personal injury. *Forsthove v. Hardware Dealers Mutual Fire Insurance Company,*[94] a case quickly supplemented with a pair of uninsured motorist cases,[95] definitively established that insurers simply could not proceed against third party tortfeasors upon any theory simply based on the insurer's payment to the injured party. The lack of privity between the insurer and the tortfeasor provided too great of a public policy obstacle to allow for the insurer to pursue any action in its own right, regardless of the actual payment directly attributable to the third party. Indeed, the Missouri Court of Appeals for the Southern District in *Travelers Indemnity Company v. Chumbley*[96] went so far as to say that the lack of privity, among other issues, prevented the court from allowing an insurer to recover its insured's medical damages via subrogation and thereby "[lift] the lid on a Pandora's Box crammed with both practical and legal problems."[97]

> "Remarkably, the doctrine's fall from grace as a lender's remedy has been so precipitous as to jeopardize the availability of the remedy for insurers as well."

Two recent cases went on to discuss the utility of equitable subrogation in the legal malpractice arena. Drawing upon the conventional wisdom and statutory mandate as to the non-assignability of personal causes of action, *Great American Insurance Co. v. Dover, Dixon Horne, P.L.L.C.*[98] and *St. Paul Surplus Lines Insurance Company v. Remley*[99] held that equitable subrogation will not allow insurers to assert claims against their insured's negligent attorneys. Both cases cited to the recent demise of equitable subrogation as to lenders and the death knell rendered by *Ethridge*. Like the *Ethridge* court, *St. Paul Surplus Lines Insurance* references equitable subrogation as a "drastic" remedy that necessitated a fraudulent act to the detriment of the insurer. Indeed, the district court in *St. Paul Surplus Lines Insurance* cites directly to *Ethridge* and several other of the cases leading up to *Ethridge*'s preclusion of equitable subrogation as to lenders. These lender-oriented cases, then, despite the disparate subject matter and background, directly led to equitable subrogation's seeming demise for insurers as well.

Similar to their lender counterparts, insurers in Missouri are all but denied the availability of the once-powerful remedy of equitable subrogation without a showing of fraud. The current standard for equitable subrogation for insurers parallels that of lenders' standard and stands in stark contrast to early notions that the doctrine was one of the purest equity meant to remedy the enrichment of one due to the acts of another, but to the detriment of the innocent.

Ethridge's Legacy and Other States' Approach

Insurers in Missouri Must Still Overcome *Ethridge*

St. Paul Surplus Lines provides an interesting snapshot into how future courts might approach the issue of equitable subrogation, both within the lending and insuring perspectives. The remedy of equitable subrogation can be an extremely powerful and useful one for those institutions, such as lenders and insurers, that regularly extend funds for the benefit of

others. Given the turbulent nature of the recent economic climate, it would seem that lenders and insurers would become increasingly motivated to seek recompense from a technically "indirect" debtor (*i.e.* not the borrower or insured), but in actuality the most direct liability (a tortfeasor or third party lender). Add to this framework Missouri's recent dubious equitable subrogation decision-making, and the situation seems ripe for institutional payors to seek equitable subrogation's relief through more creative channels. One of these channels may be to utilize other states' equitable subrogation jurisprudence, which, in many cases, is much more hospitable to the doctrine.

Such was the case in *St. Paul Surplus Lines*, a case in which an insurer sought to assert a direct legal malpractice claim against its insured's unsuccessful attorney after it paid a large personal injury settlement. In *St. Paul Surplus Lines*, the court dismissed the plaintiff's cites to recent cases from other jurisdictions, especially Illinois and Texas, which hold that "[e]quitable subrogation is a broad doctrine" or that "Texas courts are particularly hospitable to the doctrine [of equitable subrogation]."[100] However, the specter of *Ethridge* looms large in Missouri, and these citations and pleas to consider other subrogation-friendly jurisdictions fell on deaf ears.

In taking up an excess carrier's claim for equitable subrogation to its insured's legal malpractice cause of action, the court in *St. Paul Surplus* first cited to prior property-based equitable subrogation cases, such as *Metmor*[101] and *Kansas City Downtown Minority Development Corp. v. Corrigan,*[102] to define equitable subrogation as "the substitution of another person in the place of a creditor, so that the person in whose favor it is exercised succeeds to the rights of the creditor in relation to the debt."[103]

However, the decision in *St. Paul Surplus Lines* quickly echoed the "Pandora's Box"[104] sentiment held by earlier courts in regard to allowing insurers to stand in the shoes of those from whom no legal or contractual rights or privity would otherwise flow. Such was the scenario when an excess insurance carrier wished to sue its insured's lawyers for malpractice – a right traditionally solely afforded for the benefit of the client and thus impinging on the sacred lawyer-client relationship. The court then took the opportunity to examine other states' approaches to subrogation in such situations and noted that states such as Indiana took "the position that an equitable subrogation action amounts to an assignment of the legal-malpractice action . . . the potential conflict of loyalty for the attorney, or that the attorney is not garnering the alleged windfall by not having to defend against his or her malpractice."[105]

Thus, the lack of privity and potential invasion of the attorney-client privilege provided a detracting effect as to equitable subrogation. Note, too, that the windfall deterrent in that decision was targeted toward an attorney who may theoretically not face the true victim of his malpractice – the insurer. This is akin to allowing a borrower, as in *Ethridge* or *Thomson*, to retain the benefits of a loan despite a new lender's loss of collateral.

The *St. Paul Surplus Lines* court cited *Kansas City Downtown Minority Development Corp.*,[106] *Metmor Financial*,[107] and *Ethridge*[108] - all post-*Anison* cases – to justify its holding against equitable subrogation. But it based its decision on the fact that "Missouri considers equitable subrogation a fairly 'drastic' remedy . . . usually only allowed in extreme cases" where "the defendant . . . engaged in fraudulent conduct."[109] Although the court included a historic review of the privity-based arguments against equitable subrogation to the insurance context, the weight of the argument against equitable subrogation in the *St. Paul Surplus* facts orbited around fraud. In conclusion, though, the court noted that the plaintiff had not alleged fraudulent misconduct on the part of defendant, and with that the analysis ended.[110]

The Heightened Standards of *Ethridge* Have Yet to Be Tested in Missouri

In *Howard v. Turnbull,*[111] another post-*Ethridge* case assering a claim for equitable subrogation, the plaintiff guarantor sued a debtor's bank after satisfying the debtor's obligation. The guarantor was not involved in the debtor's business, which utilized the bank's loan and therefore reached an "agreement" holding that if the guaranty was ever called by the bank, the bank would assign other collateral to the guarantor in exchange.[112] However, despite the guarantor's eventual payment of the entire balance, no such collateral reached the plaintiff and he asserted claims for, among other things, unjust enrichment as to the debtors, equitable subrogation as to the bank, and fraud as to all parties. However, the fraud claim was voluntarily dismissed and all claims, including equitable subrogation, were dismissed by the trial court. On appeal, the Western District did not take the opportunity to discuss whether the plaintiff guarantor would have a claim in equity for the lender's other collateral *vis a vis* equitable subrogation. One may only speculate as to whether the voluntary dismissal of all fraud claims by the plaintiff, in the court's mind, precluded a claim for equitable subrogation per *Ethridge.*

The only other reported Missouri state court case involving equitable subrogation is equally silent as to the new standards of equitable subrogation. In *Sutton Funding, LLC v. Mueller*,[113] the Eastern District considered a case in which a judgment lienor sought priority over a subsequent, but purchase money, deed of trust. The court ruled that such a situation did not involve equitable subrogation, but rather the priority of purchase money liens as against earlier judgment liens. The court sidestepped any discussion of equitable subrogation despite the remarkable familiarity to cases like *Bunn, Landmark Bank* and *Metmor*, which held *against* equitable subrogation as to lenders who failed

to discover previous liens against their intended collateral.[114]

So it remains to be seen whether the pendulum of equitable subrogation will swing back into favorability in Missouri. Undoubtedly, the recent mortgage crisis and foreclosure glut will push the equitable remedy to the forefront again. Other states' contrasting views on equitable subrogation may also cast sway over Missouri's current harsh stance toward equitable subrogation. One thing is certain, though: Such a powerful remedy, so prevalent in American legal history, will not long remain dormant.

Endnotes

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2 *St. Paul Surplus Lines Insurance Co. v. Remley*, No. 4:08CV1868-DJS, 2009 WL 2070779 (E.D. Mo. July 13, 2009).

3 *Ethridge v. Tierone Bank*, 226 S.W.3d 127, 134 (Mo. banc 2007).

4 *Bright v. Boyd*, 4 F.Cas. 127 (C.C. Me. 1841) (No. 1,875).

5 *Anison v. Rice*, 282 S.W.2d 497, 503 (Mo. 1955)

6 *Id.*

7 *See, In re Gateway Center Bldg. Investors, Ltd.*, 95 B.R. 647 (Bankr. E.D. Mo. 1989).

8 *See, State Sav. Trust Co. v. Spencer*, 201 S.W. 967 (Mo. App. E.D. 1918).

9 *Ethridge v. Tierone Bank*, 226 S.W.3d 127, 134 (Mo. banc 2007).

10 *Id.; St. Paul Surplus Lines Ins. Co. v. Remley*, No. 4:08CV1868-DJS, 2009 WL 2070779 (E.D. Mo., July 13, 2009).

11 *Knight v. Calvert Fire Ins. Co.*, 268 S.W.2d 53 (Mo. App. E.D. 1954).

12 *Swift & Co. v. Wabash R.R.. Co.,* 131 S.W. 124, 125 (Mo. App. W.D. 1910).

13 *Nat'l Garment Co. v. New York, Chicago & St. Louis R.R. Co.*, 173 F.2d 32 (8th Cir. 1949).

14 *Bunn v. Lindsay*, 7 S.W. 473 (Mo. 1888); *Berry v. Stigall*, 162 S.W. 126 (Mo. 1913).

15 *Vallé's Heirs v. Fleming's Heirs*, 29 Mo. 152, 155 (Mo. 1859); 4 John Norton Pomeroy & Spencer W. Symons, Pomeroy's Equity Jurisprudence, § 1211 (5th ed. 1943); 37 Cyc. 363.

16 *Vallé's Heirs v. Fleming's Heirs*, 29 Mo. 152, 155 (Mo. 1859).

17 *Id.*

18 *Id.*

19 *Id.*

20 *Bright v. Boyd*, 4 F.Cas. 127 (C.C. Me. 1841) (No. 1,875).

21 *Id.* at 130-2.

22 *Id.* at 133.

23 *Id.* at 133.

24 *Vallé's Heir v. Fleming's Heirs*, 29 Mo. 152, 159 (Mo. 1859), citing *Bright v. Boyd*, 4 F.Cas. 134 (C.C. Me. 1843) (No. 1,876).

25 *Wooldridge v. Scott*, 69 Mo. 669 (Mo. 1879).

26 *Id.* at 670.

27 *Id.* at 673.

28 *Norton v. Highleyman*, 88 Mo. 621 (Mo. 1886).

29 *Id.*

30 *Id.* at 624.

31 *Id.*

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

33 *Id.*

34 *Id.* at 475-76.

35 *Oldham v. Wade*, 200 S.W. 1053 (Mo. banc 1918).

36 *Berry v. Stigall*, 162 S.W. 126 (1913).

37 *Id.*

38 *Id.* at 129.

39 *State Savings Trust Co. v. Spencer*, 201 S.W. 967 (Mo. App. S.D. 1918).

40 *Id.*

41 *Id.* at 969 (citing 37 Cyc 363).

42 *State Savings Trust Co. v. Spencer*, 201 S.W.

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967, 971 (Mo. App. S.D. 1918).
43 *Id.* at 969.
44 *Bunn v. Lindsay*, 7 S.W. 473 (Mo. 1888); *Norton v. Highleyman*, 88 Mo. 621 (Mo. 1886).
45 *Id.*
46 *Holland Banking Co. v. Spencer*, 201 S.W. 971 (Mo. App. S.D. 1918) (According to *Holland*, in order for a court to even consider using the doctrine, the petitioner had to exhibit that her activities were a) free from negligence; b) done in good faith; and c) that equitable subrogation would not infringe on another's legal rights).
47 *State Savings Trust Co. v. Spencer*, 201 S.W. 967, 971 (Mo. App. S.D. 1918).
48 *Anison v. Rice*, 282 S.W.2d 497 (Mo. 1955).
49 *Frazier v. Crook*, 204 S.W. 392 (Mo. 1918).
50 *Id.*
51 *Baker v. Farmers' Bank of Conway*, 279 S.W. 428 (Mo. App. S.D. 1926).
52 *Id.* at 432.
53 *Id.*
54 *Anison v. Rice*, 282 S.W.2d 497 (Mo. 1955).
55 *See*, *Wooldridge v. Scott*, 69 Mo. 669 (Mo. 1879).
56 *Id.*
57 *Anison v. Rice*, 282 S.W.2d 497, 503 (Mo. 1955).
58 *Ethridge v. Tierone Bank,* 226 S.W.3d 127, 131 (Mo. banc 2007).
59 *Frago v. Sage*, 737 S.W.2d 482 (Mo. App. E.D. 1987).
60 *Id.* at 483.
61 *Id.*
62 *Landmark Bank v. J.V. Ciaravino*, 752 S.W.2d 923 (Mo. App. E.D. 1988).
63 *Id.* at 928.
64 *Id.*
65 *In re Gateway Centers Bldg. Investors, Ltd.*, 95 B.R. 647 (Bankr. E.D. Mo. 1989).
66 *Id.*; citing *Landmark Bank v. J.V. Ciaravino*, 752 S.W.2d 923 (Mo. App. E.D. 1988).
67 *Id.*
68 *Metmor Fin., Inc. v. Landoll*, 976 S.W.2d 454 (Mo. App. W.D. 1998).
69 *Id.* at 462.
70 *Id.*
71 *Thompson v. Chase Manhattan Mortgage Corp.*, 90 S.W.3d 194 (Mo. App. S.D. 2002).
72 *Berry v. Stigall*, 162 S.W. 126 (Mo. 1913); *Frazier v. Crook*, 204 S.W. 392 (Mo. 1918).
73 *Ethridge v. Tierone Bank*, No. 27016, 2006 WL 1280957 at *1 (Mo. App. S.D. May 11, 2006*); Ethridge v. Tierone Bank,* 226 S.W.3d 127, 130 (Mo. banc 2007).
74 *Id.*
75 *Id.*
76 *Ethridge v. Tierone Bank,* 226 S.W.3d 127, 134 (Mo. banc 2007).
77 *Id.*
78 *St. Paul Surplus Lines Ins. Co. v. Remley*, No. 4:08CV1868-DJS, 2009 WL 2070779 at *4 (E.D. Mo. July 13, 2009).
79 *Swift & Co. v. Wabash R.R.. Co.,* 131 S.W. 124, 125 (Mo. App. W.D. 1910).
80 *The Home Ins. Co. of New York v. Smith*, 140 S.W.2d 64 (Mo. App. E.D. 1940).
81 *Id.*
82 140 S.W.2d 64 (Mo. App. E.D. 1940).
83 *Id.* at 68
84 *Knight v. Calvert Fire Ins. Co.*, 268 S.W.2d 53 (Mo. App. E.D. 1954).
85 *Id.* at 54-55.
86 *Id.*
87 *Id.*
88 *Id.*
89 *Id.*; *The Home Ins. Co. of New York v. Smith,* 140 S.W.2d 64 (Mo. App. E.D. 1940).
90 *Id.*
91 *Id.*
92 *Id.*
93 347 S.W.2d 455 (Mo. App. W.D. 1961).
94 416 S.W.2d 208 (Mo. App. E.D. 1967).
95 *Reese v. Preferred Risk Mut. Ins. Co.*, 457 S.W.2d 205 (Mo. App. E.D. 1970); *Kroeker v. State Farm Mut. Auto. Ins. Co.*, 466 S.W.2d 105 (Mo. App. W.D.1971).
96 394 S.W.2d 418 (Mo. Ct. App. S.D. 1965)
97 *Id.* at 425.
98 456 F.3d 909 (8th Cir. 2006).
99 No. 4:08CV1868-DJS, 2009 WL 2070779 (E.D. Mo., July 13, 2009).
100 *St. Paul Surplus Lines Ins. Co.*, Slip Copy, 2009 WL 2070779 at *4 (E.D. Mo., July 13, 2009) (citing *Liberty Mut. Ins. Co. v. Am. Home Assurance Co.,* 348 F.Supp.2d 940, 960 (N.D. Ill. 2004); *Bennett Truck Transp., LLC v. Williams Bros. Constr.*, 256 S.W.3d 730,734 (Tex. Ct. App. 2008).
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102 868 S.W.2d 210, 223 (Mo. App. W.D. 1994).
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104 456 F.3d 909 (8th Cir. 2006).
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106 868 S.W.2d at 224.
107 976 S.W.2d at 461.
108 226 S.W.3d 127, 134.
109 No. 4:08CV1868-DJS, 2009 WL 2070779 (E.D. Mo., July 13, 2009).
110 *Id.*
111 258 S.W.3d 73 (Mo. App. W.D. 2008).
112 *Id.*
113 278 S.W.3d 702 (Mo. App. E.D. 2009).
114 *Bunn v. Lindsay*, 7 S.W. 473 (Mo. 1888); *Landmark Bank v. J.V. Ciaravino*, 752 S.W.2d 923 (Mo. App. E.D. 1988); *Metmor Fin., Inc. v. Landoll*, 976 S.W.2d 454 (Mo. App. W.D. 1998).

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