2016 IL App (3d) 150034-U

Order filed May 27, 2016

IN THE

APPELLATE COURT OF ILLINOIS

THIRD DISTRICT

2016

REUBEN D. WALKER and KAREN JEAN WALKER, Plaintiffs-Appellees, v. OCWEN LOAN SERVICING, LLC, Defendant-Appellant, (Michael D. Flinchum, Cynthia K. Flinchum, Summit Home Lending, Inc., Unknown Third Party Owners of Note & Mortgage, Mortgage Electronic Registration Systems, Inc., Additional Unknown Owners & Nonrecord Claimants, Defendants).	)	Appeal from the Circuit Court of the 12th Judicial Circuit, Will County, Illinois. Appeal No. 3-15-0034 Circuit No. 12-CH-2010 The Honorable Daniel Rippy, Judge, Presiding.

JUSTICE LYTTON delivered the judgment of the court.
Justice McDade concurred in the judgment.
Justice Schmidt concurred in part and dissented in part.

ORDER

¶ 1 *Held*: Trial court properly struck defendant's bona fide purchaser affirmative defense where defendant had notice of plaintiffs' prior recorded mortgage when it loaned money to mortgagors. Trial court properly denied defendant mortgagee's motion for leave to file counterclaim where it was filed almost two years after defendant's answer and lacked merit.

¶ 2 Plaintiffs Reuben and Karen Walker filed a mortgage foreclosure action against Michael and Cynthia Flinchum. Defendant Ocwen Loan Servicing LLC,[1] a subsequent mortgagee, filed an answer, affirmative defenses, and a motion for leave to file a counterclaim for equitable subrogation. The trial court struck defendant's affirmative defenses and denied its motion for leave to file a counterclaim. Plaintiffs filed a motion for summary judgment, which the trial court granted. Defendant appeals, arguing that the trial court erred in (1) striking its affirmative defense of bona fide purchaser, and (2) denying it leave to file a counterclaim for equitable subrogation. We affirm.

¶ 3 FACTS

¶ 4 On September 1, 2007, Michael and Cynthia Flinchum signed a note payable to plaintiffs Reuben and Karen Jean Walker in the amount of $304,444.52. To secure the note, the Flinchums granted plaintiffs a mortgage on their home in Bolingbrook.

¶ 5 On May 23, 2008, the Flinchums obtained a loan from Eastern Savings Bank (ESB) in the amount of $82,000 in exchange for a note signed by them. The note was secured by a mortgage on the Flinchum's home in Bolingbrook. On June 6, 2008, ESB recorded its mortgage in the Will County Recorder's Office.

¶ 6 On September 12, 2008, plaintiffs recorded their mortgage on the Flinchums' home with the Will County Recorder's Office. On November 3, 2008, a purported release of plaintiffs'

[1] During the pendency of this appeal, Ocwen acquired the mortgage and note that were previously held by GMAC Mortgage, LLC. Ocwen filed a motion to be substituted as the defendant in this case, and we granted that motion.

mortgage was filed in the Will County Recorder's Office. The purported release states that it was prepared by "Michael and Cynthia Flinchum" and does not contain plaintiffs' signatures.

¶ 7 On November 25, 2008, the Flinchums obtained a loan from GVC Preferred Capital in the amount of $166,206 in exchange for a note signed by them. The note was secured by a mortgage on the Flinchums' home. On January 6, 2009, the ESB mortgage was released. The next day, the GVC mortgage was recorded.

¶ 8 On June 5, 2009, the Flinchums obtained a loan from Summit Home Lending, Inc. in the amount of $175,022 after signing a note for that amount in favor of Summit. The note was secured by a mortgage on the Flinchums' home. In July 2009, the GVC mortgage was released. Two months later, the Summit mortgage was recorded in the Will County Recorder's Office. The Summit note and mortgage were later assigned to GMAC Mortgage, LLC. Thereafter, Ocwen Loan Servicing, LLC acquired the note and mortgage from GMAC.

¶ 9 In April 2012, plaintiffs filed a mortgage foreclosure action against the Flinchums for their Bolingbrook home, alleging that the Flinchums defaulted on the note beginning on September 1, 2010, and owed them $292,111.87. Two months later, defendant filed an answer and an affirmative defense based on the purported release of plaintiffs' mortgage filed in 2008. Plaintiffs filed a motion to strike the affirmative defense, arguing that the release was not valid because they had not signed it. The trial court granted plaintiffs' motion to strike, finding that the purported release was invalid on its face because it did not contain plaintiffs' signatures. In April 2013, defendant filed amended affirmative defenses, asserting (1) that it was a bona fide purchaser, and (2) *laches*. Plaintiffs filed a motion to strike, which the trial court granted, striking defendant's affirmative defenses.

¶ 10 On August 1, 2013, plaintiffs filed a motion for summary judgment on their foreclosure complaint. In April 2014, defendant filed a motion for leave to file a counterclaim for equitable subrogation. The trial court denied defendant's motion for leave to file a counterclaim and granted plaintiffs' motion for summary judgment. Defendant filed a motion to reconsider, which the trial court denied.

¶ 11 In July 2014, the trial court entered a judgment for foreclosure and sale of the property, which was later amended. According to the amended judgment, plaintiffs were entitled to $384,171.24 from the Flinchums. In October 2014, the Sheriff of Will County filed a report of sale and distribution, showing that the Flinchums' property was sold at a public sale for $292,111.87.

¶ 12 ANALYSIS

¶ 13 I

¶ 14 Defendant argues that the trial court erred in striking its affirmative defense based on its alleged status as a *bona fide* purchaser. An affirmative defense is one that gives credence to the plaintiff's claim but asserts new matter that defeats the plaintiff's apparent right to relief. *Hartmann Realtors v. Biffar*, 2014 IL App (5th) 130543, ¶ 20. In order to establish an affirmative defense, the defendant must set forth sufficient facts to satisfy each element of the defense. *Id*. A motion to strike an affirmative defense challenges the legal sufficiency of the affirmative defense. *Id*. A trial court's decision to strike an affirmative defense is reviewed *de novo*. *Id*.

¶ 15 Purchasers have a duty to examine the record of title because they are chargeable with notice of all recorded matters affecting the chain of title. *Perry Coal Co. v. Richmond*, 287 Ill. App. 298, 302 (1936). A *bona fide* purchaser is one who takes without notice of outstanding

rights or interests of others. *Daniels v. Anderson*, 162 Ill. 2d 47, 57 (1994). Where a mortgagee, at the time of taking the mortgage, has actual or constructive knowledge of another's adverse interest in the property, it is not entitled to the protection afforded a *bona fide* purchaser. *US Bank National Ass'n v. Villasenor*, 2012 IL App (1st) 120061, ¶ 58 (2012). One who takes a mortgage on property with either actual or constructive knowledge of an earlier mortgage, takes the property subject to the earlier mortgage. *Life Savings & Loan Ass'n of America v. Bryant*, 125 Ill. App. 3d 1012, 1019 (1984).

¶ 16 A purchaser having notice of facts that would put a reasonable prudent person on inquiry is chargeable with knowledge of other facts the person might have discovered by diligent inquiry. *In re County Collector*, 397 Ill. App. 3d 535, 549 (2009). A purchaser is placed on "inquiry notice" where facts revealed in the title search process would cause a reasonable person to think twice about completing the transaction. *Id*.

¶ 17 Here, the record discloses that at the time defendant decided to loan money to the Flinchums, plaintiffs had a legally recorded mortgage on the Flinchums' property. While a purported release of the mortgage was also recorded, the invalidity of the release was obvious on its face because it was not prepared by plaintiffs and did not contain their signatures. See 765 ILCS 905/2 (West 2012) (a valid release must be prepared, executed, signed and delivered by mortgagee).

¶ 18 Defendant must be charged with notice of plaintiffs' prior mortgage and the invalid purported release of that mortgage. See *Perry Coal Co.*, 287 Ill. App. at 302. These facts would have put a reasonable person on "inquiry notice" to further investigate the nature and extent of plaintiffs' interest in the property. If defendant had investigated, it would have found that plaintiffs' mortgage was valid. Because defendant had record notice of plaintiffs' interest in the

property, defendant was not a *bona fide* purchaser. The trial court properly struck that affirmative defense.

¶ 19 II

¶ 20 Defendant also argues that the trial court should have granted its motion for leave to file a counterclaim based on equitable subrogation.

¶ 21 A. Trial Court Discretion

¶ 22 Counterclaims are to be filed at the same time as a defendant's answer. 735 ILCS 5/2-608(b) (West 2014) ("The counterclaim shall be a part of the answer[.]"). It is within a trial court's discretion to allow a defendant to file a counterclaim after its answer. *Otto Real Estate, Inc. v. Shelter Investments*, 153 Ill. App. 3d 756, 762 (1987). A trial court's decision to deny a party leave to file a counterclaim will not be disturbed absent an abuse of discretion. *Resolution Trust Corp. v. Holtzman*, 248 Ill. App. 3d 105, 110 (1993). A trial court abuses its discretion when its decision will not further the ends of justice. *Id*. When considering whether to grant a defendant leave to file a counterclaim, a court can consider (1) the timeliness of the request, (2) previous opportunities to assert the claim, and (3) the ultimate efficacy of the claim. *Id*. at 111.

¶ 23 Here, defendant sought leave to file its counterclaim over two years after plaintiffs filed their foreclosure complaint and 22 months after it filed its answer. Defendant provided no explanation for why it waited so long to bring its counterclaim. Because of defendant's delay, the trial court did not abuse its discretion in denying defendant leave to file its counterclaim. See *Otto Real Estate, Inc.*, 153 Ill. App. 3d at 762-63 (trial court did not abuse its discretion by denying motion for leave to file counterclaim filed 11 months after answer where defendant failed to offer satisfactory explanation for delay). We do not find an abuse of discretion here.

¶ 24 B. Subrogation of Mortgage

¶ 25 Though we have found that the trial court's dismissal was a proper exercise of its discretion, we will discuss the merits of defendant's equitable subrogation counterclaim.

¶ 26 The general rule with recorded liens, including mortgages, is that the first recorded has priority over those subsequently recorded. *Union Planters Bank, N.A. v. FT Mortgage Cos.*, 341 Ill. App. 3d 921, 924-25 (2003). An exception to this rule is the concept of subrogation. *Id*. at 925. Subrogation allows one party to step into the shoes of, or be substituted for, another party whose claim or debt has been paid and can only enforce those rights that the latter could enforce. *Dix Mutual Insurance Co. v. LaFramboise*, 149 Ill.2d 314, 319 (1992).

¶ 27 There are two types of subrogation: conventional and equitable. *Union Planters Bank*, 341 Ill. App. 3d at 925. Conventional subrogation applies when (1) there is an express agreement between the refinancing mortgagee and the mortgagor that the refinancing mortgagee will be able to assert the rights of the first mortgagee; (2) the new mortgage must have been used to pay off the first mortgage; (3) the intervening mortgagee must have been on notice of the original mortgage's priority when it loaned money to the mortgagor; and (3) the first mortgage must not have been released prior to the intervening mortgage. *Unionbank v. Thrall*, 374 Ill. App. 3d 785, 792 (2007). Equitable subrogation is a "creature of chancery" that is used "to prevent injustice and unjust enrichment." *LaFramboise*, 149 Ill.2d at 319. There is no general rule regarding when the right of equitable subrogation exists since it depends on the equities of each particular case. *Id*.

¶ 28 Here, there is no question that conventional subrogation does not apply because (1) there was no express agreement between defendant and the Flinchums that defendant would be able to assert the rights of ESB, and (2) plaintiffs were not on notice of ESB's mortgage when they loaned money to the Flinchums since the ESB mortgage did not yet exist.

¶ 29 Nevertheless, defendant argues that equitable subrogation applies. Our supreme court has explained the doctrine of equitable subrogation:

> "The right of subrogation is an equitable right and remedy which rests on the principle that substantial justice should be attained by placing ultimate responsibility for the loss upon the one against whom in good conscience it ought to fall. [Citation.] Subrogation is allowed to prevent injustice and unjust enrichment but will not be allowed where it would be inequitable to do so. [Citation.] There is no general rule which can be laid down to determine whether a right of subrogation exists since this right depends upon the equities of each particular case." *Id.* at 319.

¶ 30 Equitable subrogation is rarely used by Illinois courts. *LaSalle Bank National Ass'n v. Cypress Creek 1, LP*, 242 Ill. 2d 231, 258 n.8 (2011). Equitable subrogation prevents the unearned enrichment of one party at the expense of another and will be granted only where an equitable result will be reached. *Aames Capital Corp. v. Interstate Bank of Oak Forest*, 315 Ill. App. 3d 700, 707 (2000). Equitable subrogation is available only where no prejudice results. See *Detroit Steel Products Co. v. Hudes*, 17 Ill. App. 2d 514, 521 (1958).

¶ 31 A party seeking equitable relief cannot take advantage of its own wrong or misconduct. *Metcalf v. Altenritter*, 53 Ill. App. 3d 904, 908 (1977). It cannot bury its head in the sand or look the other way when a document shows that another party has an interest in the property at issue. See *In re Cutty's-Gurnee, Inc.*, 133 B.R. 934, 956 (N. D. Ill. 1991).

¶ 32 A subsequent mortgagee attempting to assert the priority of its lien over a prior mortgagee must show: (1) words or conduct by the prior mortgagee amounting to a misrepresentation or concealment of a material fact; (2) knowledge by the prior mortgagee that

the representations were untrue; (3) the truth respecting the representations was unknown to the subsequent mortgagee; (4) the prior mortgagee intended or expected that the subsequent mortgagee would act on the representations; (5) the subsequent mortgagee relied on the prior mortgagee's representations; and (6) the subsequent mortgagee acted because of the prior mortgagee's misrepresentations and is prejudiced as a result. See *Chemical Bank v. American National Bank & Trust Co.*, 180 Ill. App. 3d 219, 226 (1989). Proof of these elements must be clear, precise and unequivocal. *Id*. If these elements are not proven, the prior mortgagee is entitled to its priority position. See *Ready v. Ready*, 300 Ill. App. 3d 42, 52 (1939).

¶ 33 In this case, defendant is not entitled to equitable subrogation on the merits of its claim. Defendant cannot prove any of the elements set forth above. Plaintiffs, as the prior mortgagee, made no false representations to defendant that would cause defendant to believe that its mortgage would have priority over theirs. Furthermore, defendant did not rely on any statement or conduct by plaintiffs in deciding to make its loan to defendant. Plaintiffs' mortgage was a matter of record when defendant issued its loan to the Flinchums. Anyone who was interested could have discovered it. See *id*. at 53. It would be inequitable to allow defendant to step into the shoes of plaintiffs when plaintiffs did nothing to induce defendant to issue its mortgage.

¶ 34 As the subsequent mortgagor, defendant bears the responsibility for its loss. The doctrine of equitable subrogation was created to place the loss on the party upon whom it should fall. See *LaFramboise*, 149 Ill.2d at 319. In this case, the loss falls on defendant, who was in the best position to prevent it. Defendant loaned the Flinchums money after plaintiffs' mortgage was recorded. Since defendant had notice of plaintiffs' interest in the property at the time of its mortgage and made no attempt to extinguish plaintiffs' interest, the court properly refused to

apply the doctrine of equitable subrogation. Compare *Hudes*, 17 Ill. App. 2d at 521 (equitable subrogation applied where bank believed it had discharged all prior liens).

¶ 35 Equity will not reward inaction. See *Roberts v. Fleming*, 53 Ill. 196, 202 (1870). Defendant's failure to act caused its mortgage to be inferior to plaintiffs'. If defendant had examined the chain of title for the property, they would have found plaintiffs' mortgage on the Flinchums' property. Then, defendant could have paid off plaintiffs' mortgage, making defendant's mortgage the first mortgage on the property. See *Simpson v. Gardiner*, 97 Ill. 237, 239 (1881). Additionally, defendant might have had a priority position over plaintiffs if the original ESB loan had been assigned by each mortgagee down to defendant. See *Federal National Mortgage Ass'n v. Kuipers*, 314 Ill. App. 3d 631, 635 (2000) (assignee of mortgage entitled to priority position of original mortgagee). By failing to undertake either of these acts, defendant is not entitled to a first mortgage on the property.

¶ 36 Additionally, equitable subrogation does not apply in this case because prejudice will result to plaintiffs. See *Hudes*, 17 Ill. App. 2d at 521. Here, if equitable subrogation was applied, plaintiffs, as the first lenders, would be harmed. There was no lien on the Flinchums' property when the Flinchums became indebted to plaintiffs. Allowing defendant's mortgage to leapfrog over plaintiffs' would make plaintiffs' mortgage subject to a mortgage that was non-existent at the time of execution. Plaintiffs would be prejudiced if defendant's mortgage was treated as a first mortgage on the property.

¶ 37 For these reasons, the trial court did not abuse its discretion in denying defendant's motion for leave to file a counterclaim based on equitable subrogation.

¶ 38 CONCLUSION

¶ 39 The judgment of the circuit court of Will County is affirmed.

¶ 40 Affirmed.

¶ 41 JUSTICE SCHMIDT, concurring in part and dissenting in part.

¶ 42 While I agree with the majority's conclusion that the trial court properly struck defendant's amended affirmative defense that is where my concurrence ends. The majority determines that the trial court properly denied defendant's motion for leave to file its counterclaim because of defendant's delay. In doing so, however, it expressly notes that when considering whether to grant a defendant leave to file a counterclaim, a court may consider the ultimate efficacy of the claim. That is what the trial court did here. In denying defendant's motion for leave to file a counterclaim, the court did so not for any procedural missteps, but for the counterclaim's perceived insufficiency. Accordingly, I would review defendant's claim *de novo*. *People v. Williams*, 188 Ill. 2d 365, 369 (1999) (Where the trial court's exercise of discretion relies upon a conclusion of law, our review is *de novo*.).

¶ 43 Reviewing defendant's claim on the merits, I would find that defendant is entitled to be subrogated to the priority position originally held by the ESB mortgage. As the majority notes, conventional subrogation is an equitable doctrine recognized by the courts that allows a lender to pay a debt on behalf of a third party and, in return, be able to assert the rights of the original creditor. *Aames*, 315 Ill. App. 3d at 706 (citing *Home Savings Bank v. Bierstadt*, 168 Ill. 618, 624 (1897)). That is precisely what happened here.

¶ 44 However, the majority claims conventional subrogation does not apply because there was no express agreement between the parties. See *supra* ¶ 28. I disagree. Defendant's mortgage used language indicating that the agreement between the parties was that the new mortgage would hold a first priority, and any other prior mortgages of record would be paid off, with the new mortgage securing the debt. It is largely-accepted among the appellate districts that such

language indicates that there was an express agreement between the parties. See *e.g.*, *Aames*, 315 Ill. App. 3d at 708; *LaSalle Bank National Ass'n*, 316 Ill. App. 3d at 522; *Union Planters Bank*, 341 Ill. App. 3d at 928.

¶ 45 The majority next claims conventional subrogation does not apply because plaintiffs were not on notice of the ESB mortgage when they loaned money to the Flinchums. See *supra* ¶ 28 (citing *Unionbank*, 374 Ill. App. 3d at 792-93, which states that "the intervening lienor must have been on notice of the original mortgage's priority at the time he issued the indebtedness secured by his lien."). What the majority fails to recognize, however, is that plaintiffs are not "intervening" lenders; they are original lenders who failed to timely secure their interest in the property. Indeed, the majority's opinion later makes reference to plaintiffs being the original lenders. See *supra* ¶ 36 (Emphasis added.) ("Here, if equitable subrogation was applied, plaintiffs, *as the first lenders*, would be harmed.").

¶ 46 That being said, I find troubling the need to point out that first "lenders" are not entitled to priority. If that were the case, section 30 of the Conveyances Act, which gives priority to the first recorded mortgage, would be rendered obsolete. 765 ILCS 5/30 (West 2010). Pursuant to the terms of the Conveyances Act, plaintiffs have, at all times, held a second priority interest in the subject property.

¶ 47 It is undisputed that, had defendant's mortgage not paid off the GVC mortgage, and had the GVC mortgage not paid off the ESB mortgage, plaintiffs would hold their mortgage subject to the ESB mortgage. Yet, by not allowing defendant to assert priority for refinancing the ESB mortgage—a transaction entirely irrespective of plaintiffs—the majority is giving plaintiffs a first priority interest without them having done anything or incurred any debt for such a benefit. Such a result is far from equitable. See *Campbell v. Trotter*, 100 Ill. 281, 285 (1881) (second

mortgage was not entitled to priority where mortgagee gave no consideration and doing so would have created "an inequitable advantage which it ought not to enjoy"). While plaintiffs may not have been on notice of the ESB mortgage when they loaned the Flinchums money, they were clearly on notice of the ESB mortgage when they recorded their interest. Allowing defendant to assert ESB's rights would not change or affect plaintiffs' interest in the property in any way.

¶ 48 Accordingly, by refinancing the ESB mortgage, defendant is entitled to be subrogated to the ESB mortgage and its corresponding priority position, up to the amount that the ESB mortgage secured at the time of its perfection. *Aames*, 315 Ill. App. 3d at 710. I would reverse and remand. For this reason, I dissent.