

BANKING ALERT

August 2018

[New Jersey Trial Court Applies Doctrine of Equitable Subrogation to Mortgage Priority Dispute](#)

In *Citizens Bank, N.A. v. Victor Davis, et al.*, HUD-F-18941-17, the Chancery Division considered the priority between two mortgage lenders. The two competing mortgage loans were both extended in October 2012. First, Citizens Bank extended a home equity line of credit to Victor Davis in the amount of \$161,000, which was secured by a mortgage on real property in Jersey City. Then, TD Bank extended a mortgage to Davis in the amount of \$224,169.00 on the same property. The proceeds from the TD Bank loan were used to pay off two existing mortgages (one from Sussex Bank and one from TD Bank) on the property, both of which predated the Citizens Bank mortgage, which was recorded after TD Bank extended the mortgage but before TD Bank recorded its mortgage.

After the borrowers defaulted, Citizens Bank initiated foreclosure proceedings. TD Bank filed a contesting answer, alleging that it had priority over the Citizens Bank mortgage by virtue of equitable subrogation even though its mortgage was recorded after Citizens Bank's mortgage. After a one-day trial, the Chancery Division agreed with TD Bank. The Court explained that, despite the general rule that the party that records its mortgage first will have priority, the doctrine of equitable subrogation allows a later-recorded mortgage to take priority if "a third-party loans or advances funds to pay off an existing mortgage or other encumbrances in the belief that no junior liens encumber the subject premises, and it later appears that intervening liens existed, the new lender will be deemed to be substituted into the position of the prior mortgage holder by equitable assignment of the prior mortgage" (quoting *UPS Capital Business Credit v. Abbey*, 408 N.J. Super. 524, 529 (Ch. Div. 2009)). However, where the new lender knows of a mortgage junior to the one that its money is being used to discharge, it will not take the priority of that mortgage. The Chancery Division nevertheless found that, although New Jersey courts focus on whether the lender had notice of any junior liens, a recent federal case supported the proposition that actual knowledge may not automatically defeat the right to equitable subrogation. (discussing *Ricchi v. Am. Home Mortg. Serv. Inc.*, 470 B.R. 715 (Bankr. D.N.J. 2012)). There, the federal court

In This Issue

New Jersey Trial Court Applies Doctrine of Equitable Subrogation to Mortgage Priority Dispute
Pg 1

New Jersey Supreme Court Adopts Daubert Factors
Pg 2

New Jersey Appellate Division Affirms Entry of Summary Judgment and Final Judgment of Foreclosure
Pg 3

Office Locations

New Jersey

210 Park Avenue
2nd Floor
Florham Park NJ 07932
973.302.9700

New York

1185 Avenue of the Americas
3rd Floor
New York NY 10036
212.763.6464

Follow Sherman Wells on

LinkedIn  Twitter 

focused the analysis on unjust enrichment or prejudice to the junior lender.

The Chancery Division determined that, under either approach, equitable subrogation applied. The Court was satisfied that the proceeds from the TD Bank loan were used to pay off the preexisting mortgages. Under the more traditional approach toward equitable subrogation, the Court determined that, because TD Bank's mortgage was executed fourteen days before Citizens Bank's mortgage was recorded, TD Bank did not have constructive notice of Citizens Bank's mortgage, nor was there any evidence of actual notice. Further, even if TD Bank had actual notice, under the more flexible federal approach, the Court could find no prejudice to Citizens Bank, as it took a mortgage on property that was already subject to preexisting liens. Thus, the Chancery Division determined that TD Bank had a superior first mortgage.

[New Jersey Supreme Court Adopts Daubert Factors](#)

New Jersey was among the first states to move away from the "general acceptance" standard for admissibility of expert testimony, which required that expert testimony be based on a technique that is generally accepted in the scientific community. In *Rubanick v. Witco. Chem. Corp.*, 125 N.J. 421, 447 (1991), the Court shifted to a more methodology-based approach, asking whether the expert's method and reasoning was scientifically sound. In 1993, in *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993), the United States Supreme Court also moved away from the general acceptance standard. Yet *Daubert* provided some additional detail that New Jersey law did not; it identified a non-exhaustive list of factors to consider in assessing the reliability of scientific testimony, including whether the theory has been tested; whether the theory has been subjected to peer review; whether there is a known rate of error; and whether the theory is generally accepted in the scientific community.

In *In re: Accutane Litigation*, the Supreme Court of New Jersey recently considered whether to adopt those additional factors outlined in *Daubert* in an effort to provide additional guidance to trial courts deciding whether to allow novel expert testimony. In so deciding, the Court noted that the goal of its decisions is to permit reliable scientific evidence. Because *Daubert* sought to advance the same goal, the Court explained that "there is not much light between our standard and that which has developed in the federal sphere under *Daubert's* initial instruction." Although New Jersey's law "moved first," it moved "in the same direction and with the same general goal as that noted by the Supreme Court in its *Daubert* trilogy."

The Court then detailed the similarities between New Jersey law and *Daubert*. Both undertake a methodology-based test for reliability, and both ask whether an expert's reasoning underlying the expert testimony is scientifically valid. With those twin aims in mind, and in an effort to bring greater clarity to the trial court's gatekeeping function, the Court was persuaded that *Daubert's* factors should be incorporated and used by New Jersey courts. Those factors, according to the Court, "dovetail with the overall goal of [New Jersey's] evidential standard and would provide a helpful but not necessarily definitive guide" for trial courts. However, the Court stopped short of declaring New Jersey a "*Daubert* jurisdiction." Because there is no body of caselaw applying *Daubert* uniformly, the Court explained: "We hesitate to sweep in adherence to the various approaches taken among the circuits and state jurisdictions when applying the *Daubert* factors." Although the factors can be helpful in certain instances, the Court declined to adopt an entire body of law that can be, at times, inconsistent. Thus, the trial court's role is to require that expert testimony is based on a scientifically recognized mythology, and the *Daubert* factors can assist in that analysis. The Court's decision in *In re: Accutane Litigation* stands to impact all litigation involving expert testimony and the qualification and vetting of expert opinions and methodology.

New Jersey Appellate Division Affirms Entry of Summary Judgment and Final Judgment of Foreclosure

In *Wells Fargo, N.A. v. Gidwani et al.*, Docket No. A-3096-16T1 (N.J. App. Div. Aug. 3, 2018), a residential mortgage foreclosure action, the New Jersey Appellate Division affirmed the trial court's entry of summary judgment and final judgment of foreclosure in favor of Wells Fargo.

In 2004, defendants were married and owned a home encumbered by a mortgage and home equity line of credit. In October 2005, defendants obtained a \$165,000 refinance mortgage loan from Wells Fargo's predecessor and executed a 30-year note and mortgage against their home. The loan stated that "defendants agreed to pay interest on the unpaid principal balance, and that the 6.05 percent interest rate would be charged at a rate of 1/365th of the rate for each day." The note also stated the loan would be paid off in thirty years if the monthly payments were paid on time; otherwise, defendants "may owe additional and substantial money at the end of the credit transaction and there may be little or no reduction of [p]rincipal."

Defendants defaulted on the loan in March 2010 and Wells Fargo filed a complaint in foreclosure in 2014. In their answer, defendants asserted the affirmative defense of recoupment, claiming Wells Fargo violated the Consumer Fraud Act (CFA) and Truth in Lending Act (TILA). Specifically, defendants claimed Wells Fargo violated "Regulation Z", which requires a lender to disclose to potential borrowers certain details about the terms and costs of a proposed loan. Defendants argued that Wells Fargo failed to disclose the "daily simple interest feature" of the refinance mortgage could result in far more interest than a "conventional" mortgage.

In support of their contention that Wells Fargo engaged in predatory lending, defendants submitted an expert report from an accountant stating that the particular type of loan defendants obtained applied payments to interest first (then once interest was paid off to principal), whereas in a conventional mortgage the payment is applied to both the interest and principal. The expert argued that if defendants had resumed payment after default in 2010, they would still owe approximately \$155,000 at the time the loan matured in 2035. The trial court granted summary judgment in favor of Wells Fargo finding that any action for recoupment was dependent upon proving Wells Fargo violated the CFA, and the six year statute of limitation had already run. The trial court then entered final judgment of foreclosure.

Defendants appealed and the Appellate Division found that the claim for recoupment was not barred by the statute of limitations because recoupment is never barred by the statute of limitations so long as the main action is timely. The Appellate Division then questioned whether Wells Fargo engaged in predatory lending by extending the refinance mortgage knowing defendants were unemployed. The Appellate Division found that defendants never did resume making payments on the loan so the accounting expert's calculation was irrelevant and, thus, defendants could not show any harm as a result of Wells Fargo's conduct. The Appellate Division found, therefore, defendants could not assert a CFA claim and because defendants cannot prevail on a CFA claim, they cannot prevail on a recoupment claim.

If you have any questions about this Alert:

Attorney Contact Information

Anthony J. Sylvester
Partner
973.302.9713
asylvester@shermanwells.com

Craig L. Steinfeld
Partner
973.302.9697
csteinfeld@shermanwells.com

Caitlin T. Shadek
Associate
973.302.9672
cshadek@shermanwells.com

Anthony C. Valenziano
Associate
973.302.9696
avalenziano@shermanwells.com

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon with regard to any particular facts or circumstances without first consulting an attorney.
© 2018 Sherman Wells Sylvester & Stamelman LLP. All Rights Reserved.